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The Correlation of Catering Incentives to Stock Return - A Test of Catering Theory of Dividend*

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This research investigates whether dividend catering theory can provide the answer to explain phenomenon of dividend policy in Indonesia. The theory argues that the decision to pay dividends is driven by investors demand. Managers pay dividend when investors put a higher price on the shares of dividend payers and not paying when investors prefer non-dividend payers. Dividend premium is used as the proxy for the investor sentiment for dividend. The sample of this research is 337 non-financial firms listed within the Jakarta Stock Exchange, which is composed of 363 dividend announcements during the period 1999-2003. The correlation between catering incentives, measured by dividend premium, and the stock return shows a negative association between dividend premium and the stock return. Such a negative relationship might be caused by the relative growth opportunity of the firms showed by the decreasing number of dividend payers during period of observation.

Keywords : *Dividend catering theory; dividend premium, dividend yield, abnormal return.*

* This paper has been presented in the Accounting National Symposium (SNA) IX, Padang, 23th-26th August 2006

1. Problem Background

Several theories of dividend policy have been offered in the literature of corporate finance for firms to pay dividends. The first dividend theory; *dividend irrelevance theory*, proposed by Miller and Modigliani (1961) find that dividend policy is “only a financing decision”. The way of income is distributed (in the form of capital gain or dividend) does not affect the overall value of the firm, because of the two assumptions-given the firm’s investment decision and the existence of the perfect capital market. Then, *the-bird-in-the-hand theory*, suggest by Myron Gordon and John Lintner states that stockholders prefer dividend to retain earnings since dividend is less risky compared to retain earnings. Next, *the tax preference theory* hypothesizes that investors prefer a low dividend payment to a high pay-out because dividends are taxed at higher rates than capital gains. *The dividend clientele theory* states that the clienteles of investors becomes the consideration in changing the dividend policy. Meanwhile, *the residual dividend theory* hypothesizes that dividends are only paid when there are residual earnings after financing of the new investment. The next theory is the *dividend signaling hypothesis* suggests that payout to shareholders convey valuable information to the capital market (e.g. Bhattacharya, 1979; Miller and Rock, 1985; John and Williams, 1985 in Lie 2004). The theory predicts that the announcement of changes in current dividend brings information about the future performance of a firm. The empirical evidences associated with this theory are still inconclusive. In the support of the signaling theory, Hanlon et al. (2006) investigates the information content of dividend: whether market can understand and predict future earnings for dividend paying firms. Their result shows that the greater the association between current returns and future earnings, the more relevant the dividend information content of future earning. In contrast, Grullon et al. (2002) find the dividend increasing firms experience a decline in profitability in the years after the dividend change.

Baker and Wurgler (2002) (hereafter BW) propose a new dividend theory; *a dividend catering theory*. This theory assumes the market efficiency as proposed by Miller & Modigliani (*dividend irrelevance theory*). The essence of catering is that managers give investors “what they want”. The theory argues that the decision to pay dividends is driven by investor demand. There are two categories of stocks: dividend paying stock and non-dividend paying stock category. This theory hypothesizes that the demands for the two categories of stocks depend on the sentiment for the stock category. When investors choose the dividend paying stocks, they will bid up the price that cause a high dividend premium, then the managers will initiate dividend payment. Likewise, when investors do not favor the dividend paying stock, the managers will omit the dividend payment.

The timing of dividend initiation is an important issue to the aspect of corporate dividend policy. Bulan et al. (2005) presents evidence consistent with the dividend catering theory. They find that the timing of dividend initiation is affected by the investors’ sentiment, measured by the dividend premium. The firm that has higher dividend premium is more likely to initiate dividend than other firms with lower dividend premium.

The other empirical evidence that relates to the catering explanation as proposed by Denis and Osobov (2005) is the time series evidence on the propensity to pay dividend

in several developed financial markets in France, Japan, Germany (civil law countries), and U.S, Canada, United Kingdom (common law countries). The findings show that dividend premium is a measure of relative growth opportunity of payers and non-payers rather than a measure of investor sentiment for dividend.

Lie and Li (2005) propose that their result is consistently support the extended version of catering theory which allows a continuous dividend level. Lie and Li (2005) revisit the dividend catering theory because it is useful to examine the changes in dividend rather than just initiations and omissions. The following article of Lie (2005) also suggests that managers appear to consider both future performance changes as predicted by the signaling theory and investor demand for dividend as predicted by the catering theory when dividend raised. Another research by Hoberg and Prabhala (2005), found that catering becomes statistically and economically insignificant when they control for risk. Their result affirms the theory that risk is an important determinant of dividend decisions, but provides little evidence about dividend policies cater to investor sentiment.

The latest research has been conducted to determine the dividend policy in Indonesia. By using the signaling theory explanation, Kurniawan et al. (2005) find that firms that increase dividends experience significant improvement in the financial performance after the announcement period, while firms that decrease dividends experience significant decline in terms of financial performance. But this result is contradict to the research finding done by Warastuti (2003), that suggests there is a positive correlation between dividend changes and firms future earning, but dividend changes do not affect the firms future earnings significantly since the amount of dividend in Indonesia is determined in the annual general meeting of shareholders. A part from that, Hartono (2004) shows the fact of dividend policy in Indonesia is mostly determined in the annual general meeting of shareholders rather than as a signal of the firms' future prospect. As such, this article will investigate whether catering dividend theory could provide the answer to explain phenomenon of dividend policy in Indonesia particularly.

1.1. Problem Definition

In order to examine the dividend premium that measures the strength of investor preferences for dividend payers, some researchers have conducted the study of dividend catering theory. Lie and Li (2005) examine the link between investor sentiment for dividend and dividend changes. They find that the announcement period-return for dividend increases are positively related to the dividend premium, and for dividend decreases the relation is negative. Then, Bulan et al. (2005) explain the timing of dividend initiation and the relationship between dividend premium and the market reaction. By considering at the phenomenon in Indonesia, the dividend payment is mostly determined in the annual general meeting of shareholders, there is a possibility that the dividend payout can be explained through the catering incentives. Based on the explanation above, the relationship between the investor demand for dividend and the stock return at the dividend announcement event is an empirical question to be answered.

1.2. Research Contribution

This research investigates the association between investors sentiment for dividend to the stock return around the dividend announcement. The result of this research is aimed to contribute into the literature of dividend catering theory, particularly on the literature related to whether dividend catering theory can provide the answer to explain phenomenon of dividend policy in Indonesia.

2. Theoretical Frameworks

2.1. The Dividend Catering Theory

This theory is proposed by Baker and Wurgler (2002). The theory has three main components. The first component is investor demand for dividend. There are two categories of stock based on investor's preferences-dividend-paying stock and non-dividend paying stock. There are several reasons why investors categorize firms as dividend payers. One reasons for dividend-paying stock category is dividend-paying stocks are less risky as stated in the bird-in-the-hand argument. The second reason is that dividend is used to infer manager's investment plan. That is dividend-paying stock is chosen if investor's perception about the overall growth opportunity of the firm is small. The next reason is the dividend clientele, that is dividend-paying stock is used for the investors that need current income. Investor demand for dividend will be measured by the dividend premium that is the difference in logs of average market to book ratio of payers minus non-payers. The second component is limited arbitrage. In a perfect and efficient capital market that is used by the dividends irrelevance theory, arbitrage will be limited. The uninformed demand for dividends would not affect stock prices. Then, the last component is that catering as a rational response. Catering implies that manager will initiate dividend when investors put a higher price on payers and omit dividends when investors favor non-payers. The objective of catering is to get the stock price premium associated with the characteristics investors favor.

This theory hypothesizes that the demands for the two categories of stocks-dividend paying stock and non-dividend paying stock depend on the sentiment for the stock category. When the dividend paying stocks are chosen, investor will bid up the price causes a high dividend premium then the managers initiate dividend payment. Likewise, when the dividend-paying stock is not interested by the investor, the managers omit the dividend payment. This theory assumes the market efficiency as proposed by Miller & Modigliani (*the dividend irrelevance theory*).

There are four variables utilized to measure the investor demand for dividends. The first measure is dividend premium, which is the difference in the logs of the average market-to-book ratio of payers and non-payers. The market-to-book ratio is book assets minus book equity plus market equity all divided by book assets. The second measure of

investor demand for dividend payers is the difference in the prices of Citizens Utilities (CU) cash dividend and stock dividend share classes. BW measures CU dividend premium as the difference in the log price of the cash payout share and the log price of stock payout share. The third measure is the average announcement effect of recent initiation, which is cumulative abnormal announcement return. If investors clamor for dividends, they make themselves heard through their reaction to initiation or they should respond to news of dividend initiations more favorably. The last demand measure is the difference between the future returns on value-weighted indexes of payers and non-payers. Dividend premium variable is the single best reflection of investor sentiment for dividend because it is correlated with all of other variables in positive direction.

The sources of demand for dividend as stated by BW can be explained by the traditional dividend clientele and sentimental investors. As suggest by Black and Scholes (in BW 2002), the uninformed demand for dividends comes from the dividend clientele that is derived from the imperfections in taxes, transaction cost, and institutional investment constraints. The proxy for tax clientele is the relative tax advantage of dividend income versus capital gain. It shows that the initiation rate is positively related to tax rate variable, but the tax rate inclusion does not affect the dividend premium significantly. For the transaction cost variable, the regression shows that the dividend premium has more statistical significance than transaction cost in explaining the initiation rate. The sentimental investor explanation comes from two specific sentiment mechanisms. One that is based on the "bird-in-the-hand" fallacy proposes that investors prefer dividend-paying firm because of dividend is less risky. Another sentiment mechanism is from the time-varying investor perception of growth opportunities. It states that unsophisticated investors infer the firm's investment plans through the use of dividend policy. If the firm makes a zero-payout policy, then investors infer that the firms want to reinvest and grow. Investors believe that a high-growth firm will pay a less dividend and otherwise the low-growth firms will be likely to pay more dividends. From the two sources of time-varying demand for dividend, there is no strong evidence for a traditional dividend clientele. Meanwhile, the demand for dividend is affected significantly by the investor sentiment.

2.2. Studies about Dividend Catering Theory

Dividend catering theory brings new theory of dividend in the corporate finance. This theory introduced by BW (2002), develop a theory that the decision to pay dividends is driven by investors demand. Managers pay dividend when investors put a higher price on the shares of payers and not paying when investors prefer non-payers. The following article by BW (2003) found that catering incentives can explain the dramatic decline in the propensity to pay dividend. In their empirical research about the propensity to dividend payment and catering incentives within NYSE, AMEX, and NASDAQ firms, they find that there are four distinct trends in the propensity to pay dividend between 1963 and 2000 as documented by Fama and French (2001): two appearances and two decreases of dividend payment. Each of these trends can be connected to the fluctuation of dividend

payment by using the proxy of the catering incentives. The result shows that the dividend premium as proxy for catering incentives is able to account for the magnitude of the post-1977 disappearance. The catering incentive that is measured by the dividend premium is also able to forecast the relative stock return of payers and non-payers.

Lie and Li (2005) found strong evidence to support the catering theory using a sample of 1,815 dividend decreases and 18,964 dividend increases announced between 1963 and 2000. They extend the catering theory proposed by BW(2002) to include decreases and increases in the dividend level. They extend the theory due to the two shortcomings of BW findings. The first shortcoming is that their empirical model only classified firm as either dividend payers or non-payers. The model can only explain why firms initiate or omit dividends, but it cannot explain why firms change their dividend level. The second shortcoming is that there is no significant relationship between announcement return and dividend premium. It is reasonable to assume that investors not only categorize firms into groups based on they pay dividend, but they also have subcategories based on dividend level. They find that the magnitude of dividend changes can be explained by the dividend catering partially. Finally, Lie and Li (2005) investigate the link between the abnormal stock returns around dividend decreases or increase announcement and the dividend premium. The result shows that the announcement returns for dividend increases relate to the dividend premium positively, while the announcement return for dividend increases are positively related to dividend premium.

Lie (2005) reexamines the relationship between dividend increases and performance changes. Lie (2005) analyzes the operating performance that is composed of unadjusted and adjusted performance around the dividend increase announcement. Unadjusted performance is the operating performance for the firms that announce dividend increases. Adjusted performance is the unadjusted performance less the performance for control firms. Lie (2005) also analyzes the relationship between operating performance and the dividend premium. The result shows that at the time of the announcement, the unexpected subsequent performance improvement is greater when the dividend premium is low. Thus, if the dividend premium is low, dividend increase is a strong signal of future firm specific improvement.

Denis and Osobov (2005) extend the literature by examining the time series evidence on the propensity to pay dividend in several developed financial markets in the civil law countries: Germany, France, Japan and in the common law countries: United States, United Kingdom, and Canada. This time series prediction allows them to conduct a further test of the catering hypothesis and agency explanation. The measure of catering incentives that is the relative market-to-book ratios of dividend payers and non-payers might also be viewed as a measure of the relative growth opportunities of payers and non-payers. If the relative growth opportunity of dividend payers improves, then agency theory predicts that these firms will be less likely to pay dividend. The result finds that there is a failure to support the catering hypothesis, especially in the civil law countries for several reasons. Managers in outside United States are less concerned with maximizing shareholder's wealth. The other reason is that dividend premium is a proxy for the relative growth opportunity of dividend payers rather than a measure of investor sentiment. Al-

though they cannot reject the catering hypothesis in the common law countries, the relative growth opportunities can explain the evidence in all six countries.

In their empirical research about the disappearing dividends, Hoberg and Prabhala (2005) investigate the role of idiosyncratic risk in explaining the propensity to pay dividends. In explaining between risk and the propensity to pay dividends, risk, specifically idiosyncratic risk is an economically and significant determinant of the propensity to pay dividends. In the relationship of risk and catering hypothesis, the result shows that catering variable loses its significance in explaining the changing propensity to pay dividends when risk is not controlled. Thus, catering could explain the changes in the propensity of dividend payment when risk is excluded, but when the risk is included, the catering loses its significance in explaining the propensity to dividend payment.

Bulan, et al. (2005) have done research using NYSE, AMEX, and NASDAQ firms to test the catering hypothesis. They test all theories of dividend policies including signaling, free cash flow, and clientele theories, which they reject, and the life-cycle and catering theories for which they support. Firstly, they examine the differences between initiators and non-initiators by using the matched sample logit estimation. The result shows that the dividend initiators are firms with higher cash level and higher profitability and has fewer growth opportunities than non-initiators. Then, they use the hazard model, which includes all observations of a firm from IPO to initiations and compares firms at the same stage in their life cycle. The result indicates that the propensity to pay dividend is positively related to firm size, profitability, and cash reserves. Meanwhile, it has negative relationship with growth opportunities and capital expenditure. Furthermore, they study the initiation through BW's catering theory that can determine the timing of the initiations. The empirical evidence shows that in the timing of dividend initiation, there is a role of dividend premium as proxy for the catering incentives. They also examine the positive announcement effect of dividend initiations on dividend premium by controlling for firms specific control variables. By including abnormal return around the initiation, they find that abnormal return around an initiation is positively related to the dividend premium.

2.3 The Catering Incentives and Abnormal Return

BW use average announcement effect of initiations as the measurement of dividend payment variable and test the relationship to the dividend premium. If investors favor for dividends, they should respond more favorably to the news of dividend initiations. However, in their empirical research BW found no statistically significance relationship between the announcement return and the dividend premium. The reason for managers catering to investor's demand for dividend is that the stock price of the firms will be affected by the higher dividend premium and the lower dividend premium. If the investor sentiment for dividend is high, then the stock price reaction will be higher, and if the investors sentiment for dividend is low, then the stock price reaction will also be lower. By looking at the dividend policy in Indonesia, that the payment is mostly determined in the annual general meeting of shareholder, this research will be examined further about whether

the catering incentives could help explained the dividend decision in Indonesia.

2.4. Hypothesis Development

Baker and Wurgler (2002) develop a theory that the decision to pay dividend is driven by investor demand. If investors put a higher price on the shares of payers, then manager will pay dividend. The following article by BW (2003), they find that there are four distinct trends in the propensity to pay dividend between 1963 and 2003. The result shows that the dividend premium as proxy for catering incentives is able to forecast the relative stock return of payers and non-payers. The result shows that the dividend premium as proxy for catering incentives is able to forecast the propensity to pay dividend and the relative stock return of payers and non-payers because if investors favor for dividends, they should respond more favorably to the news of dividend initiations.

Bulan, et al. (2005) study the BW's catering theory to determine the timing of dividend initiation. The result shows that abnormal return around initiation is positively related to the dividend premium because if investors favor for dividend, they should respond more favorably to the news of dividend payment. If the investors sentiment for dividend is high, which is measured by dividend premium, then the stock price reaction, measured by abnormal return will be higher.

From the research above, the hypothesis of the research is ; there is a relationship between abnormal return around dividend announcement and dividend premium.

3. RESEARCH METHOD

The research population covers all companies listed in the Jakarta stock Exchange from January 1, 1999 to December 31, 2003. The research samples are taken based on the purposive sampling method. The samples are explained in the following table:

TABLE 1.
Sampling Procedure

Data Description	Year of Observations					Total
	1999	2000	2001	2002	2003	
Firms Listed in the JSX	296	317	318	318	321	1570
<u>Minus</u> : finance related firms (banking, insurance, credit agencies other than banks, and securities companies)	64	71	71	71	73	350
<u>Minus</u> : non-dividend paying firms	192	148	180	179	184	883
Dividend paying firms (Final Sample)	40	98	67	68	64	337

FIGURE 1.
Percentage of Dividend Payers vs Non Dividend Payers
among Non Financial Firms

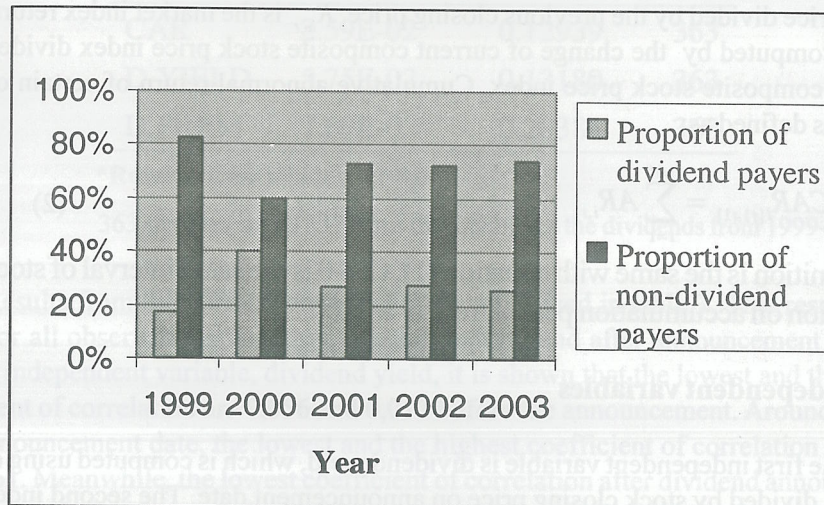


Figure 1 shows the proportion of dividend-paying firms and non-dividend paying firms. The result shows that there is high increase of dividend payers in 2000, but then it decreases until 2003.

3.1. Data Collection Procedure

Financial data are taken from Indonesian Capital Market Directory (1999-2003). Market data which consist of firm cumulative abnormal return, dividend announcement date, dividend per share, and closing stock price data are taken from Indonesian Securities Market Database of Gadjah Mada University.

3.2. Variable Measurement

3.2.1. Dependent Variable

The dependent variable is the market reaction measured by cumulative abnormal return (CAR). The market-adjusted model is used to estimate the abnormal return. This model uses the market index return as the best estimator for expected security return. This model does not need estimation period to form an estimation model because the expected return of security is the same with market index return. Abnormal return is estimated by using the following equation:

$$AR_{i,t} = R_{i,t} - R_{m,t} \quad (1)$$

where, $AR_{i,t}$ is abnormal return of security i during period t , and $R_{i,t}$ is the return on security during period t , measured as the change of current stock price to the previous closing price divided by the previous closing price. $R_{m,t}$ is the market index return on day t . $R_{m,t}$ is computed by the change of current composite stock price index divided by the previous composite stock price index. Cumulative abnormal return of certain observed window is defined as:

$$CAR_{i[t1,t10]} = \sum_{t=1}^{t=10} AR_{i,t} \quad (2)$$

$AR_{i,t}$ definition is the same with equation (1), $t1, t10$ is the same interval of stock return observation on accumulation period from $t1$ to $t10$.

3.2.2. Independent variables

The first independent variable is dividend yield, which is computed using dividend per share divided by stock closing price on announcement date. The second independent variable is dividend premium, which is defined as the proxy for investors' sentiment for dividend-paying stocks. Dividend premium is the difference in natural logarithm of the average market-to-book ratio between dividend payers and non-payers in each year. The average market-to-book ratios are constructed by value-weighting (by book value) across dividend payers and non-dividend payers. The market-to-book ratio is book assets minus book equity plus market equity all divided by book assets. Market equity is fiscal-year closing price times shares outstanding.

In order to establish the evidence for the catering dividend theory, correlation analysis is used to look at the association between dividend yield, dividend premium and the abnormal return. The strength of the correlation will be determined by examining the Pearson correlation coefficient for each windows. Pearson correlation coefficient can only take value -1 to $+1$. The positive sign indicates that there is a positive correlation (as the dividend yield or dividend premium increases, so too the market reaction). The negative sign indicates that there is a negative relationship between variables, when the dividend premium decreases, the market reaction increases. The size of the absolute value (ignoring the sign) provides an indication of the strength of the relationship.

The windows used in this research are 10-days event windows (before, after, and around the dividend announcement (Hartono, 2003: p.436).

4. Results

Table 2 shows descriptive statistic from the correlation model using event windows $[-8, 0]$. Mean value of CAR, dividend yield, and dividend premium is 0.026, 0,058, and 0,077 respectively.

TABLE 2.
Descriptive Statistics

Variables	Mean	Std.Deviation	N
CAR	2.59E-02	0.12939	363
D.YIELD	5.75E-02	0.13180	363
D.PREM	7.69E-02	0.20384	363

*Result is from window t [-8,0].

363 samples are all 337 firms that announce the dividends from 1999-2003

Results from the correlation model are summarized in table 3. This result is estimated for all observations windows: around, before, and after announcement date. For the first independent variable, dividend yield, it is shown that the lowest and the highest coefficient of correlation are 0,056 and 0,017 before the announcement. Around the dividend announcement date, the lowest and the highest coefficient of correlation are 0,065 and 0,161. Meanwhile, the lowest coefficient of correlation after dividend announcement is 0,043 and the highest coefficient of correlation is 0,143. It means that the highest coefficient of correlation for all windows shows a positive statistically significant correlation between dividend yield and abnormal stock return variable. While, the lowest coefficient of correlation for all windows shows that there is also a positive, but statistically insignificant correlation between abnormal stock return and dividend yield.

The second independent variable is the dividend premium. The highest coefficient of correlation is -0,078 and the lowest coefficient of correlation is -0,015 before the announcement date. Then, around the dividend announcement date, the highest and the lowest coefficient of correlation are -0,103 and 0,001. The highest and the lowest coefficient of correlation after announcement date are -0,078 and -0,005. From all event windows, the highest coefficient of correlation is statistically significant, meaning that there is a negative statistically significant relationship between the stock return and the dividend premium. This result is consistent with the hypothesis that there is relationship between stock return and the dividend premium. Meanwhile, given the lowest coefficient of correlation for all three event windows, it shows that there is also negative statistically insignificant association between the stock return and the dividend premium. At windows [-3,+3] and [0, +3], the correlation between dividend premium and stock return is positive and statistically insignificant. Therefore, this result has two outcomes in the relationship between dividend premium and the stock return, but generally it can be stated that mostly there is a negative association between the stock return and dividend premium.

However, in all event windows, the coefficient of correlation for dividend yields and dividend premium variables shows statistically significant relationship. Except for windows [-3, +3], [-3, 0] and [-7, +7], the results do not show statistically significant relationship between the variables. In general, the abnormal return is lower and statistically significant to the dividend announcement made by the firm with high dividend premium be-

cause investors do not really consider the dividend premium made by the firms, and that is also why the dividend premium shows negative relationship to the stock return.

TABLE 3
Person Correlation Coefficient

Dependent Variable: CAR

Independent Variable: Dividend Yield and Dividend Premium

Event Windows		Coefficient of correlation(r)	
		Div.yield	Div.premium
Before	[-10,0]	0.107***	-0.064
	[-9,0]	0.117***	-0.078**
	[-8,0]	0.084**	-0.075**
	[-7,0]	0.075**	-0.077**
	[-6,0]	0.062	-0.069**
	[-5,0]	0.073**	-0.032
	[-4,0]	0.073**	-0.025
	[-3,0]	0.056	-0.015
	[-2,0]	0.078**	-0.025
	[-1,0]	0.102**	-0.015
Around	[0]	0.065	-0.018
	[-10,+10]	0.161***	-0.079**
	[-9,+9]	0.161***	-0.103**
	[-8,+8]	0.118***	-0.099**
	[-7,+7]	0.066	-0.093**
	[-6,+6]	0.083**	-0.101**
	[-5,+5]	0.097**	-0.048
	[-4,+4]	0.097**	-0.017
	[-3,+3]	0.065	0.011
	[-2,+2]	0.09**	0.001
	[-1,+1]	0.111***	0.004
After	[0,+1]	0.082**	0.008
	[0,+2]	0.081**	0.017
	[0,+3]	0.069**	0.022
	[0,+4]	0.089**	-0.005
	[0,+5]	0.087**	-0.041
	[0,+6]	0.082**	-0.078**
	[0,+7]	0.043	-0.060
	[0,+8]	0.106**	-0.069**
	[0,+9]	0.135***	-0.073**
		[0,+10]	0.143***

*** statistically significant at 1%; ** statistically significant at 5%; * statistically significant at 10%

5. Conclusion and Future Research

This research investigates the association between market reaction around dividend announcement and the investor demand for dividends by using dividend catering theory to be tested within Indonesian firms in the Jakarta Stock Exchange. Market reaction is measured by CAR and the investor sentiment for dividend is measured by dividend premium.

The result shows that there is positive statistically significant correlation between the dividend yield variable and the stock return. It means that stock return will be higher if the ratio of dividend yield is also higher since there will be stock price increases followed by the high market reaction. Then, most event windows show that the stock return becomes lower when the investor sentiment for dividend is higher. The reason for the negative relationship between dividend premium and the stock return may be explained on the research done by Denis and Osobov (2005). They conclude that dividend premium is a proxy for the relative growth opportunity of dividend payers rather than a measure of investor sentiment. It can be seen from the dividend decreases samples in Indonesia from the period 2000-2003 (Figure 1). Figure 1 seems to confirm their result since there is a decreasing number of dividend paying firms in our sample. Growth opportunity may be one of the reasons for firms to not paying dividends.

In summary, the results of this research support the catering theory of dividend to explain the phenomenon of dividend policy in Indonesia because as the result shows, there is correlation between catering incentives to stock return. According to the catering theory of dividend, investor sentiment for dividend has positive relationship to the stock return. However, this research shows the opposite result to the theory. The explanation for the opposite result might be explained on the research done by Denis and Osobov (2005) that is when the relative growth opportunity of dividend payers improves, then these firms will decrease the dividend payout. This decreasing amount of dividend payment might cause investors becomes unresponsive to the dividend announcement as showed by the lower stock return.

This research, however, still has limitations. It is only used five years period observation to look at the investor sentiment for dividend. The use of the samples years might cause inconclusive result since the year 1999 is the period after the financial crisis occurred in Indonesia. This research only classified firms as either dividend payers or non-payers and also does not include the level of dividend increases and dividend decreases that might cause some missing explanations. The inclusion of the change in dividend level will give more explanation on the catering theory of dividend particularly on the firms' growth opportunity explanation to the stock return.

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