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Financial features of dividend-paying firms in the hospitality industry: A logistic regression analysis

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ABSTRACT

The purpose of this study was to identify the financial features that distinguish dividend-paying firms from non-dividend-paying companies in the U.S. hospitality industry. The logistic regression model shows that firm size and profitability are significant drivers of dividend payout, whereas investment opportunities deter dividend payout. In the U.S. hospitality industry, larger hospitality firms with higher profitability but fewer investment opportunities are more likely to pay out dividends to their shareholders.

1. Introduction

Gordon's (1959) dividend relevance theory suggests that investors consider current dividends to be less risky than future dividends or capital gains, indicating that paying dividends at present has a positive impact on firm value. More recently, Gitman and Madura (2001) and Van Horne and Wachowicz (2001) posited that paying out dividends can reduce investors' uncertainty, causing them to discount the firm's earnings at a lower required rate of return and hence increase the stock value. Conversely, if the firm reduces or stops paying dividends, investors' uncertainty will increase, thus raising their required rate of return and lowering the stock value. Many research studies (Cornell and Shapiro, 1987; Peterson and Branesh, 1983; Prezas, 1988; Ravid, 1988) have found that dividend policy can affect the firm value via its interactions with investment and financing policies. In particular, Gitman and Madura (2001) observed that, in practice, both managers and stockholders tend to support the belief that firm dividend policy indeed affects stock prices.

Since the dividend relevance theory (Gordon, 1959) was first proposed, numerous studies (Alli et al., 1993; Amidu and Abor, 2006; Chen and Steiner, 1999; Dickens et al., 2003; Holder et al., 1998; Jensen et al., 1992; Omran and Pointon, 2004; Ooi, 2001; Zeng, 2003) have investigated the factors that affect the levels of dividends paid. On the other hand, some studies have concentrated on the financial characteristics of dividend-paying firms or factors that affect the dividend payout decision itself rather than levels of dividends (Fama and French, 2001; Mancinelli and Ozkan, 2006). In the hospitality industry, while some firms pay dividends to their shareholders, many other firms distribute no dividends at all. What are the particular financial features of those dividend-paying hospitality firms, and what are the reasons for hospitality firms' decisions to distribute or not to distribute dividends? While the corporate dividend payout decision has been widely examined in the general finance literature, it is a thinly investigated area in hospitality financial management.

The hospitality finance literature contains reports of studies on the information signaling value of dividends (Canina et al., 2001) and the impact of dividend initiation or dividend increase on hospitality stock investment return (Sheel, 1998; Borde et al., 1999; Sheel and Zhong, 2005). However, to the best of our knowledge, no study has been conducted to investigate the financial characteristics of dividend-paying hospitality firms. According to Fama and French (2001), at the time of their study, the proportion of U.S. firms paying dividends was around 21%. However, the COMPUSTAT database (2005) showed that about 41% of U.S. hospitality firms distributed dividends. The much higher proportion of dividend-paying firms in the hospitality industry suggests that hospitality firms' dividend policy may have some unique features that deserve our investigation.

Following the studies by Fama and French (2001) and Mancinelli and Ozkan (2006), this study attempted to identify financial features that distinguish dividend-paying hospitality firms from their non-dividend-paying counterparts, thus determining factors that affect hospitality firms' dividend payout

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decisions. Those financial features, if identified, will shed light on the drivers behind hospitality firms' dividend payout decisions. The findings should help hospitality researchers to better understand why some hospitality firms pay dividends while other firms distribute no dividends and why hospitality firms are more prone to dividend distributions than U.S. corporations in general, thus enriching the hospitality finance literature from the dividend policy perspective. On a practical basis, our findings may assist pro-dividends investors and portfolio managers to identify hospitality companies that have the potential to pay out dividends, better suiting their needs for hospitality investment.

2. Literature review

2.1. Theoretical overview of the dividend policy

There is considerable debate on how dividend policy affects the firm values. While some researchers believe that dividend payout increases shareholder's wealth (Gordon, 1959), some argue that dividend payout may decreases shareholder's wealth (Litzenberger and Ramaswamy, 1979), and some others posit that the amount of dividends is irrelevant to firm value (Miller and Scholes, 1978). The theoretical principles underlying corporate dividend policy can be described either in terms of information asymmetries, the tax-adjusted-theory, or behavioral factors (Amidu and Abor, 2006).

The information asymmetries between managers and shareholders in the context of dividend policy cover three aspects including signaling models, agency cost, and the free cash flow hypothesis (Amidu and Abor, 2006; Frankfurter and Wood, 2002). The signaling theory suggests that firms pay dividends to signal their future prospects. Since dividends are good predictors of the future earnings, the announcement of dividend increase is viewed as good news and accordingly the stock price reacts favorably, and vice versa (Alli et al., 1993). Thus, dividend payments may signal information to shareholder and reduce the information asymmetries. In terms of agency costs, the dividend payment may serve as a mechanism to reduce cash flows under management control, and thus help mitigate the agency problems (Frankfurter and Wood, 2002). If managers have much cash flow under their control, they have incentive to increase their compensation by enlarging the firm size beyond the optimal level because executive compensation is often related to firm size (Wang et al., 1993). Jensen (1986) asserts that for a firm with large amount of free cash flow, increasing dividend payments will reduce the agency costs associated with overinvestment and increase the firm's market value. If the firm reduces funds under management control by paying out dividends, managers are more likely to go to the capital markets for external financing where monitoring of management decisions is less costly (Easterbrook, 1984).

The tax-adjusted-theory posits that high dividend payout ratios raise the investor's required rate of return and decrease the market value of a firm's stocks (Brennan, 1970; Frankfurter and Wood, 2002; Litzenberger and Ramaswamy, 1979). This argument is based on the relative tax disadvantage of dividends compared to capital gains. The tax-adjusted-theory leads to the division of investors into dividend tax clienteles. Masulis and Trueman (1988) suggest that investors with different tax liabilities will not be uniform in terms of ideal firm dividend policy. The tax clientele hypothesis suggests that different tax clienteles prefer different dividend policies, and investors may invest in the firms that have dividend policies appropriate to their tax circumstances (Zeng, 2003). For instance, investors with dividends taxed at a lower rate than capital gains may prefer higher dividend payout ratio. On the other hand, investors with dividend receipts taxed at a higher rate than capital gains may prefer low or zero payout ratio.

Many researchers suggest that behavioral factors may affect the corporate dividend policy. Shiller (1984) asserts that since investor behavior can be significantly influenced by social norms and attitudes, including these influences in dividend policy models can enrich the development of corporate dividend theory. According to Frankfurter and Wood (2002), corporate dividend policy will be better explained by the addition of social economic-behavior paradigm into dividend policy models. Dividends could be viewed as the social-economic repercussion of corporate evolution and the information asymmetry between managers and shareholders cause dividends to be paid to increase the attractiveness of equity issues. Michel (1979) argues that managers may be influenced by the actions of corporate executives of competitive firms when determining dividend payout levels. Frankfurter and Lane (1992) assert that dividends are partially a tradition and partially a way to dispel investor anxiety. Dividends are paid because shareholders expect continued dividend growth and managers believe that investors want to receive them. According to Frankfurter and Wood (2002), managerial views of dividend policy are essentially unchanged since Lintner's (1956) survey of the views of corporate chief executive officers and chief financial officers about their perception of dividend policy. Corporate managers believe that dividend payments are necessary to maintain or increase share price and to attract new investors.

2.2. Previous studies on determinants of dividend policy

Studies of corporate dividend policy have focused on either the reasons or motivations for dividend payout or the factors that determine the amounts of the dividends. Most of the empirical studies have employed multiple regression analysis (Agrawal and Jayaraman, 1994; Amidu and Abor, 2006; Chen and Steiner, 1999; Dickens et al., 2003; Holder et al., 1998; Omran and Pointon, 2004; Ooi, 2001; Wang et al., 1993; Zeng, 2003) to investigate the factors affecting levels of dividends, or have utilized logistic regression analysis (Fama and French, 2001; Mancinelli and Ozkan, 2006) to identify the financial features of dividend-paying companies. In those studies, firm size, liquidity, investment opportunities, profitability, debt leverage, growth, and earnings variability are the variables commonly referred to as having an impact on corporate dividend policy.

The association between firm size and dividend policy has been widely investigated in previous studies. Firm size was measured by either total assets (TA) (Alli et al., 1993; Fama and French, 2001; Mancinelli and Ozkan, 2006; Omran and Pointon, 2004; Ooi, 2001) or total sales (Barclay et al., 1995; Dickens et al., 2003; Holder et al., 1998; Zeng, 2003). A positive effect of size on dividend policy has been proposed. According to Holder et al. (1998), larger firms are more mature and thus have easier access to capital markets, which reduces their dependence on internally generated earnings for new financing and allows for dividend payout. Dickens et al. (2003) suggested a positive effect of firm size on dividend policy from the sales perspective. They argued that the firms with greater sales revenue should have lower bankruptcy probability and hence are more likely to pay higher dividends. Empirical findings are unanimous on the positive relationship between firm size and amounts of dividends (Alli et al., 1993; Dickens et al., 2003; Holder et al., 1998; Omran and Pointon, 2004; Ooi, 2001; Zeng, 2003). In particular, the logistic regression models developed by Fama and French (2001) and Mancinelli and Ozkan (2006) both found firm size to be a significant variable positively associated with dividend payout decisions.

Firm liquidity is another factor that has been hypothesized to positively impact dividend payouts. According to Amidu and Abor (2006), poor liquidity means a cash shortage and thus fewer or no dividends, whereas good liquidity implies sufficient cash for large