



Dividend policy and the organization of capital markets

Varouj Aivazian^a, Laurence Booth^{a,*}, Sean Cleary^b

^a *Rotman School of Management, University of Toronto, 105 St George Street, Toronto, Ontario, Canada M5S 3E6*

^b *York University, York, UK*

Received 4 November 2001; accepted 20 April 2002

Abstract

The hypothesis that dividend policy serves as a signaling mechanism and also serves to control managerial opportunism is usually supported by empirical studies showing that firms in developed countries (e.g. the USA) smooth their dividends as noted by Lintner (*Am. Econ. Rev.* 46 (1956) 97). However, the theoretical justification for these results largely stems from models based on arms length contracting in capital markets. In contrast, most emerging markets have a bank centered financial system, where contracting is not normally at arms length. Consequently, this paper compares the dividend policy of companies from eight emerging markets to the policies adopted by 100 US firms over the same period. Firms in these emerging markets have more unstable dividend payments than their US counterparts. Regression results indicate that dividends are much less sensitive to past dividends. These results support the substitute view of dividend policy on the premise that the institutional structures of these developing countries make dividends a less viable mechanism for signaling and for reducing agency costs than for their US counterparts operating in more highly developed arms length capital markets.

© 2002 Elsevier Science B.V. All rights reserved.

Keywords: G35; G32

Keywords: Dividends; Information asymmetries; Agency costs; Developing countries

* Corresponding author. Tel.: +1-416-978-6311; fax: +1-416-971-3048

E-mail address: booth@rotman.utoronto.ca (L. Booth).

1. Introduction

How firms determine their dividend policy has been a puzzle to financial economists for many years. Miller and Modigliani (1961) (M&M), showed that under certain assumptions the payment of a cash dividend should have no impact on a firm's share price. M&M assumed that the firm's investment is fixed, since all positive net present value projects will be financed regardless of the firm's dividend policy. Consequently, the firm's future free cash flow is independent of the firm's financial policies, so that the dividend is the firm's residual free cash flow. The fact that this result flies in the face of casual empiricism, not to mention most empirical studies,¹ was called the dividend puzzle by Fischer Black (1976).

Several strands of research have developed to explain actual dividend policies, focusing on relaxing some of the M&M assumptions. Brennan (1970), for example, relaxed the equal tax assumption. However, in Brennan's model the higher the dividend the higher the tax penalty. Consequently, a tax wedge drives up the pre-tax investor required rate of return for high payout firms. Despite extensive empirical investigation this hypothesis does not seem to be borne out by the data.² Moreover, Poterba (1987) has documented the remarkable stability of dividend payouts throughout periods of extensive tax changes in the USA.

While the impact of taxes remains inconclusive, increasing attention has been given to the problem of information asymmetries. Miller and Modigliani (1961) explicitly suggested that dividend changes could have an *informational* impact. Subsequent research by Watts (1973) and others have documented that initiating a dividend increases the share price and cutting a dividend generally leads to a price decline.³ Information asymmetries have also given rise to *agency* cost explanations for paying dividends. With the increased separation of ownership from control, managers frequently face very little supervision. In this context, a commitment to a high dividend policy attenuates managerial opportunism and forces the firm to frequently interact with the capital market.

A central message of asymmetric information models is that dividend payments are important both as a pre-commitment device to reduce agency costs and as a signal of management's expectations of future earnings. Both models have been used to justify Lintner's observation (1956) that actual dividend policies tend to follow a

¹ See Lintner (1956) and Fama and Blahnik (1968).

² The empirical evidence is at best ambiguous, see the classic papers by Litzenberger and Ramaswamy (1979), and Black and Scholes (1974).

³ There is a large signaling literature. See Asquith and Mullins (1986) for a review and comprehensive analysis and DeAngelo et al. (1996) for a rebuttal.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات