# DIVIDEND POLICY AND MARKET BEHAVIOR: EVIDENCE FROM INDONESIA

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A R T I C L E I N F O

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A B S T R A C T

***Research Purposes**. This study investigates the effect of market behavior on dividend policy within the Catering Theory framework, where market conditions reflect underlying investor sentiment. In this study, market behavior is captured through proxies, namely, unexplained market behavior and abnormal trading volume.*
***Research Methods**. Using a quantitative causal research design, this study examines secondary data derived from annual reports and market data of listed firms during the 2020–2024 period, with the change in dividend payout ratio serving as the dependent variable, free cash flow, Debt, and net income included as control variables and multiple regression analysis applied to test the proposed hypotheses.*
***Research Results and Findings**. The findings indicate that unexplained market behavior and abnormal trading volume have a positive and significant effect on changes in the dividend payout ratio. At the same time, free cash flow also shows a significant influence, whereas Debt and net income do not. These results suggest that corporate dividend decisions in Indonesia are driven not only by firm fundamentals but also by market preferences and behavioral factors as explained by the Catering Theory. This study implies that dividend policy should consider both firm fundamentals and market conditions in corporate decision-making.*

A B S T R A K

***Tujuan Penelitian** Penelitian ini mengkaji pengaruh perilaku pasar terhadap kebijakan dividen dalam kerangka Catering Theory, di mana perilaku pasar tercermin pada sentimen investor. Dalam penelitian ini, sentiment investor diukur menggunakan proksi unexplained market behavior dan abnormal trading volume.*
***Metode Penelitian**. Desain penelitian kausal kuantitatif untuk menganalisis data sekunder yang bersumber dari laporan tahunan dan data pasar dari perusahaan yang go public selama periode 2020–2024, dengan perubahan dividend payout ratio sebagai variabel dependen, serta free cash flow, debt, dan net income sebagai variabel kontrol, dengan analisis regresi berganda untuk pengujian hipotesis.*
***Hasil Penelitian dan Temuan Penelitian** Hasil penelitian menunjukkan bahwa perilaku pasar yang tercermin pada sentiment investor dan diproksikan dengan Unexplained Market Behavior dan Abnormal Trading Volume berpengaruh positif dan signifikan terhadap perubahan Dividend Payout Ratio, sementara free cash flow juga berpengaruh signifikan namun debt dan net income tidak berpengaruh, sehingga dapat disimpulkan bahwa keputusan pembagian dividen perusahaan di Indonesia tidak hanya dipengaruhi faktor fundamental tetapi juga sangat dipengaruhi oleh preferensi dan tekanan psikologis pasar sebagaimana dijelaskan dalam Catering Theory. Penelitian ini berimplikasi bahwa kebijakan dividen perlu mempertimbangkan faktor fundamental dan kondisi pasar guna mendukung pengambilan keputusan manajerial, investasi, serta peningkatan transparansi pasar.*

## INTRODUCTION

Dividend policy is also crucial because it directly influences firm valuation, investor expectations, and financial sustainability, especially in emerging markets where information asymmetry is relatively high. Dividend policy also remains a central strategic decision for corporations as it involves the complex trade-off between distributing profits to shareholders and retaining earnings for future expansion (Baker et al., 2021; de Souza Junior et al., 2025). In modern financial markets, companies that consistently pay dividends are

often perceived as having superior financial stability and robust governance than those that do not. However, the traditional view that dividend decisions are solely based on firm fundamentals has been increasingly challenged by behavioral finance perspectives (Byun et al., 2021; Ghose et al., 2025). Recent empirical evidence suggests that management's decision to distribute wealth is not only a signal of internal health but also a reaction to external market dynamics. Consequently, understanding the psychological drivers behind payout decisions is essential for analyzing corporate behavior in volatile emerging markets like Indonesia. Dividend policy remains a critical financial decision because it directly affects firm valuation, investor expectations, and long-term financial sustainability. Managers must balance between distributing profits and retaining earnings for future growth, making dividend policy a strategic tool in corporate financial management (de Souza Junior et al., 2025; Trinh et al., 2022; Harakeh, 2020; Sulistyowati et al., 2025)

In an inefficient market environment, deviations between market valuation and firm fundamentals often arise, which may influence how managers formulate dividend policy. Investors often exhibit irrational behaviors that deviate from fundamental values, creating a dividend premium that managers seek to capture (Rochmah & Ardianto, 2020). This irrationality is often manifested through unexplained market behaviors where stock prices do not align with the firm's actual financial performance. Managers, acting as rational agents in an irrational market, recognize these mispricings and adjust dividend policies to exploit investor sentiment for the firm's benefit. Current research underscores that firms operating in developing economies are especially sensitive to sentiment-driven market pressures due to lower information transparency (Byun et al., 2021; Huynh et al., 2025). Thus, dividend policy serves as a tactical tool to maintain stock attractiveness amidst shifting investor moods (Wang et al., 2021)

In this study, investor sentiment is not measured using the traditional dividend premium as proposed in prior catering literature. However, it is captured through alternative market-based proxies, namely unexplained market behavior and abnormal trading volume. These proxies reflect different dimensions of sentiment, including market mispricing and investor attention (Huynh et al., 2025; Pham et al., 2025; Xin & Zhen, 2025; Yang et al., 2025; Herculano & Lütkebohmert, 2023; Neves, 2018; Zhang et al., 2023). A positive residual indicates that the market is overvaluing the firm due to high investor optimism or sentiment bubbles. On the other hand, a negative residual reflects investor pessimism that may irrationally suppress the firm's valuation (Fonou-Dombeu et al., 2024; Kang & Kim, 2021) By isolating these non-fundamental deviations, the study provides a robust empirical framework to test whether Indonesian managers are truly responding to market sentiment (Rochmah & Ardianto, 2020).

In addition to market valuation residuals, abnormal trading volume is used as a secondary proxy to reflect the intensity of investor sentiment (Astuti & Prayoga, 2020; Li et al., 2024). The financial literature over the last five years suggests that sudden spikes in trading volume often reflect the dominance of irrational noise traders (Zhou et al., 2002). These spikes create psychological pressure on management as they signal a period of high emotional engagement from the market (Melati & Nurwulandari, 2017; Taylor, 2024). When liquidity increases due to speculative activity, firms may feel compelled to adjust their dividend payouts to signal safety (Wang et al., 2021; Xin & Zhen, 2025). Therefore, abnormal volume serves as a critical indicator of the market's current emotional state and its potential influence on corporate payout strategies.

The emergence of Catering Theory provides a compelling alternative to traditional signaling and agency theories by highlighting the role of investor psychology (Baker & Stein, 2004; Bilel & Mondher, 2021; Rochmah & Ardianto, 2020). This theory posits that managers adjust dividend decisions in response to market preferences, suggesting that dividend policy may also be influenced by external market conditions (Al-Hiyari et al., 2024 ; Neves, 2018). During periods when investors exhibit a strong appetite for dividend-paying stocks, firms are more likely to initiate or increase payouts to meet this demand (Bilel & Mondher, 2021). Conversely, when market sentiment shifts toward capital gains from non-dividend-paying stocks, managers may reduce or omit dividends to align with prevailing sentiment (Nuansari et al., 2023). Recent studies confirm that this adaptive response is particularly prevalent in markets characterized by high retail investor participation and emotional decision making (Al-Hiyari et al., 2024; Israeli et al., 2022). The Indonesian capital market presents a unique setting for testing Catering Theory because it is heavily influenced by domestic retail investors prone to herding (Budiarso et al., 2019; Wijaya et al., 2022). Previous studies on the Indonesia Stock Exchange (IDX) have shown inconsistent results regarding the stability of dividend policies during periods of economic fluctuation (Fransiska et al., 2018; Pratiwi et al., 2022; Wijaya et al., 2022). While some firms maintain dividends to project stability, others appear to fluctuate their payouts in direct response to shifting market preferences. Empirical findings from 2020 to 2022 confirm that Indonesian manufacturing

firms tend to increase dividends when the market offers a higher valuation premium (Rochmah & Ardianto, 2020). This highlights the necessity of a comprehensive study that spans the most recent volatile period, including the post-pandemic recovery (Hutauruk, 2021; Liu et al., 2020; Okorie & Lin, 2021).

This study examines how market behavior influences dividend policy decisions, emphasizing the role of dividend policy as a key corporate financial strategy. While previous Indonesian studies have often focused solely on the dividend premium, this study adopts a multi-proxy approach to capture a more nuanced picture of the investor. By including control variables such as free cash flow, debt, and net income, the study ensures that the observed effects are truly driven by sentiment (Dewasiri et al., 2019). The ultimate goal is to determine if the catering mechanism is a dominant driver of dividend decisions in the Indonesian context. From an accounting perspective, this study contributes to the contemporary accounting literature by highlighting the interaction between financial reporting information and investor sentiment in shaping corporate dividend decisions. Financial statements provide fundamental indicators such as net income, free cash flow, and leverage that traditionally serve as the primary basis for dividend policy decisions. High-quality accounting information reduces information asymmetry and enables investors to evaluate firm performance more accurately. However, recent studies suggest that dividend decisions may also reflect managerial responses to market perceptions rather than purely accounting fundamentals (Deng et al., 2024)

Furthermore, this research enriches accounting-based capital market research by demonstrating how accounting fundamentals can serve as a benchmark for detecting sentiment-driven mispricing. When a firm's market valuation deviates from the value predicted by accounting variables, the residual component may capture unexplained market behavior associated with investor sentiment. Prior literature emphasizes that accounting numbers play a critical role in identifying such deviations because they represent the underlying economic performance of the firm (Fonou-Dombeu et al., 2024)

Specifically, this study aims to analyze how market behavior influences dividend policy among IDX-listed companies within the Catering Theory framework. Through this analysis, the research seeks to offer valuable insights for both academic development and practical corporate management. Academically, it enriches the understanding of the interaction between market psychology and corporate finance in a developing economy (Al-Hiyari et al., 2024; Byun et al., 2021; Taylor, 2024). In practice, it provides managers with a guideline for formulating responsive dividend strategies that take into account their investor base's prevailing preferences.

This study also offers several important contributions to the contemporary accounting and finance literature. First, unlike prior studies that primarily focus on the dividend premium as a proxy for investor sentiment, this research adopts a multi-proxy approach by integrating unexplained market valuation residuals and abnormal trading volume to capture sentiment dynamics more comprehensively. Second, the study bridges accounting information and behavioral finance by positioning accounting fundamentals as a benchmark to identify sentiment-driven mispricing that may influence managerial dividend decisions. Third, by examining firms listed on the Indonesia Stock Exchange during the recent volatile economic period, this research provides new empirical evidence from an emerging-market context where retail investor dominance and information asymmetry may amplify managers' catering behavior. Overall, this study suggests that dividend policy should be determined not only by firm fundamentals but also by market conditions, underscoring the importance of considering market dynamics in decision-making for managers and investors.

## LITERATURE REVIEW

### *Catering Theory*

Catering Theory, pioneered by Baker & Wurgler. (2003); Bilel & Mondher (2021); Rustan et al. (2022); Rochmah & Ardianto (2020), suggest that corporate dividend policy is not solely driven by a firm's internal fundamentals, but may also be influenced by changing market preferences. Managers act as caterers to the market, adjusting dividend payouts to align with what investors currently value most; for instance, firms are more likely to initiate or increase dividends when the market places a premium on dividend-paying stocks, and conversely, they may withhold payouts when preferences shift toward non-dividend-paying shares. This theory shifts the focus from traditional Signaling Theory, which views dividends as a supply-side information signal, to a demand-side perspective where dividends are a reactive response to market sentiment, while still positioning dividend policy as the central corporate financial decision. In markets that are not fully efficient, this theory provides an essential explanation for fluctuations in dividend trends that

cannot be adequately accounted for by a firm's internal financial fundamentals (Baker & Wurgler., 2003; Byun et al., 2021).

Beyond its core proposition, Catering Theory also implies that dividend policy may vary systematically over time following waves of investor sentiment and mispricing in the capital market (Bilel & Mondher, 2021; Hu et al., 2021). When investor optimism is high and dividend-paying stocks are relatively overvalued, managers have incentives to initiate or increase dividends to capitalize on favorable pricing conditions and sustain firm valuation. Conversely, when market sentiment shifts and investors favor growth-oriented or non-dividend-paying firms, managers may reduce or omit dividends without necessarily signaling deterioration in fundamentals. In this sense, dividend decisions become partially market-timing mechanisms rather than purely reflections of profitability, cash flow, or agency considerations (Al-Hiyari et al., 2024; Frijns & Huynh, 2018; Kumar et al., 2022). Empirical evidence further shows that the dividend premium, defined as the valuation difference between dividend payers and non-payers, fluctuates over time and influences corporate payout behavior, reinforcing the view that managers respond strategically to investor demand conditions rather than relying solely on internal financial metrics (Baker & Wurgler., 2003; Kumar et al., 2022)

Building on this foundation, recent empirical studies have further validated the role of market conditions as an important factor influencing dividend decisions, especially in markets characterized by high retail participation. (Byun et al., 2021; Frijns & Huynh, 2018; Neves, 2018) demonstrates that in the Eurozone, managers do not just look at internal liquidity but actively monitor unexplained market behavior to decide whether a payout will enhance the firm's market valuation. This suggests that the catering incentive is a global phenomenon where the dividend premium, the price difference between payers and non-payers, serves as a behavioral compass for corporate boards. Furthermore, (Ghose et al., 2025; Rochmah & Ardianto, 2020) highlight that in emerging markets like Indonesia, the pressure to cater to investor demands often outweighs traditional factors such as free cash flow, underscoring the importance of sentiment-driven policies for maintaining stock attractiveness during periods of high market optimism.

In the last decade, the evolution of behavioral finance has introduced more complex proxies to measure the catering effect, such as market volatility and abnormal trading volumes. Chen (2023) argues that during periods of high market sentiment, firms are significantly more likely to initiate dividends to anchor investor expectations and stabilize stock prices against irrational fluctuations. This proactive catering is seen as a strategic tool to reduce the agency costs of equity by aligning management actions with the prevailing market mood. Additionally, research by Baker & Stein (2004), which remains highly influential in recent studies, combined with contemporary findings by Harakeh (2020 and Lai et al., (2020) confirms that when irrational investors drive market liquidity, managers use dividend policy as a reactive mechanism to capture the resulting valuation gains, further cementing Catering Theory as a cornerstone of modern corporate finance (Budiarso et al., 2019; Kumar et al., 2022; Rustan et al., 2022).

From an accounting perspective, the catering view of dividends also highlights the relevance of financial reporting information in shaping managerial responses to investor sentiment. Accounting figures reported in financial statements, such as earnings, free cash flow, and leverage, traditionally serve as fundamental indicators of a firm's capacity to distribute dividends. However, recent accounting research suggests that managerial payout decisions may be influenced not only by these accounting fundamentals but also by market perceptions that deviate from financial reporting information (Kumar et al., 2022). In this context, accounting information functions as a benchmark that allows investors and researchers to distinguish between fundamental firm value derived from financial statements and sentiment-driven valuation in capital markets.

Furthermore, integrating accounting-based valuation with behavioral indicators strengthens the analytical framework for understanding dividend policy. When market prices diverge from values predicted by accounting fundamentals, such deviations may reflect investor sentiment rather than the firm's actual financial performance. Recent studies emphasize that accounting information plays a crucial role in identifying market mispricing and evaluating whether managerial financial decisions, including dividend policy, respond to fundamental performance or to market-driven sentiment (Deng et al., 2024; Trinh et al., 2022). Therefore, the catering mechanism can also be interpreted as a managerial reaction to discrepancies between accounting-based firm value and market valuation.

In addition, this perspective aligns with contemporary accounting literature that views dividend policy as part of a broader corporate communication strategy within financial reporting environments characterized by information asymmetry. In emerging markets where transparency and information dissemination may vary across firms, dividend payments can complement accounting disclosures by reinforcing managerial

credibility and strengthening investor confidence (Al-Hiyari et al., 2024; Sulistyowati et al., 2025). Consequently, dividend decisions may not only reflect internal accounting performance but also function as a communication tool that interacts with investor sentiment and market perceptions. Overall, this perspective emphasizes that dividend policy remains the central decision, while market conditions act as external factors that may influence how firms adjust their payout strategies. Recent literature also emphasizes the growing role of behavioral factors and investor attention in shaping corporate financial decisions (Raza et al., 2025; Taylor, 2024)

While dividend premium is commonly used as the primary proxy in the catering theory literature, it mainly captures valuation differences between dividend-paying and non-paying firms. However, catering behavior may also be reflected through broader market-based indicators. In this study, unexplained market behavior and abnormal trading volume serve as alternative proxies for market-driven conditions that may influence dividend policy decisions. These measures reflect mispricing and trading activity that reflect market preferences beyond the traditional dividend premium approach.

*Hypothesis Development*

The first pillar in developing this hypothesis rests on conceptualizing unexplained market behavior as a proxy for investor sentiment, captured by market mispricing within the catering framework. According to the foundational catering theory, corporate managers act as rational intermediaries who strategically respond to the irrational or shifting psychological demands of the stock market. In the last decade, Byun et al. (2021) and Neves (2018) have refined this perspective by demonstrating that when stock prices deviate from their fundamental values, a phenomenon captured as unexplained market behavior, managers perceive a dividend premium that incentivizes them to distribute profits. This behavioral shift occurs because managers believe that catering to these transient investor preferences will lead to a higher share price and a lower cost of equity. Furthermore, Rochmah & Ardianto (2020) argue that in emerging economies, this unexplained sentiment often becomes a more dominant predictor of dividend initiation than traditional profitability metrics. Their research indicates that companies listed on the Indonesia Stock Exchange are particularly sensitive to these market-wide psychological shifts, leading to a situation where dividend policy becomes a tool for sentiment management. Huang et al. (2015) add that during periods of high sentiment, the pressure to cater is amplified as investors exhibit herd behavior, rewarding companies that align with their immediate desire for cash returns. Thus, unexplained market behavior serves as a critical barometer for managers seeking to maximize firm valuation through sentiment-aligned payout decisions.

Beyond simple market reactions, the relationship between unexplained behavior and dividends involves a complex trade-off between long-term investment and short-term market gratification. Recent studies by Huynh et al, (2025) and Kumar et al. (2022) suggest that managers are willing to sacrifice some internal funding stability to satisfy the market's dividend cravings when the sentiment-driven premium is high. This behavior is rooted in the belief that the market is currently mispricing dividend-paying firms, creating an opportunity for the firm to acquire equity at a discount. Baker & Wurgler (2003); Bilel & Mondher (2021) in their ongoing research, emphasize that this is not merely an information signal but a direct response to demand-side pressures that traditional signaling theories fail to capture. Market mispricing has been widely documented as a key factor influencing corporate decisions beyond accounting fundamentals (Fonou-Dombeu et al., 2024). In the Indonesian context, where retail investor sentiment can fluctuate rapidly, Rustan et al. (2022) found that unexplained price movements create a sense of urgency for boards to declare dividends to prevent capital flight. This suggests that the catering mechanism is deeply embedded in corporate governance practices across the region. Consequently, firms with higher exposure to unexplained market optimism are significantly more likely to increase their payout ratios to maintain their competitive standing in the eyes of irrational investors. Therefore, unexplained market behavior does not just reflect noise; it represents a tangible market force that dictates the flow of corporate earnings.

The integration of unexplained market behavior into dividend modeling also highlights the limitations of the efficient market hypothesis in contemporary finance. Point out that if markets were perfectly efficient, there would be no unexplained component to trigger a catering response. However, empirical data consistently show a significant correlation between residual market value and changes in dividends. This suggests that managers are acutely aware of market inefficiencies and actively exploit them to boost investor confidence. Cheema & Fianto (2024) have shown that this catering incentive is particularly strong when the overall market sentiment is positive, as investors become less sensitive to the long-term opportunity costs of

dividend payments (de Souza Junior et al., 2025; Deng et al., 2024). This environment encourages managers to prioritize short-term dividends over capital expenditures, effectively buying investor loyalty during periods of exuberance. The persistent significance of unexplained behavior across various international markets confirms that investor psychology is a global determinant of corporate finance. As such, the presence of positive unexplained market behavior creates a predictable upward pressure on dividend levels as firms strive to meet the irrational expectations of their shareholders. Unexplained market behavior (UMB) is measured annually using firm-level data. It is derived as the residual from a valuation regression model, representing the difference between the actual market value and the value predicted by fundamental variables. The resulting data are continuous and reflect firm-year observations based on this extensive behavioral evidence. The first hypothesis is formulated to test the positive impact of this sentiment proxy on corporate payout decisions.

$H_1$: Unexplained market behavior has a positive effect on the dividend policy of companies listed on the Indonesia Stock Exchange.

Abnormal trading volume (ATV) serves as a vital behavioral indicator that captures the intensity of investor interest and the potential dominance of noise traders in the market (Astuti & Prayoga, 2020; Li et al., 2024). In the context of catering theory, high trading volume that deviates from the historical norm is often interpreted by management as a sign of heightened investor sentiment and speculative demand. Baker & Stein (2004), posit that liquidity itself is a proxy for sentiment because irrational investors are more likely to trade when they are optimistic. When managers observe a surge in abnormal trading volume, they see an opportunity to cater to this active investor base by paying dividends, which serve as an anchor for these highly engaged shareholders. Raza et al. (2025) further elaborate that abnormal volume often precedes significant shifts in dividend policy, as it signals that the market is paying attention and is ready to reward firms that fulfill their payout expectations. In emerging markets, Rochmah & Ardianto (2020) highlight that trading volume acts as a more immediate signal of market mood than annual financial statements, making it a primary input for tactical dividend decisions. Thus, abnormal volume represents the voice of the market that managers feel compelled to satisfy through catering. Investor attention, as reflected in trading activity, has been shown to influence corporate behavior and market outcomes (Raza et al., 2025).

The attention-grabbing theory of behavioral finance further supports the psychological underpinnings of using trading volume as a dividend determinant. Rustan et al. (2022) suggest that retail investors are drawn to stocks with high visibility and high trading activity, and that dividends serve as a powerful secondary attraction to keep them invested. When abnormal volume is high, it indicates that the stock is currently under a speculative spotlight, and managers use dividends to convert this temporary attention into long-term shareholder loyalty. (Huynh et al., 2025; Neves, 2018) provides evidence that firms experiencing high liquidity shocks are more likely to initiate dividends to reduce the volatility associated with speculative trading. This suggests that catering to high-volume investors is not just about price maximization, but also about stabilizing the investor base during periods of intense market activity. Furthermore, find that the catering effect is most potent in stocks where sentiment-prone individuals, rather than institutional investors, drive trading volume. In Indonesia, where the influx of young retail investors has increased market liquidity, companies are increasingly pressured to show tangible returns through dividends to satisfy this new, active demographic.

Finally, the relationship between abnormal trading volume and dividends can be seen as a strategic response to market-wide irrationality and agency costs. Huang et al. (2015) argue that when trading volume is abnormally high, it creates a liquidity premium that managers can exploit by issuing dividends, thereby aligning the firm's payout with the market's current preference for liquid assets. This behavior is consistent with the catering view, which holds that managers are not just passive observers but active participants in the market's psychological cycles. Huang et al. (2015); Xin & Zhen (2025) have shown that firms that ignore these volume-based sentiment signals often suffer lower valuations than their peers that cater to them. The surge in trading volume essentially serves as a demand signal that investors believe the dividend yield has increased. Consequently, managers who are sensitive to their firm's market standing will respond to these liquidity spikes by increasing dividend payouts to capture the sentiment-driven valuation boost. This alignment between high trading activity and dividend increases forms a core component of modern behavioral corporate finance. ATV is calculated using daily trading data, which is then aggregated into annual measures to ensure consistency with other variables in the regression model. ATV is computed as the deviation of

actual trading volume from its historical average, producing a continuous firm-year variable. Therefore, it is logical to predict that higher levels of abnormal trading volume will be associated with more generous dividend policies, as firms seek to cater to active, optimistic market participant.

$H_2$: Abnormal trading volume has a positive effect on the dividend policy of the companies listed on the Indonesia Stock Exchange.

*Research Model*

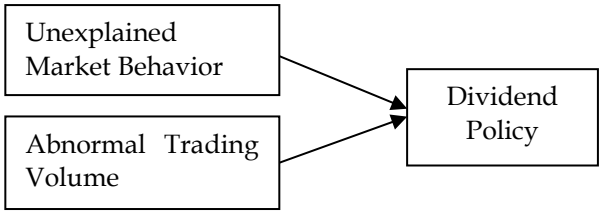


**Figure 1. Research Model**

## RESEARCH METHODS

*Population and Research Sample*

The population of this study consists of all companies listed on the Indonesia Stock Exchange (IDX) during the observation period from 2020 to 2024. This period is strategically selected to analyze the dynamics of dividend policy during the global economic fluctuations caused by the COVID-19 pandemic and the subsequent recovery phase. By including all listed firms, the study aims to capture a broad spectrum of market sentiment and its impact on corporate payout decisions across various industrial sectors.

This research uses a purposive sampling method to ensure the selected data meet the specific requirements for testing the Catering Theory. Purposive sampling is a nonprobability sampling technique in which the researcher selects participants based on predetermined criteria to increase the reliability of the statistical analysis. As noted by Susanto et al. (2026), selecting a sample in capital market research should prioritize the availability and completeness of financial data to avoid bias in calculating market reactions.

The specific criteria for the sample selection in this study are as follows:

1. Companies listed on the Indonesia Stock Exchange (IDX) that have remained active throughout the 2020–2024 period.
2. Companies that consistently publish audited annual financial statements and have complete data regarding stock prices and trading volumes for the calculation of Unexplained Market Behavior (UMB) and Abnormal Trading Volume (ATV).
3. Companies that distributed cash dividends at least once during the observation period are included, as the study focuses on the shifts and initiations in dividend policy.
4. Companies that do not have negative equity during the observation period are required to ensure that the financial ratios used as control variables, such as Debt and Net Income.

*Research Variable*

This research design adapts the regression model utilized by Neves (2018) to analyze the relationship between investor sentiment and the dividend policy of firms in Indonesia. Investor sentiment in this study is operationalized using alternative proxies rather than the traditional dividend premium, allowing for a broader representation of market-driven behavior which is represented in the following equation:

$$\Delta DPR = \beta_0 + \beta_1 UMB + \beta_2 ATV + \beta_3 FCF + \beta_4 DEBT + \beta_5 NI + \in \ldots\ldots\ldots (1)$$

**Table 1. Operational Definition and Measurement of Variables**

| Variable Category | Variable Name | Operational Definition | Measurement | Source |
|---|---|---|---|---|
| Dependent Variable | Dividend Policy (ΔDPR) | The annual change in the proportion of net income distributed to shareholders as dividends. | $\Delta DPR = DPR_t - DPR_{t-1}$ | (Neves, 2018) |
| Independent Variable | Unexplained Market Behavior (UMB) | The residual value representing market valuation that cannot be explained by fundamental financial factors. | $UMB_{it} = \varepsilon_{it}$<br>$\varepsilon_{it}$ = derived from the residual of the valuation model:<br>$\frac{V}{K} = \alpha 0 + \alpha 1\left(\frac{I}{K}\right) + \alpha 2D + \alpha 3\left(\frac{CIDV}{K}\right) + \varepsilon$<br>$\frac{V}{K}$ = market capitalization / total asset<br>$\frac{I}{K}$ = (fixed asset$_t$ -fixed asset$_{t-1}$) /total asset<br>$D$ = total liability/total asset<br>$\frac{CIDV}{K}$ = Dividen / Total Asset | (Neves, 2018) |
| | Abnormal Trading Volume (ATV) | The deviation of a stock's trading volume from its historical average , indicating irrational investor attention. | $ATV = \frac{TVt - \frac{\sum_{t=5}^{t=1} TV}{5}}{\frac{\sum_{t=5}^{t=1} TV}{5}}$<br>TVt = Trading Volume<br>$\frac{\sum_{t=5}^{t=1} TV}{5}$ =Average Trading Volume of the company for 5 years | (Baker & Stein, 2004) |
| Control Variable | Free Cash Flow (FCF) | The amount of cash a company generates after accounting for cash outflows to support operations. | $FCF = \frac{FCF}{Total\ Asset}$ | |
| | DEBT | The ratio used to measure the extent to which a firm's assets are financed by debt. | $DEBT = \frac{Total\ Liabilitas}{Total\ Asset}$ | |
| | Net Income (NI) | The total profit of a company after all expenses and taxes have been deducted, scaled by size. | $NI = \frac{Laba\ Bersih}{Total\ Asset}$ | |

*Data Collection and Processing*

This study utilizes the documentation method to gather all necessary data. As secondary research, the required information is retrieved from audited annual financial statements and historical stock market data. The data collection process involves accessing the official website of the Indonesia Stock Exchange (www.idx.co.id) and other reliable financial platforms, such as Yahoo Finance and Bloomberg, to obtain daily stock prices and trading volumes. This method ensures that the data is objective, verifiable, and consistent with the official records provided by the listed companies.

The primary data sources consist of corporate annual reports and a summary of stock performance from 2020 to 2024. To ensure data quality, a purposive sampling technique is applied. The steps for processing the initial population into the final research sample are as follows:

1. Identifying all companies listed on the IDX during the 2020–2024 period.
2. Filtering firms that consistently publish financial statements in IDR currency to avoid exchange rate bias.

3. Excluding companies with incomplete trading data required for calculating Abnormal Trading Volume (ATV).
4. Ensuring the availability of variables such as net income, total assets, and total liabilities to calculate control variables like Debt and Net Income.

*Research Analysis*

Once the raw data is collected, it undergoes several processing stages to transform it into the final variables used in the regression model:

1. Calculating Sentiment Proxies: The Unexplained Market Behavior (UMB) is computed by running a preliminary regression to estimate the residual of the firm's market value relative to its fundamentals. Simultaneously, Abnormal Trading Volume (ATV) is calculated by subtracting the average normal trading volume from the daily actual volume.
2. Financial Ratio Standardization: Financial data is converted into ratios (e.g., the Debt-to-Asset ratio for DEBT) to ensure comparability between companies of different size.
3. Software Integration: All processed data is tabulated in Microsoft Excel and subsequently imported into EViews for hypothesis testing and classical assumption tests.

The processed data are analyzed using multiple linear regression. Before final hypothesis testing, the data must pass several Classical Assumption Tests, including tests for multicollinearity, heteroscedasticity, and autocorrelation. This rigorous processing ensures that the relationship between investor sentiment and dividend policy, as hypothesized in the Catering Theory framework, is statistically valid and free from econometric bias. Consistent with Neves (2018). these procedures provide a robust foundation for interpreting how market-side psychology influences corporate financial decisions.

## RESULTS AND DISCUSSION

*Results*

The findings should be interpreted within the framework of investor sentiment as captured by market-based proxies, rather than a single traditional measure such as the dividend premium. The sampling process for this research used purposive sampling criteria to ensure that the data accurately reflect the variables required by the Catering Theory. As of 2025, the population consisted of 955 companies listed on the Indonesia Stock Exchange (IDX). Through a rigorous filtering process, the sample was narrowed down to 102 companies that met all criteria, including consistent financial reporting and dividend distribution.

**Tabel 2. Number of Sample**

| No | Sample Selection Criteria | Number of Firm |
|---|---|---|
| 1 | Total companies lister on the IDX | 955 |
| 2 | Companies with audited financial statements submitted since 2019 | (634) |
| 3 | Companies that distributed dividends during the period | (342) |
| 4 | Companies distributing dividends at least 3 times (2019 - 2025) | 102 |
| 5 | Total sample of 102 firm-year over a five-year period | 510 |
| 6 | Data outlier | 93 |
| 7 | Final research sample | 417 |

Descriptive statistics provide an overview of the data distribution, showing the central tendency and dispersion of both the independent sentiment proxies and the financial control variables.

**Table 3. Descriptive Test Results**

| Variable | N | Minimum | Maximum | Mean | Std. Dev. |
|---|---|---|---|---|---|
| ΔDPR | 417 | -1.8565 | 6.1150 | 0.0092 | 0.4013 |
| UMB | 417 | -0.9985 | 3.2039 | 0.0103 | 0.5107 |
| ATV | 417 | -2.0726 | 16.1787 | -0.2029 | 1.6506 |
| FCF | 417 | 0.0619 | 0.9949 | 0.4790 | 0.2334 |
| DEBT | 417 | -0.1381 | 51.9836 | 0.2665 | 2.8678 |
| NI | 417 | -0.1205 | 0.6143 | 0.0757 | 0.1031 |

The mean value of ΔDPR is 0.0092, indicating that on average, firms in the sample experienced a slight increase in their dividend payout ratios during the observation period. The Unexplained Market Behavior (UMB) shows a mean of 0.0103, suggesting that there is a persistent, albeit small, sentiment-driven valuation gap in the Indonesian market. Meanwhile, the wide range of Abnormal Trading Volume (ATV), with a maximum of 16.1787, reflects periods of intense investor attention and speculative activity, which is a key driver for catering incentives according to (Baker & Stein, 2004)

*Results*

To ensure that the regression model is a Best Linear Unbiased Estimator (BLUE), several diagnostic tests were performed, including tests for multicollinearity, heteroscedasticity, and autocorrelation. After passing a series of classical assumption tests, including normality, multicollinearity, heteroskedasticity, and autocorrelation tests, the results indicate that the regression model satisfies all the required Ordinary Least Squares (OLS) assumptions. The residuals are normally distributed, no serious multicollinearity is detected among the independent variables, the error variance is constant, and there is no autocorrelation in the model. Therefore, the regression estimates are considered reliable and appropriate for further interpretation. Below are the results of the linear regression analysis for the research model. The core of this research is the regression analysis that tests whether sentiment proxies (UMB and ATV) significantly influence dividend policy.

**Table 4. Multiregresion Test Results**

| Variabel Independen | Model 1 | Model 2 | Model 3 |
|---|---|---|---|
| UMB | 0.0247** | | 0.0249** |
| | (0.0421) | | (0.0423) |
| ATV | - | 0.0891** | 0.0865** |
| | - | (0.0205) | (0.0245) |
| FCF | -0.3919** | -0.3382* | -0.3932** |
| | (0.0439) | (0.0756) | (0.0459) |
| DEBT | - | - | 0.0536 |
| | - | - | (0.5367) |
| NI | - | - | -0.0034 |
| | - | - | (0.6099) |
| $R^2$ | 0.016235 | 0.019168 | 0.029669 |
| F-Stat | 3.4161** | 4.0453** | 2.5133** |
| Probability | 0.0337 | 0.0182 | 0.0294 |

Model 1: $\Delta DPR = a + \beta_1 UMB + \beta_2 FCF + \varepsilon$
Model 2: $\Delta DPR = a + \beta_1 ATV + \beta_2 FCF + \varepsilon$
Model 3: $\Delta DPR = a + \beta_1 UMB + \beta_2 ATV + \beta_3 FCF + \beta_4 DEBT + \beta_5 NI + \varepsilon$

Based on the regression results presented in Table 4, the empirical findings can be analyzed as follows. First, in model 1, unexplained market behavior (UMB) shows a positive and significant effect on the change in dividend payout ratio (ΔDPR), with a coefficient of 0.0247 and a p-value of 0.0421 ($p < 0.05$). This indicates that higher unexplained market behavior, reflecting investor sentiment not explained by fundamentals, leads to greater dividend payout changes. Free cash flow (FCF), on the other hand, has a negative and significant coefficient of –0.3919 ($p = 0.0439$), suggesting that firms with higher free cash flow tend to reduce changes in dividend payouts. The F-statistic of 3.4161 and p-value of 0.0337 confirm that the model is jointly significant. However, the $R^2$ value of 0.016235 indicates that the model explains only 1.62% of the variation in ΔDPR.

Second, in model 2, abnormal trading volume (ATV) has a positive and significant impact on ΔDPR, with a coefficient of 0.0891 and a p-value of 0.0205 ($p < 0.05$). This finding implies that higher abnormal trading activity, which reflects stronger investor attention or sentiment, is associated with greater changes in dividend payouts. FCF remains negative and significant at the 10% level (–0.3382; $p = 0.0756$), indicating a weaker but still relevant influence. The F-statistic of 4.0453 ($p = 0.0182$) confirms the overall significance of the model, while the $R^2$ of 0.019168 suggests that 1.92% of the variation in ΔDPR is explained.

Third, in model 3, both investor sentiment proxies, UMB and ATV, remain positive and significant, with coefficients of 0.0249 ($p = 0.0423$) and 0.0865 ($p = 0.0245$), respectively. This consistency indicates that investor

sentiment continues to influence dividend policy even after controlling for firm-specific variables. FCF remains significant (–0.3932; p = 0.0459), while debt (0.0536; p = 0.5367) and net income (–0.0034; p = 0.6099) are not statistically significant. These results suggest that leverage and profitability do not have a direct effect on changes in dividend payout in this sample. The F-statistic of 2.5133 (p = 0.0294) confirms that model 3 is jointly significant, with an $R^2$ of 0.029669, meaning that the independent variables explain 2.97% of the variation in ΔDPR.

Overall, the findings demonstrate that investor sentiment, as proxied by UMB and ATV, positively and significantly influences changes in dividend policy. Although the explanatory power ($R^2$) of the models is relatively low, consistent with financial and behavioral research, the regression results are statistically robust and support the hypothesis that firms respond to market sentiment when adjusting dividend payouts.

**Table 5. Hypothesis Testing Results**

| Hypothesis | Statement | Expected Sign | Model 1 | Model 2 | Model 3 | Decision |
|---|---|---|---|---|---|---|
| $H_1$ | Unexplained market behavior has a positive effect on the dividend policy | (+) | 0.0247** | – | 0.0249** | Accepted |
| $H_2$ | Abnormal trading has a positive effect on the dividend policy | (+) | – | 0.0891** | 0.0865** | Accepted |

Based on the regression results reported in Table 5, the empirical findings for H1 and H2 provide strong evidence that investor sentiment significantly shapes corporate dividend policy. The discussion below elaborates these results within the relevant theoretical and empirical literature. Hypothesis 1 (H1) proposes that unexplained market behavior (UMB), as a proxy for investor sentiment, has a positive effect on changes in the dividend payout ratio (ΔDPR). The regression results show that UMB is positive and statistically significant in model 1 (0.0247; p < 0.05) and remains significant in model 3 (0.0249; p < 0.05). This finding suggests that when firm fundamentals cannot fully explain market movements, firms tend to increase their dividend payouts. This result is consistent with the catering theory of dividends developed by Baker & Wurgler (2003), which argues that managers cater to investor demand for dividend-paying stocks when investor sentiment is high. According to this theory, firms are more likely to increase or maintain dividends when the market places a premium on dividend-paying firms. Therefore, the positive relationship between UMB and ΔDPR indicates that internal financial considerations do not solely determine dividend policy but are also influenced by external market sentiment.

Furthermore, this result aligns with behavioral finance theory, which challenges the assumption of fully rational markets proposed by traditional finance theory. Behavioral scholars (Raza et al., 2025; Taylor, 2024) argue that investor sentiment can systematically affect asset prices and corporate financial decisions. When market sentiment is overly optimistic, stock prices may deviate from intrinsic value, creating incentives for managers to respond strategically. In this context, increasing dividend payouts can serve as a signaling or catering mechanism to maintain a favorable investor perception. Thus, the empirical support for H1 reinforces the argument that dividend policy may serve as a response to sentiment-driven market conditions rather than as a purely residual decision based on earnings.

Hypothesis 2 (H2) posits that abnormal trading volume (ATV), another proxy capturing investor sentiment through investor attention and trading intensity, positively affects changes in the dividend payout ratio. The results indicate that ATV is positive and statistically significant in model 2 (0.0891; p < 0.05) and remains significant in model 3 (0.0865; p < 0.05). This suggests that higher abnormal trading activity, reflecting heightened investor attention or speculative interest, is associated with greater adjustments in dividend payouts. This finding is consistent with the investor attention literature, which suggests that increased trading activity often reflects behavioral biases and attention-driven investing. When trading volume rises abnormally, it may signal strong investor demand or a shift in sentiment, prompting managers to respond with dividend adjustments.

Additionally, abnormal trading volume may reflect temporary market mispricing. From a market-timing and catering perspective, managers may exploit such conditions by adjusting dividend policies to align with investor expectations. This behavior can be understood within the broader frameworks of agency theory and

signaling theory, in which dividends reduce information asymmetry and maintain investor confidence. By increasing dividends during periods of heightened trading activity, firms may reinforce positive market sentiment and stabilize their stock prices.

Overall, the consistent positive and significant effects of both UMB and ATV across different model specifications suggest that investor sentiment plays a meaningful role in corporate dividend decisions. Although traditional dividend theories, such as the residual dividend theory and the irrelevance proposition, emphasize that dividend policy should not affect firm value in perfect markets, the present findings indicate that behavioral factors influence real-world markets. Consequently, firms appear to adjust dividend payouts not only based on profitability and cash flow considerations but also in response to market sentiment dynamics.

In conclusion, the empirical support for H1 and H2 strengthens the behavioral explanation of dividend policy. The results suggest that managers actively respond to investor sentiment, as captured by unexplained market behavior and abnormal trading volume, when determining changes in dividend payout ratios. This evidence contributes to the growing body of literature demonstrating that both fundamental and behavioral market forces influence corporate financial policies.

*Discussion*

The empirical findings indicate that investor sentiment plays a meaningful role in shaping corporate dividend policy. The positive and significant relationship between proxies of market-driven behavior and changes in dividend payout ratios suggests that dividend decisions are not determined solely by internal financial fundamentals but are also influenced by external market dynamics. This evidence is consistent with more recent behavioral corporate finance research showing that investor sentiment significantly affects corporate financial policies, including payout decisions (Baker et al., 2021; Wang, 2024)

The positive association between unexplained market behavior and dividend adjustments supports the contemporary development of the catering view of dividends. Although the catering theory was initially introduced, empirical studies over the last decade continue to validate its relevance in modern capital markets. For instance, recent research finds that firms adjust payout policies in response to shifts in investor sentiment, as measured by market-based indicators and sentiment indices (Baker & Wurgler., 2003; Chen, 2023; Salur & Ekinci, 2023). These findings suggest that managers respond strategically to time-varying investor demand for dividend-paying stocks, reinforcing the interpretation that dividend policy may reflect market sentiment rather than purely fundamental considerations. The role of abnormal trading activity further strengthens the behavioral explanation of dividend decisions. Elevated trading intensity is frequently interpreted in recent literature as a proxy for investor attention and sentiment. Studies over the past decade show that attention-driven investors can influence corporate policies, particularly in environments characterized by higher sentiment volatility (Israeli et al., 2022; Welagedara et al., 2017). When trading activity increases due to sentiment-driven demand, managers may adjust dividend payouts to maintain favorable investor perceptions and stabilize stock valuations. In this sense, dividend changes may serve as a response mechanism to heightened market attention.

These findings are also consistent with recent behavioral asset pricing research, which argues that investor sentiment can systematically affect asset prices and corporate decisions. Modern behavioral models emphasize that mispricing caused by optimism or pessimism can persist and influence managerial actions (Baker et al., 2021). When market sentiment is elevated, managers may rationally respond by adjusting dividend payouts to align with prevailing investor expectations, particularly if such actions help sustain firm valuation. From a signaling perspective, dividend adjustments can also be interpreted as managerial efforts to communicate stability and confidence in periods of heightened investor sentiment. Recent empirical studies demonstrate that dividend announcements convey information beyond earnings performance and are interpreted differently depending on prevailing market sentiment (Pham et al., 2025). When investor mood is optimistic, dividend increases may reinforce positive expectations, whereas in uncertain environments, dividends can serve as a credibility-enhancing signal. Thus, dividend policy functions both as a distribution mechanism and as a communication tool under asymmetric information.

The evidence also challenges the strict assumptions of classical dividend irrelevance in perfectly efficient markets. Over the last decade, numerous studies have documented that capital markets are influenced by behavioral biases and sentiment fluctuations, which weaken the assumptions of full rationality. Under such conditions, dividend decisions may carry valuation implications because they interact with investor psychology. The present findings, therefore, align more closely with behavioral corporate finance than with

purely traditional models. Although traditional determinants such as profitability and leverage remain important theoretical drivers of dividend policy, their comparatively weaker explanatory role in this context suggests that firms may be particularly responsive to external market signals when adjusting payouts. Recent cross-country and emerging-market studies indicate that sentiment effects tend to be stronger when information asymmetry is higher, and markets are less fully efficient (Byun et al., 2021). This supports the interpretation that managers integrate both financial fundamentals and investor mood when determining dividend changes.

The collective significance of the regression models indicates that sentiment-related variables meaningfully explain variation in dividend adjustments. In financial research, especially within behavioral frameworks, relatively modest explanatory power is common because corporate policies are influenced by a wide array of interacting macroeconomic and firm-specific factors. Nonetheless, statistically significant relationships highlight the economic relevance of investor sentiment as a determinant of payout policy. Taken together, the findings suggest that dividend policy should be interpreted within an integrated framework combining traditional corporate finance theory with behavioral insights. Recent literature increasingly recognizes that (Baker et al., 2021; Pham et al., 2025). Dividend adjustments, therefore, reflect not only internal cash flow considerations but also strategic responses to market conditions.

From an accounting perspective, these findings highlight the important role of financial reporting information as a benchmark for evaluating whether market valuations reflect fundamental performance or sentiment-driven deviations. Accounting figures such as net income, free cash flow, and leverage typically reflect a firm's ability to distribute dividends while maintaining financial sustainability. However, recent studies indicate that managerial dividend decisions may not rely solely on accounting fundamentals but may also respond to investor perceptions reflected in market behavior (Kumar et al., 2022). In this context, accounting information serves as a reference point that allows investors and researchers to distinguish between fundamental firm value derived from financial statements and valuation changes driven by investor sentiment.

Furthermore, the use of residual valuation models in this study reinforces the relevance of accounting-based measures in contemporary capital market research. By comparing actual market valuations with values predicted from accounting fundamentals, the residual component captures unexplained market behavior that may reflect sentiment rather than economic performance. Recent literature emphasizes that accounting information plays a crucial role in detecting market mispricing and evaluating the gap between intrinsic value and market price (Deng et al., 2024). Consequently, dividend policy may partly represent a managerial response to discrepancies between accounting-based firm performance and market valuations shaped by investor sentiment.

In addition, these findings have implications for interpreting dividend announcements as informational signals within financial reporting environments characterized by information asymmetry. Recent research suggests that dividend policies may complement accounting disclosures by strengthening managerial credibility and reinforcing investor confidence when financial reporting alone may not fully capture market expectations (Al-Hiyari et al., 2024; Sulistyowati et al., 2025). In emerging markets such as Indonesia, where information asymmetry and retail investor dominance remain relatively high, dividend adjustments may therefore serve not only as a distribution mechanism but also as a strategic communication tool that interacts with accounting information and investor sentiment to shape market perceptions.

This study contributes to the expanding contemporary literature demonstrating that investor sentiment materially influences corporate financial policy. By providing empirical evidence that sentiment proxies are associated with dividend changes, the results reinforce the importance of incorporating behavioral variables into dividend policy research. In doing so, the study supports the modern view that corporate payout decisions are shaped by an interaction between economic fundamentals and investor psychology in real-world capital markets. These findings suggest that dividend policy is a strategic decision influenced not only by internal firm conditions but also by market dynamics, indicating that managers should consider market conditions in setting dividend policies. At the same time, investors should recognize that market behavior may affect dividend decisions.

## CONCLUSION

This study concludes that investor sentiment significantly influences corporate dividend policy, particularly changes in the dividend payout ratio. The findings indicate that dividend decisions are not determined

solely by internal financial fundamentals such as profitability, leverage, or cash flow, but are also shaped by external market dynamics and investor behavior. The positive relationship between sentiment proxies and dividend adjustments suggests that managers respond strategically to market mood and investor attention when formulating payout policies. These results support the behavioral corporate finance perspective, which emphasizes that corporate financial decisions are influenced by both economic fundamentals and psychological factors in capital markets. Overall, the study highlights that dividend policy reflects the interaction between a firm's financial capacity and prevailing investor sentiment.

Several limitations should be acknowledged, including the use of limited proxies to measure investor sentiment, which may not fully capture its multidimensional nature; the relatively limited set of control variables; and the sample scope, which may affect the generalizability of the findings. Future research is therefore encouraged to employ broader sentiment measures, such as textual analysis or survey-based indicators, incorporate additional firm-specific and macroeconomic variables, and expand the sample across different industries, periods, or countries to enhance the robustness and external validity of the results. Practically, this study implies that dividend policy should consider both firm fundamentals and market conditions to support more effective decision-making.

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