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How Norwegian managers view dividend policy☆

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Abstract

We survey managers of Norwegian firms listed on the Oslo Stock Exchange about their views on dividend policy. The key factors that drive dividend policies are the level of current and expected future earnings, stability of earnings, current degree of financial leverage, and liquidity constraints. No significant correlation exists between the overall rankings of factors influencing dividend policy between Norwegian and U.S. managers. Norwegian managers express mixed views about whether a firm's dividend policy affects firm value. In general, management views provide support for the signaling hypothesis of payout policy but not the tax-preference explanation.

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1. Introduction

In his classic work, Black (1976) found no convincing explanation of why companies pay cash dividends to their shareholders. In the three decades since Black first described the "dividend puzzle", financial economists have intensely studied the possible role of dividends in maintaining or increasing corporate values. According to Baker, Powell, and Veit (2002a, p. 255), "despite a voluminous amount of research, we still do not have all the answers to the dividend puzzle." That is, we do not have definitive answers on why companies pay dividends and why investors care about them. Nonetheless, theoretical and empirical studies have provided many useful insights about dividend policy. Although the various theories of dividend policy typically take a "one-size-

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fits-all" approach, evidence suggests that dividend policy may vary substantially from one firm to another. As Frankfurter and Wood (1997, p. 31) conclude, dividend policy "... cannot be modeled mathematically and uniformly for all firms at all times."

Researchers have followed two major paths in trying to explain why firms pay dividends. The most well traveled path is to develop and test various theories to explain the dividend puzzle. Some of the earliest research focused on the Miller and Modigliani (1961), hereafter called M&M, argument for dividend irrelevance. Based on some highly restrictive assumptions involving perfect capital markets, M&M contend that one dividend policy is as good as another.

Others provide plausible explanations for dividend relevance outside of M&M's idealized world of economic theory. Common explanations of dividend relevance involve asymmetric information (signaling), taxation, and agency costs.[1] Baker and Wurgler (2004) propose a new explanation called the "catering theory of dividends." According to this theory, investor preferences for dividends may change over time. Managers cater to investors by paying dividends when investors place a stock premium on payers, and by not paying when investors prefer non-payers. Each theory has some empirical support but no single theory has emerged as the dominant explanation.

The second path is to survey managers about their views toward possible reasons underlying dividend decisions. The evidence using survey research methodology both complements and provides a check of the purely econometric research on dividends. Lintner (1956) conducted the seminal study about dividend decisions in the United States. According to Lintner's model, the best predictors of current dividends are past dividends and current profits. He finds that firms have long-term target dividend payout ratios that lead to smoothing of dividend payments over time. His evidence also shows that managers are reluctant both to announce dividend increases that they may later have to reverse and to cut dividends temporarily.

Almost 30 years later, Baker, Farrelly, and Edelman (1985) and Farrelly, Baker, and Edelman (1986) surveyed chief financial officers (CFOs) of NYSE firms from three industry groups (utilities, manufacturing, and wholesale/retail) to identify the major determinants of corporate dividend policy. Their evidence shows that the most important factors are the anticipated level of future earnings, the pattern of past dividends, the availability of cash, and the desire to maintain or increase the stock price. Similar to the findings of Lintner (1956), they report that firms try to avoid changing dividend rates that might soon need to be reversed, maintain an uninterrupted record of dividend payments, have a target payout ratio, and periodically adjust the payout toward the target. Respondents show strong agreement that dividends provide a signaling device and the market uses dividend announcements to help value firm stocks. Finally, they report differences in responses between more regulated (utilities) and less regulated (manufacturing and wholesale/retail) industry groups.

Numerous dividend surveys involving U.S. firms followed (e.g., Baker & Farrelly, 1988; Baker & Powell, 1999, 2000; Baker, Powell, & Veit, 2002b; Baker, Veit, & Powell, 2001; Brav, Graham, Harvey, & Michaely, 2005; Farrelly & Baker, 1989; Pruitt & Gitman, 1991). For example, Baker and Powell (1999, 2000), who survey CFOs from NYSE firms, report most respondents believe that dividend policy affects firm value. Respondents show strong support for the signaling explanation for dividends. Overall, the views of managers about setting dividend payments are surprisingly consistent with Lintner's (1956) findings, especially regarding the concern about continuity of dividends. Unlike Baker et al. (1985), Baker and Powell (2000) report few differences among the responses of managers in different industries. They attribute this finding to changes in the economic and competitive environment for utilities.

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[1] Lease, John, Kalay, Loewenstein, and Sarig (2000) provide a useful discussion of these dividend theories and research related to them.