Emerging Markets Review
1 (2000) 252–270

EMERGING MARKETS REVIEW

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Instability in the dividend policy of the Istanbul Stock Exchange (ISE) corporations: evidence from an emerging market

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Received 13 January 2000; received in revised form 31 August 2000; accepted 5 September 2000

Abstract

Dividend policy behaviour of corporations operating in emerging markets is significantly different from the widely accepted dividend policy behaviour of corporations operating in developed markets. This study provides evidence from the Istanbul Stock Exchange (ISE), an emerging European stock market, and analyses empirically whether the ISE corporations follow stable cash dividend policies in a regulatory environment that imposed mandatory dividend policies. Unlike the empirical results supporting the stable dividend policy behaviour of corporations operating in developed markets, the empirical results show that the ISE corporations follow unstable cash dividend policies and the main factor that determines the amount of cash dividends is the earnings of the corporation in that year. © 2000 Elsevier Science B.V. All rights reserved.

JEL classifications: G35; G38

Keywords: Dividend policy; Stability; Regulations; Istanbul Stock Exchange

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PII: S1566-0141(00)00011-X

1. Introduction

Dividend policy has attracted a great deal of research and still keeps its prominent place in the finance literature. However, it is still not satisfactorily explained why corporations distribute a substantial portion of their earnings as dividends or why investors pay attention to dividends. This is known as the 'dividend puzzle' in the finance literature (Black, 1976) and several hypotheses have been put forward in order to shed some light on this puzzle. The Miller and Modigliani (1961) dividend irrelevance proposition states that a managed dividend policy cannot increase (decrease) shareholders' wealth in a complete and perfect market as long as it does not alter the investment policy of the corporation. However, the capital market is neither perfect nor complete. The complete and perfect capital market assumptions of the dividend irrelevance proposition have been researched vigorously, especially focusing on the effects of taxes, information content of dividends, agency cost and institutional constraints. The research and theory on the dividend policy have also been influenced by the empirical observations about the market, corporate and investor attitude towards the dividend policy (see Lease et al., 2000; Megginson, 1997; Allen and Michaely, 1995). Two prominent empirical observations on dividend policy show that corporations follow stable dividend policies and pay out a substantial portion of their earnings as dividends (Lintner, 1956).

Emerging markets add more pieces to the 'dividend puzzle' and have recently attracted research trying to explain the dividend policy behaviour of corporations operating in these markets (Glen et al., 1995). As emerging markets get a bigger portion of global equity investments, international investors are more concerned with the dividend policy behaviour of emerging market corporations. The focus of this research is to study how the corporations that trade in the Istanbul Stock Exchange (ISE), an emerging European stock market, set their dividend policies in a different institutional environment and to research empirically whether they follow stable dividend policies as in developed markets where dividend smoothing is a management tendency.

Unlike the stable dividend policy behaviour of the corporations trading in developed capital markets, this research provides evidence from the ISE in which corporations follow unstable dividend policies. Specifically, regulations imposed mandatory dividend policies on the ISE corporations during the 1985–1994 fiscal years and mandatory dividend policies are still used in both developed and developing countries such as Germany, Switzerland, Brazil, Chile, Colombia, Venezuela, Greece and Philippines (La Porta et al., 2000; Lease et al., 2000, p. 138; Glen et al., 1995). In a broad sense, this study shows how sensitive the financial decision making is to institutional and regulatory environments which can vary from country to country.

With the establishment of the Istanbul Stock Exchange in 1986 and the advances in the information technology, the number of empirical studies on the Turkish stock market has increased substantially. Since its establishment in 1986, the ISE has followed a fast pace growth in terms of trading volume, market capitalisation,