

STOCK MARKET RESPONSE TO UNEXPECTED DIVIDEND CHANGED IN INDONESIA

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ABSTRACT

The writer finds that bond rating and dividend can change the firm value. Specifically, when a firm with bond rating has an increase in their dividend, their firm value will decrease. While when the firm without bond rating has an increase in their dividend, their firm value will also increase. It is very strange as why the firm with bond rating can decrease in their firm value when their dividend is increasing. In this research, the writer can explain that phenomena why it is like this. Besides explaining that phenomena, the writer also can prove that bond rating and dividend is really critical in determining the firm value by conducting two researches (firm with and without bond rating) which other researchers have not done yet. The data that will be using is the firms with and without bond rating in Indonesia between 2007 and 2016.

Keywords: bond rating; dividend payment

1. Background

The statement of startling dividend changes can effectively affect budgetary related markets. The data content speculations communicate that managers are more instructed than outside stakeholders about organization execution, and as such unforeseen dividend changes are seen by stakeholders as a flag sent by the administrators about a company's future gainfulness (Bhattacharya, 1979; Kalay, 1980; Miller & Rock, 1985). Thusly, these theories suggest that stock markets will react positively (negatively) to the updates on startling dividend increments (diminishes), anyway their gauge of the response in bond market varies. While the data and free cash stream theories propose a positive connection between surprising dividends changes and bond returns, the wealth transfer speculations suggest a switch relationship.

A superior bond rating reflects lower obligation esteem vulnerability. In this way, the connection between obligation credit ratings and stock data asymmetry uncovers the connection among obligation and stock esteem vulnerabilities. The issue of bond ratings is important because investors will compare the coupon rate (bond interest) given with the level of risk default risk of the issuing company (Wendy & Sianturi, 2017). The ranking carried out by independent institutions in Indonesia (PT Pefindo) aims to assess the company from various factors (directly or indirectly), especially those related to the company's financial health. The ranking results reflect the ability of bond issuing companies to fulfill their financial obligations (Estiyanti & Yasa, 2012). In addition, through rating bonds, IDX also provides protection to bondholders by periodically presenting information on default risk potential so that investors can measure potential risks faced in each type of bond.

Moody's's rating agency and Standard & Poor's review different types of influencing factors and characters in ranking a bond. These factors are debt, economy, finance, and

administration. Bonds with low ratings are considered riskier and investors want a very large return and vice versa. Standard & Poor's or Moody's classify bonds based on their risk of default. These agency ratings make extensive commitment to intrinsic analysis of publisher characteristics, such as the ability to pay interest and principal. Companies with good ratings generally can issue bonds with low interest compared to companies that have a bad rating.

Regardless of the way that in the literature a couple of analysts have examined bond market reaction to sudden dividend changes, the verification is dubious. Woolridge (1983) and Handjinicolaou & Kalay (1984), for instance, find that bond returns are emphatically associated with startling dividend changes. In any case, reliable with the wealth transfer theory, Dhillon & Johnson (1994) report that bond costs move in inverse ways to stock costs because of huge dividend changes. In this examination, we use far reaching exchange data from PEFINDO to take a gander at the reaction in stock market dependent on bond rating to dividend declarations and contrast it and the other reaction in stock market without bond rating. This exploration empowers us to all the more likely comprehend the impact of stock market reaction dependent on bond rating to startling dividend changes, contrast and the other stock market reaction without bond rating to unforeseen dividend changes.

We also want to improvise this research by making two categories of firm which is one with bond rating and another one without bond rating. In Indonesia the lowest rating which can be accepted is only until BB grade and there are a lot of firms which their grade is below BB. For investors the firm with the grade below BB can be considered as well for no bond rating because it is very risky. Therefore, in order for this research to be more accurate, we want to categorize the firms into two groups (firm with bond rating and without bond rating) and see the results whether the response of the stock market reacting to the unexpected dividend change is really affect on their bond rating.

2. Literature Review

2.1. Stock market response to unexpected dividend changes

Miller and Modigliani (1961) were the first to reason that dividends don't influence firm value under perfect capital markets. Rather, they contended that just the investment policy can influence corporate value. The principal clarification behind the choice to appropriate dividends depends on market flaws because of data asymmetries. Managers should have prevalent data about the present and future monetary position of the firm to that of financial specialists and utilize the dividend to flag awry data about the firm's future income (Daniels et al., 1997). Hence, dividend change declarations pass on profitable data to the market as an impression of administrative assumptions about present and future cash flows. Therefore, dividend increment (decline) pass on positive (negative) data to the market about the future prospects of firms that disseminate dividends. Under this clarification, thusly, a declaration of a dividend increment (decline) is joined by an ascent (fall) in stock costs.

As indicated by flagging hypothesis of dividends, managers use dividend payments as a signal about organizations' future development and benefits (Bhattacharya, 1979; Jensen, 1986; Ross, 1977; Ghosh & Woolridge, 1988). Therefore, market response to dividend declarations is reflected in the organization's stock cost. Late research by Liu & Chen (2015) gives proof for this and moreover explores that dividends are signaling future equity scaled profit as opposed to future resource scaled income, which can be related to the way that equity financial specialists are the essential focus to which the management team needs to motion about firm income prospects.

The reason behind this investigation is to direct an occasion ponder that inspects the impact of sudden dividend change declarations on the stock and bond markets. Due to

Merton (1974), if unforeseen dividend changes are translated by the market as a flag sent by managers about future achievement of the organization, we ought to envision that the two stockholders and bondholders respond emphatically to the declarations of startling dividend increments, and contrarily to surprising dividend cuts (e.g. Bhattacharya, 1979; Kalay, 1980; Miller & Rock, 1985). This line of thought is additionally bolstered by the empirical proof that managers will in general keep up a steady dividend circulation strategy and are hesitant to cut dividends. Conversely, the circulation of dividends increments money related influence which thus expands firm risk. Merton's (1974) choice estimating hypothesis predicts that firm risk is decidedly identified with stock esteem however adversely to bond esteem. From this point of view, the declarations of surprising dividend increments (diminishes) should result in positive (negative) stock returns yet negative (positive) bond returns.

The impact of dividend dissemination on the abundance of stock and bond holders can likewise be clarified by organization hypothesis. As indicated by Jensen and Meckling (1976), there exist irreconcilable situations among chiefs and stockholders in that managers can develop their domains or addition non-financial advantages, while a large portion of the cost is paid by stockholders. So also, Jensen (1986) shows that managers are bound to take part in negative NPV ventures that decline firm esteem when there are all the more free cash flows under their control. Since the dispersion of dividends lessens the measure of free cash flows in the organization, Jensen's (1986) free cash stream hypothesis proposes that the declarations of startling dividend increments should cause a positive response in stock and bond markets. Then again, because of the irreconcilable circumstance among stockholders and bondholders as showed in Jensen and Meckling (1976), stockholders may have a motivator to appropriate dividends and in this way exchange riches from bondholders to stockholders. From this point of view, bondholders will respond contrarily to the declarations of dividend increases, while stockholders will respond decidedly. In entirety, current speculations have diverse expectations about the response in bond market to the declaration of sudden dividend changes.

2.2. Wealth Transfer Hypothesis Theory

The wealth transfer theory, which starts from the irreconcilable situation among bondholders and stockholders, differs from the data content speculation by expressing that an incline (decline) in the equity market value is joined by a reduction (increment) in the debt market value. All things considered, wealth can be transfer from bondholders to stockholders by expanding the danger of the remarkable bonds. Higher bond risk can come about because of expanding the difference of the association's conceivable future values. On the other hand, financing dividend installments by issuing new debt at equivalent or higher status than exceptional debt, or by decreasing speculation expenses, builds the danger of the extraordinary debt. These two wealth transfer systems are (1) debt-financed dividends and (2) investment financed dividends, depend upon the stockholders' capacity to pay out assets. If more debt or investment financed dividends than anticipated are paid, wealth is transfer from the bondholders to the stockholders. (Handjinicolaou & Kalay, 1984).

Wealth transfers suggest that stockholders advantage to the detriment of bondholders or the other way around. The occurrence of wealth transfers because of the general firm related events is offered by Holthausen & Leftwich (1986), Zaima & McCarthy (1988), and Jorion & Zhang (2007). They contend that stock prices could likewise increment when a rating agency predicts an increment in a firm's leverage. Unexpected increment in firm leverage that outcomes in a higher firm probability of default may prompt wealth transfers from bondholders to stockholders. Usually when dividend is incrementing, it will prompt bond

price increment as dividend increment shows a solid firm performance. But in wealth transfer theory, it predicts dividend increment may prompt bond price decline as a dividend increment to shareholders might be negative news for bondholders as bonds ought to have a payout priority (Zhao, 2007).

H1: Unexpected dividend changes have a negative relation to stock market response based on bond rating.

The hypothesis is that stock markets will respond positively (negatively) to the news of unexpected dividend increases (decreases), anyway their estimate of the response in bond market contrasts. While the information and free cash flow hypothesis propose a positive connection between unexpected dividends changes and bond returns, the wealth transfer hypothesis suggests a reverse relationship. The wealth transfer theory, which starts from the irreconcilable situation among bondholders and stockholders, differs from the data content speculation by expressing that an incline (decline) in the equity market value is joined by a reduction (increment) in the debt market value. Wealth transfers suggest that stockholders advantage to the detriment of bondholders or the other way around. If more debt or investment financed dividends than anticipated are paid, wealth is transfer from the bondholders to the stockholders. Therefore, wealth transfer theory predicts that dividend increment may prompt bond price decline as a dividend increment to shareholders might be negative news for bondholders as bonds ought to have a payout priority.

2.3. Dividend Smoothing

For the firm to have an optimum between paying the dividend and to increase the firm value by allocating the money in somewhere else, they can use dividend smoothing policy. Dividend smoothing suggests increase in firm value, lower average dividends, and lower deviation from their original dividends. We infer that dividend smoothing gives an incomplete solution for underinvestment due to the asymmetric information (one party possesses greater information or knowledge about the economic transaction than the other party). We recommend that last year's dividends can fill in as a standard point, enabling managers and investors to arrange on one out of a continuum of equilibria in which dividends are smoothed.

H2: Unexpected dividend change have a positive relation to stock market response for company without bond rating.

Based on the research of Tsai & Wu (2014) they agree that unexpected dividend change have a positive relation to stock market response for company without bond rating. It is very logical that when dividend is incrementing, it will prompt bond price increment as dividend increment shows a solid firm performance.

3. Research Method

We obtain the data of the company from PEFINDO for the period from 2007 through 2017. The samples that we use are 180 companies from 11 industries according to the companies that issued bond rating.

Emperical model

$$\frac{(E_t - E_{t-1})}{B_{-1}} = \beta_0 + \beta_1 \%div_0 + \varepsilon_t$$

E_t = Denotes Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA) in year t.

B_{-1} = The book value of assets in year t = -1.

$\%div_0$ = Denotes the quarterly percentage change in dividends.

t = 0 is the year of dividend announcement.

ε_t = The error of prediction

$$\frac{(E_t - E_{t-1})}{B_{-1}} = \beta_0 + \beta_1 \%div_0 + \beta_2 SD \times SInfo + \beta_3 SD \times BInfo + W_t$$

SD = Takes the value of 1 (-1) for unexpected dividend increases (decreases)

SInfo (BInfo) = A dummy variable that takes the value of 1 when the abnormal stock (bond) return on the announcement date is significantly positive for dividend increases or significantly negative for dividend decreases

4. Result & Discussion

Table 1. Descriptive Statistic (Firm with Bond Rating)

Variable	Obs	Mean	Std.dev	Min	Max
Firm Value lag 1	110	0.0058914	0.0461574	-0.1101471	0.3620599
%Dividend lag1	110	-0.1766891	1.1236	-5.631766	0.8420708
SDSinfo lag 1	110	-0.1454545	0.9938929	-1	1
Firm lag 1	110	6	3.17675	1	11
Firm Value lag 2	99	0.0130362	0.0630709	-0.0714121	0.4044367
%Dividend lag 2	99	-0.295526	1.61289	-12.48259	0.8966187
SDSinfo lag 2	99	-0.1515152	0.9934853	-1	1
Firm lag 2	99	6	3.178371	1	11

Source: data processing (2019)

Table 2. Descriptive Statistic (Firm without Bond Rating)

Variable	Obs	Mean	Std.dev	Min	Max
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Firm Value lag 1	600	0.0000656	-0.0013924	-0.0013924	0.001699
%Dividend lag 1	600	-0.0648151	0.6598114	1.96368	0.76414
SDSinfo lag 1	600	-0.01	1	-1	1
Firm lag 1	600	30.5	60	1	60
Firm Value lag 2	540	0.000134	0.0003406	-0.000533	0.0040038
%Dividend lag 2	540	-0.0648599	0.6621526	-1.96368	0.760308
SDSinfo lag 2	540	-0.0037037	1.00092	-1	1
Firm lag 2	540	30.5	17.33416	1	60

Source: data processing (2019)

4.1 Regression Result

The results are divided into 2 models, the first model Firm with Bond Ratings have 2 regression, $t=1$ and $t=2$. $T=1$ shows from 2007-2016 and $t=2$ shows from 2008-2016. The second model, Firm without Bond Rating also have 2 regression $t=1$ and $t=2$. Then is also a R-square which is to explain how much the independence variable can explain variable dependence.

Table 3. Regression results for Firm with Bond Rating

	FwBR	FwBR
	t=1	t=2
	Coefficient (P-value)	Coefficient (P-value)
%Div	-0.0015756 (0.000) ***	-0.0000513 (0.000) ***
SDSinfo	0.0001169 (0.105)	0.0000912 (0.000) ***
_cons	0.0008514 (0.314)	0.0018394 (0.406)
R-sq: within	0.0066	0.0025
between	0.0327	0.0396
overall	0.0023	0.0052
Prob > chi2	0.0004	0.0000

Significant level <5% = ***

Significant level <10% = **

Source: data processing (2019)

In the $t=1$ there is a significant negative for the dividend and the P-value. It means that when the dividend is decreasing, the value of the firm is increasing or at least stay the same. The reason for this phenomenon is because the firm or stockholders have a lesser burden to pay the dividend as the amount of the dividend that they have to pay to investor is decreasing, therefore the money can be allocated in different areas which can improve the firm. This also can be called a wealth transfer hypothesis. For the SDSinfo and P-value there is a significant positive. In the $t=2$ there is also a significant negative for the dividend and the P-value. As it was mention before the firm can allocate the money to different areas that can improve the firm rather than to pay a lot of dividend to the investors. For the SDSinfo and P-value there is also a significant positive.

From this result, we can assume that this support our hypothesis for H1 which is unexpected dividend changes have a negative relation to stock market response based on

bond rating. This is the example of the wealth transfer theory which is the irreconcilable situation among bondholders and stockholders, differs from the data content speculation by expressing that an incline (decline) in the equity market value is joined by a reduction (increment) in the debt market value.

Table 4. Regression results for Firm without Bond Rating

	FWoBR	
	t=1	t=2
	Coefficient (P-value)	Coefficient (P-value)
%Div	0.0000273 (0.052) **	0.0000307 (0.001) ***
SDSinfo	0.0000157 (0.108)	0.00000393 (0.753)
_cons	0.0000837 (0.000)	0.000148 (0.000)
R-sq: within	0.0030	0.0198
between	0.0157	0.0258
overall	0.0039	0.0195
Prob > chi2	0.0887	0.0054

*Significant level <5% = ****

*Significant level <10% = ***

Source: data processing (2019)

In the t=1 there is a significant positive for the dividend and the P-value. It means that when the dividend is increasing, the value of the firm is also increasing. This can happen because when investors see that the firm can pay a lot of dividend, they tend to also invest in that firm which result in increasing the value of the firm. For the SDSinfo and P-value there is also a significant positive. In the t=2 there is also a significant positive for the dividend and the P-value. The meaning for this is the same in t=1. When the dividend of the firm increases, they attract a lot of investors which impact the value of the firm to be positive. For the SDSinfo and P-value there is also a significant positive. From this result, we can also assume that this support our hypothesis for H2 which is unexpected dividend change have a positive relation to stock market response for company without bond rating. Based from the previous researcher Tsai and Wu (2014), their result is also the same like this. They found that stock returns are positively correlated with unexpected dividend changes. There are two theories in this research which is quite conflict. The first one is when the dividend is decreasing, the value of the firm is increasing. And the second one is when the dividend is increasing, the value of the firm is also increasing. This is because for the first reason it is only valid if the firm is with bond rating. When the firm has a bond rating, it means that the firm is already well known so it is safe or almost risks free to invest there. As a result, a lot of investors tend to invest in those firms which lead to increasing in dividend and decreasing in the value of the firm because the firm or the stockholders have to pay a large sum of money for the dividend.

For the second reason, it is only valid if the firm has no bond rating. It is because the firm is still not well known and it is risky for the investors to invest there. Therefore, only some of the investors want to invest those firms. The same theory that applies to this is high risk, high reward. So, when there is an increase in investors, the dividend is also increasing which result in increasing the value of the firm. Based on the journal Tsai and Wu (2014) it is

stated that following two years of declarations, the connection between dividend changes and future profitability turns out to be a lot weaker. As in the regression results for firm with bond rating, it is stated that the percentage dividend is improving a little from lag 1 to lag 2 while for the firm value it stayed the same. This is because the firms are already well known or big so it will not affect very much to the firm value. As in the regression results for firm without bond rating, it is also stated that the percentage dividend is increasing a little from lag 1 to lag 2 while for the firm value it is decreasing. This can happen because after 2 years of announcement, investors will become more familiar with those firms as a result their investors for the firms increase which leads to the firms or stockholders have to pay more dividends.

Table 5. Abnormal Returns of Stock Portfolios in Indonesian Companies with Bond Ratings

Event Day (t)	Mean Abnormal Return (%)	Test Statistic	No. Positive	No. Negative
-8	-0.10%	-1.09621	35	75
-7	-0.12%	0.12651	32	78
-6	-0.10%	0.86612	30	80
-5	-0.05%	0.18444	35	75
-4	-0.07%	-0.06822	27	83
-3	-0.04%	0.63521	24	86
-2	-0.07%	-1.59285	32	78
-1	-0.06%	-0.36142	30	80
0	-0.06%	-0.66392	27	83
1	-0.09%	-0.53026	27	83
2	-0.10%	-0.32696	33	77
3	-0.09%	-0.95881	32	78
4	-0.08%	-1.16306	28	82
5	-0.07%	-0.75527	30	80
6	-0.07%	1.12720	36	74
7	-0.06%	0.74947	36	74
8	-0.06%	2.12563	38	72

Source: Data Processing (2019)

This table shows the abnormal returns of equally weighted stock portfolios around dividend announcements. The announcement is made when $t=0$, whereas $t=-k$ and $t=k$ denote the k th business day before and the announcement date, respectively. The test statistic of the mean excess return is provided in the column next to it. No. positive (No. negative) shows the number of stocks with positive (negative) abnormal returns in the portfolio. The last two columns show the number of stocks with positive and negative abnormal returns in the portfolio. More stocks with positive (negative) abnormal returns within the first few days after the announcements of unexpected dividend increases (decreases). It suggests that the stock market reacts before the announcements are made.

Before the announcement date the abnormal return is much higher than the abnormal return after the announcement date. The abnormal return of the investment stock portfolio on

the announcement date is -0.06 percent. In the announcement date for $t-3 = -0.04\%$, $t-2 = -0.07\%$, and $t-1 = -0.06\%$ but after the announcement date $t 1 = -0.09\%$, $t 2 = -0.10\%$, and $t 3 = -0.09\%$. It is clearly that the abnormal return is higher before the announcement date due to the fact that the firms have a bond rating so it is well known and trustworthy that it will very difficult for them to go default so after the announcement date a lot of investors invest in those firms which lead to the firms or stockholders have to pay more dividends.

Therefore, this result supports the wealth transfer theory as before the announcement date the abnormal return is -0.07% and -0.06%. But after the announcement date the abnormal change to -0.09% and -0.10% which become worse. Another proof is that the number of positive stocks which before the announcement date is 30 but then after the announcement date it drops to 27. It is the same with number of negative stocks. Before the announcement date the number of negative stocks is 80 and after the announcement date it becomes 83. Thus, this clearly proves that firm with bond rating has a negative relation to stock market response due to the unexpected dividend changes.

Table 6. Abnormal Returns of Stock Portfolios in Indonesian Companies without Bond Ratings

Event Day (t)	Mean Abnormal Return (%)	Test Statistic	No. Positive	No. Negative
-8	-0.11%	0.50911	264	336
-7	-0.11%	-0.37702	283	317
-6	-0.08%	0.39918	269	331
-5	-0.08%	-2.63276	263	337
-4	-0.12%	-1.42973	272	328
-3	-0.09%	1.19369	283	317
-2	-0.08%	1.00590	267	333
-1	-0.08%	-0.71279	272	328
0	-0.11%	-0.43890	254	346
1	-0.06%	-2.32021	264	336
2	-0.08%	-0.87569	275	325
3	-0.06%	-1.82182	257	343
4	-0.09%	0.08551	269	331
5	-0.08%	0.10319	259	341
6	-0.07%	0.19989	276	324
7	-0.11%	-0.97671	288	312
8	-0.08%	0.88723	295	305

Source: Data Processing (2019)

After the announcement date the abnormal return is much higher than the abnormal return before the announcement date. The abnormal return of the investment stock portfolio on the announcement date is -0.11 percent. In the announcement date for $t-3 = -0.09\%$, $t-2 = -0.08\%$, and $t-1 = -0.08\%$ but after the announcement date $t 1 = -0.06\%$, $t 2 = -0.08\%$, and $t 3 = -0.06\%$. It is clearly that the abnormal return is higher after the announcement date due to the fact that after the announcement date some of the investors invest in those firms which

lead to the value of the firms improving while the firms still manage to control the quota of their dividends.

Therefore, this result support the research of Tsai and Wu (2014) as before the announcement date the abnormal return is -0.08%. But after the announcement date the abnormal change to -0.06% which become better. Another proof is that the number of positive stocks which on the announcement date is 254 but then after the announcement date it rises to 264. It is the same with number of negative stocks. On the announcement date the number of negative stocks is 346 and after the announcement date it becomes 336. Thus, this is clearly proof that firm with bond rating has a positive relation to stock market response due to the unexpected dividend changes.

5. Conclusion

This research tries to see the stock market response to unexpected divided changed based on bond rating in Indonesia between 2007–2016. In this research, there are two categories for the firms. One is firm with bond rating and another one is firm without bond rating. In order to know the stock market response, two methods are required which is by using classic assumption test and regression analysis. The variables that are being used in the study is the average of EBITDA, book value, and percentage change of dividends. There is also a comparison between lag 1 and lag 2. Lag 1 which is after one year of announcements taken from 2007–2016 and lag 2 which is after two years of announcements taken from 2008–2016.

In the first category of firm with bond rating in lag 1 is when the dividend is decreasing, the value of the firm is increasing or at least stay the same. The reason for this phenomenon is because when the firm has a bond rating, it means that the firm is already well known so it is safe or almost risks free to invest there. As a result, a lot of investors tend to invest in those firms which lead to increasing in dividend and decreasing in the value of the firm because the firm or the stockholders have to pay a large sum of money for the dividend. If there is a decrease in dividend, the firm or the stockholders will pay less for the dividends and they allocate their money to different area which can improve the firm value. For the lag 2, it is the same as lag 1 which is when the dividend is decreasing, the value of the firm is increasing or at least stay the same. From this result, we assure that this is clearly support our hypothesis for H1 which is unexpected dividend changes have a negative relation to stock market response based on bond rating as it represents the wealth transfer theory which is the irreconcilable situation among bondholders and stockholders, differs from the data content speculation by expressing that an incline (decline) in the equity market value is joined by a reduction (increment) in the debt market value.

In the second category of firm without bond rating in lag 1 is when the dividend is increasing, the value of the firm is also increasing. This can happen because the firm is still not well known and it is risky for the investors to invest there. Therefore, only some of the investors want to invest those firms. So when there is an increase in investors, the dividend is also increasing which result in increasing the value of the firm. For the lag 2, it also the same as lag 1 which is when the dividend of the firm increases, they attract a lot of investors which impact the value of the firm to be positive. From this result, we can also assure that this is clearly supports our hypothesis for H2 which is unexpected dividend change have a positive relation to stock market response for company without bond rating as it is the same result with the previous researcher Tsai and Wu (2014). They found that stock returns are positively correlated with unexpected dividend changes. In the following two years of declarations, the connection between dividend changes and future profitability turns out to be a lot weaker. Therefore after 2 years there is not too much change.

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