



## CATERING THEORY OF DIVIDEND IN DIVIDEND POLICY: THE EVIDENCE FROM INDONESIA

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### Abstract

This study aims to examine the possibility of companies in paying dividend if there are investors demands for dividends. Researcher used purposive sampling for determine the sample. Sample are used as many as 527 companies with total are 4375 observations during 2007-2016. The data analysis technique used logistic regression in Eviews 9. The results show that investors demands for dividends (catering incentives) were measured by dividend premiums have a positive and significant correlation to dividend payout decisions. It means that companies have bigger probability for paying dividend if the are investors demands. Probability of companies to pay dividend up 2.19 times for increasing a unit of dividend premium.

### Abstrak

Penelitian ini bertujuan menguji peluang perusahaan dalam membayar dividen jika terdapat permintaan investor atas dividen. Peneliti menggunakan *purposive sampling* untuk menentukan sampel. Sampel yang digunakan sebanyak 527 perusahaan dengan total sebanyak 4375 observasi selama tahun 2007-2016. Analisis data menggunakan regresi logistik pada Eviews 9. Hasil penelitian menunjukkan bahwa permintaan investor atas dividen (*catering incentives*) yang diukur dengan *dividend premium* memiliki hubungan yang positif dan signifikan terhadap keputusan pembayaran dividen. Artinya perusahaan berpeluang lebih besar membayar dividen jika terdapat permintaan investor. Peluang perusahaan membayar dividen naik 2.19 kali untuk setiap kenaikan satu unit *dividend premium*.

## INTRODUCTION

The development of capital market became one of the factors driving the economic progress of various countries. The Indonesian capital market has an appeal that to make investors from inside and outside participate in investing (Tastaftiani & Khoiruddin, 2015). Shareholders who invest in a companies would expect return that will be gained from their investments (Erfiana & Ardiansari, 2016).

Profits from investments in shares are dividends and capital gain. Investors generally invest the shares in long-term to gain dividends (Khoiruddin & Faizati, 2014). Dividends are part of the net income that distributed to shareholders (Awat, 1998). So investors need information about dividend for making the right investment decision (Wardoyo & Veronica, 2013).

Companies have a goal to prosper their owner in this case is shareholders by increasing the value of the companies. According to Yulianto et al. (2014) enhance managerial ownership can increase value of companies. In addition, financial management is one of way that can be used to increase the value of companies through the policies have been taken (Cahyaningdyah & Resnany, 2012). One of the policies from financial management is dividend policy.

Managements face difficulties in deciding profits that be earned by the companies will be distributed in dividend or holding the profits to be invested in to operating assets, used to pay the debt and others (Brigham & Houston, 2001). If the companies want to divide dividend, companies must have positive net profits (Abiprayu & Wiratama, 2016).

Distribution of high dividends to shareholders is expected to increase the value of the companies (Widanaputra, 2010). The dividend payout is largely influenced by the behavior of investors who generally prefer the high dividends payouts and to make low retained earnings (Sari, 2013). However, there are companies that do not want a high dividends payout to shareholders. This is because if the higher dividends that distribute to shareholders will be make retained earnings is low (Anita & Yulianto, 2016). So funding focused on external financing especially on the use of debt in the optimal capital structure which can increase the value of the firms (Yulianto et al., 2015).

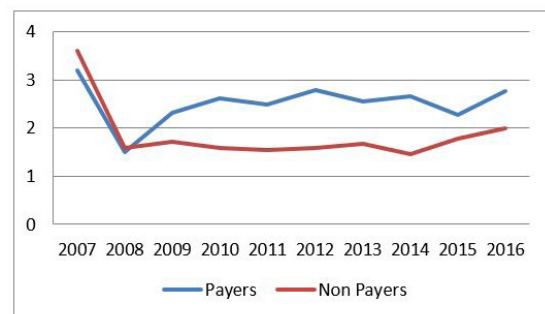
Therefore, managers must consider the decision of dividends payments as well as, because it will affect the future corporate financing (Simbolon & Sampurno, 2017). A false dividend poli-

cy will make investors perception of the companies will be bad (Sari & Wijayanto, 2015).

Baker and Wurgler (2004) proposed the theory about dividend known as catering theory of dividend. Catering theory of dividends proposed that the company's dividend policy driven by investors demands for dividends. This theory explains the managers divide the dividend when investors want dividends and does not divide when investors do not want dividends.

Catering theory of dividend explains that managers pay dividends when investors put a relatively high stock price on dividend payers than dividend non payers. So if dividend payers are overpriced when compare to firms that do not pay dividends (Baker & Wurgler, 2004). On the condition means investors have interest and demand for cash dividends.

Catering theory of dividend uses the term of catering incentives as motif that affect the companies determine the dividend policy. Catering incentives is investors demands for dividends (Baker & Wurgler, 2004). Baker and Wurgler (2004) proposed several ways to measure investors demands for dividend, but mostly used in research such as Li and Lie (2006), Ferris, et al. (2009) and Tangjitprom (2013), they used a dividend premium in measuring investor's demands for dividend by subtracting the average market to book ratio of companies dividend payers and dividend non payers. Below is empirical data of market to book ratio of dividend payers and dividends non payers periode 2007-2016:



**Figure 1.** Market to Book Ratio Period 2007-2016

Picture 1 shows in the last ten years, the average market to book ratio companies of dividend payers and dividend non payers in Indonesia listed on the Indonesia Stock Exchange. As shown by the chart, the average of market to book ratio dividend payers and dividend non payers has a fluctuating trend. However, the average market to book ratio of dividend payers tends to be higher than dividend non payers. It means that

investors tend put a relatively high stock price on dividend payers. So it show that there are investor's demands for dividend in the market.

This phenomenon further can be explained by the value of dividend premium, which result from reduction log of the average market to ratio dividend payers and dividend non payers. Based on empirical data, the value of dividend premium in Indonesia from 2007 until 2016 tends to be positive. But there are two years that have negative dividend premium. It means that, investor's valuation is higher for dividend non payers. In that years, investos do not want dividen payment. Below is the data of dividend premium period 2007-2016:

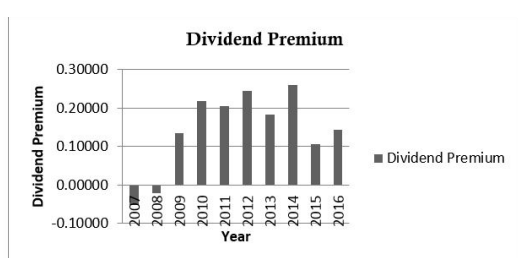


Figure 2. Dividend Premium Tahun 2007- 2016

According to Baker and Wurgler (2004), when dividend premium is positive, it shows that investor put a relatively high stock price on dividend payers so it means that investors ask the companies to divide the dividend. Accordance with catering theory of dividend, it can encourage the companies to pay dividend and because that the percentage of dividend payers increases.

The last ten years number of companies that divide the dividend fluctuating, but in the last three years has a downward trend. The average percentage of dividend payers in 2007-2016 is 39.41% (IDX, 2018). So it can be said that number of dividend payers in Indonesia are still low. Below is percentage of dividend payers period 2012-2016:

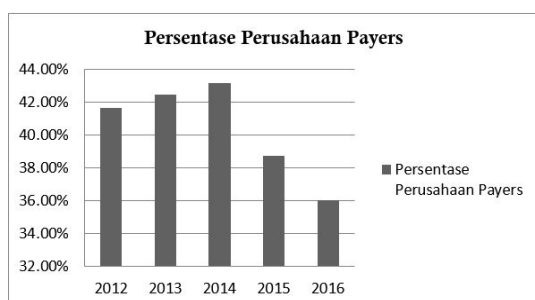


Figure 3. Percentage of Dividend Payers Period 2012-2016

The phenomenon is not accordance with catering theory of dividend, there is a gap phenomenon . In catering theory of dividend, if there are investors demands for dividends which captured by positive dividend premium values, opportunity of companies to pay dividend will be increased, so the number of dividend payers also increases. But in fact on the other hand.

The study about catering theory of dividend is still limit in Indonesia. Fatmawati and Ahmad (2017), they examined implication of catering theory of dividend on the probability of dividend payout decision. The sample is 110 BUMN's companies period 2010-2015. The result was investor's demands has not significant effect on propensity to pay dividend. It means catering theory of dividend did not effect on the company's decision to pay dividends.

Studies about catering theory of dividend have been done in other countries. Ming et al. (2016) examined implication of catering theory of dividend in dividend policy on the Taiwan Stock Exchange. The result was catering theory of dividend is existed in Taiwan. It was consistent with the prediction of catering theory in that managers choose a dividend policy to cater to the demands of investors.

Tangjitprom (2011) aimed to measure investor's demands for dividend in Thailand and examined whether the demands for dividends can be link to firm's decision to pay dividends. The result was a positive relationship between propensity to pay dividend and catering incentives, and the result was statistically significant. This can be concluded that catering effect of dividend has existed in Thailand.

The research about catering theory of dividend in Asia by Tsuji (2010) examined catering theory of dividends using data from in the Japanese electrical appliances industry. The result was corporate manager do not consider catering behavior in either their dividend initiation decision or continuation decisions.

Based on past studies which have been done, and still limited the study about catering theory of dividend. Beside that, in Indonesia dividend payout decision still became a puzzle (Prasetyo, 2013). So testing catering theory of dividend is done. Maybe this theory can explain the dividend payout policy in Indonesia market.

Thereis a gap with the theory and inconsistency of results from past researches, researcher want to examine whether in Indonesia pay attention sentiment market factor to making dividend decision. The object of research is com-

panies listed on Indonesia Stock Exchange period 2007-2016.

This study aims to examine probability of companies to divide the dividend if there are investor's demands for dividend which measured by dividend premium and how much company's probability to divide the dividend if there are investor's demands for dividend which measured by dividend premium.

**Hypothesis Development**

Baker and Wurgler (2004) in catering theory of dividend said that companies will divide the dividend and adjust dividend payment based on investor's demands for dividends.

Based on Baker and Wurgler (2004) catering theory of dividend built on this assumption. First, for either psychological or institutional reasons, some investors have an uninformed and perhaps time-varying demands for dividend-paying stocks. Second, arbitrage fails to prevent this demands from driving apart the prices of payers and non payers. Third, manager rationally cater to investor demands-they pay dividend when put higher prices on payers and they do not pay when investors prefer non payers.

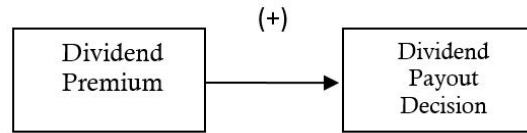
According to the assumption, manager will divide the dividend if investors put higher prices on dividend payers than dividend non payers. On other hand, manager do not divide the dividend if investors put higher prices on dividend non payers than dividend payers.

Baker and Wurgler (2004) used dividend premium to measured investor's demands for dividend. Baker and Wurgler (2004) found a positive correlation among dividend premium with dividend payout decision.

Positive dividend premiums show propensity of investor's demands for dividends. It means that rise of dividend premiums, will make probability of companies to pay dividend is higher. The encouragement of investors will make managers of companies willing to distribute the dividend for increases of stock price and because of that will make number of dividend payers increases (Fatmawati & Ahmad, 2017).

The companies believe if they divide the dividend to shareholders, the market price of their shares in the capital market will increase. Because of that, dividend payers will pay dividend when their prices in high valuation. (Easterbrook, 1984; Baker & Wurgler, 2004).

Hypothesis of this research is as follows:  
H1: Companies are more likely to share dividends if there are investor's demands for dividends.



**Picture 4.** Framework of Model

**METHOD**

This study is a quantitative research, because the research data in the form of numbers and the data analysis using statistic. This research is testing a hypothesis. The goal is to understand the influence between variables. The type of this study is causal research, that is influence between dependent variable and independent variable. The data in this study is secondary data obtained from the Indonesian Capital Market Directory (ICMD) as well as annual reports of companies listed on Indonesia Stock Exchange from 2007 to 2016 and finally obtained samples as much as 527 companies with total 4375 observations.

The sample of this research is conducted by purposive sampling technique, where sampling method based on certain considerations or certain criteria (Sanusi, 2014). The sampling criteria in this study are presented in Table 1.

**Table 1.** Sampling Result

No.	Criteria	Total
1	Companies listed on Indonesia Stock Exchange Period 2007-2016	573
2	Companies are delisting and relisting during 2007-2016	(38)
3	Companies did not publish annual report during 2007-2016	(8)
Final Sample		527

Dividend payout decision as the dependent variable in this study using a dummy variable, where the value will be 1 if the company share the dividend and value will be 0 when company does not share the dividend (Ferris et al., 2009). Dividend payment decision is a decision to pay dividend or does not pay dividend. Dividend decision will be company's dividend policy. The dividend policy is the issue of the use of profit. Basically, the profit can be divided as dividend or retained for investment (Husnan, 2000).

Investor's demands for dividends as the independent variable. Baker and Wurgler (2004) investor demands for dividends was measured by dividend premium, which is the difference between market-to-book ratio of dividend paying firms and non-payers. Market-to-book ratio and dividend premium are formulated as follows:

$$MTB_{i,t} = \frac{\text{Market price per share of common stock}_{i,t}}{\text{Book value per share of common stock}_{i,t}}$$

$$DivPrem_t = \log(\overline{MTB}_{t \text{ payer}}) - \log(\overline{MTB}_{t \text{ non payer}})$$

The method of collection data is documentation, it means that data obtained from annual report that has been published by IDX from their website *www.idx.co.id*. Other data obtained from other website for example *www.ksei.co.id*.

**Data Analysis**

**Model Estimation Selection**

This research uses qualitative response regression analysis because the dependent variable in this study using dummy variable. There are 3 models approaches are used to estimate qualitative response regression, there are LPM, logit and probit (Gujarati & Porter, 2013).

Determine the best model should test the selection of estimation model. There are two way to determine the best model; first fulfillment of  $0 \leq E(Y_i | X_i) \leq 1$ , second normality assumption test. Since  $E(Y_i | X_i)$  in LPM measured the conditional probability of the event Y occurring given X, it must necessarily lie between 0 and 1. But the LPM is plagued by several problem, such as (1) non-normality of  $\mu$  (2) heteroscedasticity of  $\mu$  (3) possibility of  $Y_i$  outside the 0-1 range and (4) the generally lower (Gujarati & Porter, 2013).

**Regression Model**

This study uses a dummy variable, where the value will be 1 if the company share the dividend and value will be 0 when company does not share the dividend. Regression analysis is done by Eviews 9. Regression equation in this research is as follows:

$$Ddiv_i = \ln \left[ \frac{P_i}{1-P_i} \right] = \beta_1 + \beta_2 X_1 + u_1$$

Where :

$Ddiv_i$  = Dependent variable (=1 if company share the dividend; = 0 if company does not share the dividend)

$P_i$  = Probability of company to share dividend

$X_1$  = Dividend premium (divprem)

The determination of the value of 1 and 0 as variable of dividend payout decision by looking data of the firm paying cash dividends and non payers each period. The data can be downloaded at KSEI which can be accessed by website.

**Goodness-of-fit Test**

Examine the goodness-off-fit in logistic regression using *Hosmer dan Lemeshow's*, where testing the null hypothesis that the model is fit or the prediction generated by model are able to explain observed data (Gozhali & Ratmono, 2013). Beside Hosmer and Lemeshow's testing, McFadden R-Square, that is equal to the coefficient determination in general regression and adjusted. This coefficient is used to measured how much the dependend variable can be explained by the independent variable.

**Hypothesis Testing**

In a hypothesis testing used  $\alpha = 5\%$ , it means the reseaecher has a belief that of 100% of samples, probability of sample members who don not have population characteristics is 5%. Testing the hypothesis about the independent variable in influencing the dependent variable used Eviews 9.

**RESULT AND DISCUSSION**

Before hypothesis testing, the first do estimation model selection. Model with dummy variable in dependet variable uses 3 approach, there are LPM, logit model and probit model. After select the model, the best approach is logit model (logistic regression).

In the description of the result of this research will be presented the result of data processing companies listed on IDX period 2007-2016. Table 2 shows that descriptive of dividend premium and number of dividend payers.

Table 2 shows dividend premium values of companies listed on IDX period 2007-2016 have values that to be tend positive. Because of avarege of market-to-book ratio firms paying dividend higher than non payers. As shown by Table 2, the highest dividend premium on 2014 dan in this 2014 there are more companies share the dividend. Percentage of firm paing dividend in 2014 is the highest at 43.17%. It means that high investor's demand for dividends in 2014 encourages companies for paying dividends to maximize their market prices.

**Table 2.** Description of Result

Year	Dividend Premium	Payers	Non Payers	Total Company	Presentase Payers
2007	-.05227	125	221	346	36.13%
2008	-.02134	136	229	365	37.13%
2009	.13428	137	248	385	35.58%
2010	.21790	160	237	397	4.30%
2011	.20458	180	241	421	42.76%
2012	.24421	187	262	449	41.65%
2013	.18235	200	271	471	42.46%
2014	.25971	215	283	498	43.17%
2015	.10609	200	316	516	38.76%
2016	.14303	190	337	527	36.05%
		1730	2645	4375	39.41%

In 2007 and 2008, the value of dividend premiums are negative, because the average of market-to-book-ratio dividend non payers higher than dividend payers. The percentage of firms paying dividends tend to below ranging from 36-37%, that is below from the average percentage of dividend payers durung 2007-2016.

Overall, the dividend premiums are positive, it means there are investor’s demand for dividends in market. When investor ask dividend, it will encourage managers to divide the dividend, so the probability of dividend transaction will increase. Therefore number of firms paying dividend should be increased. However, the fact is the number of firms paying dividend at 39.41%. Even the percentage of dividend payers are decline in the last 3 years.

**Goodness-of-fit Test**

Hosmer and Lemeshow’s, where testing the null hypothesis that the model is fit or the prediction generated by model are able to explain observed data (Gozhali & Ratmono, 2013). Table 3, the result of Hosmer dan Lemeshow’s testing in Eviews 9.

**Table 3.** Hosmer dan Lemeshow’s

HL statistics	Prob. Chi-Sq
5.5758	.6986

Table 3 shows HL statistics at 5.758 with significance 0.6986 which the value above 0.05 (0.6986 > 0.05). Thus it can be concluded the model is acceptable (model fit), so the models can predict data from observation. Beside Hosmer

and Lemeshow’s testing, McFadden R-Square is done for measuring how much the dependend variable can be explained by the independent variable. Here is the result:

**Table 4.** McFadden R-squared Testing

Dependent Variable: ddiv	
Method: ML- Binary Logit	
McFadden R-squared	.000982
LR statistic	5.764
Prob(LR statistic)	.01635

Based on Table 4 shows value of McFadden RSquare at 0.000982, it means dependent variable that can be explained by independent variable at 0.0982 %.

**Testing Hypothesis**

Testing of hypothesis can be assessed from z statistic value because logit/probit estimation using *maximum likelihood* (ML) estimation model not OLS. The function of z statistic shows how far independent variable influence the dependent variable. (Ghozali & Ratmono, 2013). In Table 5 shows the result of logistic regression.

Based on Table 5 the result of logistic regression shows the significance value of dividend premium is less than level of significant ( $\alpha$ ) 5%, it means accepted, there is influence between dividend premium and the dividend payout decision, so probability of firms paying dividend became bigger with the investor’s demands for dividends.

Coefficient is positive, it means the higher of dividend premium, probabilities of companies

**Table 5.** The Result of Logistic Regression

Independent Variable	Coefficient	Std. Error	z-statistic	Prob.	Odd Ratio/ Exp(B)
Divprem	.7855	.05839	2.3928	.0167	2.19
C	-.5424	.32825	-9.2889	.0000	.58
Dependent Variable: Ddiv					
Obs with dep=1	1730	Total Obs		4375	
Obs with dep=0	2645				

paying dividend greater and opposite. Higher dividend premium give a signal that investor's demand for dividend is high.

Based on Table 5 can be obtained regression equation as follows:

$$\ln \left[ \frac{P_i}{1-P_i} \right] = -5424 + 0.7855 \text{divprem} + u_1$$

or

$$\left[ \frac{P_i}{1-P_i} \right] = e^{(-5424+0.7855 \text{divprem}+ u_1)}$$

Interpretation of logistic regression equation uses odds ratio or Exp(B) (look Table 5). From this equation can be know: coefficient *divprem* 0.7855 with odd ratio 2.19. It means that probability of companies to pay dividend up 2.19 times for increasing a unit of dividend premium.

#### **The Influence of Investor's Demands for Dividends (Catering Incentives) to Dividend Payout Decision Pengaruh**

Based on Baker and Wurgler (2004) catering theory of dividend built on this assumption. First, for either psychological or institutional reasons, some investors have an uninformed and perhaps time-varying demands for dividend-paying stocks. Second, arbitrage fails to prevent this demands from driving apart the prices of payers and non payers. Third, manager rationally cater to investor demands-they pay dividend when put higher prices on payers and they do not pay when investors prefer non payers. Based on the assumption manager will share the dividends if investors give the positive dividend premium.

Core of catering theory of dividend is manager tend to initiate dividends when investors put a relatively high stock price on dividend payers and tend omit dividend when investors prefer non payers. The main prediction of this theory is propensity to pay dividends depending on the dividend premium that measured by stock price. Dividend premium is used to measure investor's valuation for dividend.

Baker and Wurgler (2004) used dividend premium derived from the differences average of firms paying dividend and non payers. Baker and Wurgler (2004) argue that if dividend premium is positive, it means that investor's valuation of dividend payers is higher than dividend non payers. Because of that managers are more likely to share the dividend.

In Indonesia, overall the dividend premiums are positive, it means there are investor's demand for dividends in market. Investors prefer dividend than capital gain. When investor ask dividend, it will encourage managers to divide the dividend, so the probability of dividend transaction will increase.

Investors in Indonesia are more likely dividend because have weak protection for investor because of civil law's country (Mayapada et al., 2017). When investor's protection is weak so shareholders tend choose dividend. Investors prefer dividend than being reinvested because of uncertainty is high (Ferris et al., 2009). Investors might be more risk-averse and more conservative (Tangjitprom, 2013).

Based on empirical data in Indonesia, the last ten years number of companies that divide the dividend fluctuating, but in the last three years has a downward trend. The average percentage of dividend payers in 2007-2016 is 39.41% (IDX, 2018). So it can be said that number of dividend payers in Indonesia are still low.

The result of logistic regression shows the significance value of dividend premium is less than level of significant ( $\alpha$ ) 5%, ( $0.0167 < 0.05$ ). it means accepted, there is influence between dividend premium and the dividend payout decision, so probability of firms paying dividend became bigger with the investor's demand for dividends. Coefficient is positive, it means the higher of dividend premium, probabilities of companies paying dividend greater and opposite. Higher dividend premium give a signal that investor's demand for dividend is high.

Investor's demand for dividend can make manager's probability to share the dividend to be

bigger because investor has given relatively high value to the dividend payers than dividend non payer so that to keep share price, company must fulfill and satisfy desire investors by starting or continue to share the dividend, because by dividing the dividend, the value of the company that is reflected from the stock price will rises. The dividend payout is often followed by a rise in stock prices (Baker & Wurgler, 2004). While if the company does not divide the dividend generally leads to a fall in stock prices (Brigham & Houston, 2001).

Brigham and Houston (2001) said the action that taken by the company's management that give clues for investors about how management future prospects. The dividend initiation has information in the form of a good and bright future prospect for the company so that the investor will react with the information provided by the company and will affect the stock price.

So it can be concluded that the purpose of the company serving the demand of investors by dividing the dividend is to maximize the value of the company measured by the increase of the company's stock price. (Baker & Wurgler, 2004).

#### **Value of opportunity of Companies Paying Dividends**

The results of statistical tests show that firms are more likely to share dividends if there are investor's demands for dividends in market, which is shown by significant dividend premium coefficients. Based on the interpretation of the logistic regression equation will be able to know the magnitude of the company's opportunity to pay dividends when there is investor demand. If with the increase of one dividend premium unit then the probability of the company pay dividends 2.19 times.

Increasing the value of premium dividend indicates that investor's demand for dividends will be higher. More high of the value of the premium dividend will make it possible for the companies to pay out dividend is high. High premium dividend shows investors give high value to companies that divide the dividend, so this will encourage managers to be willing to pay dividends.

Testing of catering theory of dividend in Indonesia with research sample at company listed in Indonesia Stock Exchange during period 2007-2016 got the result that investor's demand for dividends was measured by dividend premium have positive and significant influence to dividend payment decision of company, that is decision of dividend payment company is in-

fluenced by investor demand for dividends, thus making the company's opportunity to divide more dividends.

It can be concluded that management of companies in Indonesia when they take the dividend decisions, they pay attention to market sentiment, so the effect of catering has existed in Indonesia. The results of this study support the catering theory of dividends from Baker and Wurgler (2004) where managers tend to divide the dividend when investors place a relatively high premium price on payers shown by the positive value of premium dividend.

According to Baker and Wurgler (2004) investors are willing to provide more value (premium) for cash dividends for several reasons. First a clientele effect exists in the capital market where investors prefer cash dividends. Second, investors believe that companies paying dividends have a low risk. Third, investors may avoid high risk so that dividend payout is preferred. Because that's what causes investors in Indonesia prefer dividends and make the company's opportunity dividend increases.

The results of this study are also in line with research conducted by Tangjitprom (2011) and Ming et al. (2016) that investor demand for dividends affects the company's decision to pay dividends. This study does not support research conducted by Fatmawati and Ahmad (2017) and Tsuji (2010) which states that investor demand is not a determinant of the company's dividend payout decision.

#### **CONCLUSION AND RECOMMENDATION**

Based on research with 4375 observation on companies listed on Indonesia Stock Exchange period 2007-2016, so the conclusion are: (1) There are the bigger probability for firms paying dividend if the are investors demands. Probability for firms paying dividend are bigger because investor's demand for dividends can encourage the companies for paying dividends to maximize their market prices.(2) Probability of companies to pay dividend up 2.19 times for increasing a unit of dividend premium.

Based on the conclusion, suggest from researcher are For investors, they can pay attention to market sentiment for making the best decision in investing. For manager of companies, they must pay dividend to maximize share price. For further researcher, they can test catering theory of dividend to other dividend variable for example change of dividend payout.



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