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Dividend policy in Nordic listed firms☆

Tor Brunzell [a], Eva Liljeblom [b], Anders Löflund [b], Mika Vaihekoski [c]

[a] *Stockholm University, School of Business, Sweden*
[b] *Hanken School of Economics, Department of Finance and Statistics, Finland*
[c] *University of Turku, Turku School of Economics, Finland*

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A B S T R A C T

In this paper we analyze the results from a survey among all publicly listed Nordic firms on their dividend payout policy. The results show that 72% of the Nordic companies have a specified dividend policy. Larger and more profitable companies are more likely to have a defined dividend policy in place. The dividend policy is mostly influenced by capital structure considerations and the outlook of future earnings. We also find that the likelihood for a firm having an explicit dividend policy is positively related to ownership concentration as well as to the presence of large long-term private or industrial owners. Our results support the use of defined dividend policies for agency or monitoring reasons rather than signaling reasons.

1. Introduction

Ever since studies such as Lintner (1956) and Fama and Babiak (1968), a large number of papers have studied corporate dividend policies (payout ratios) and factors that contribute to the payout decision. Recently, focus has been on the choice between dividends and share repurchases (see for example Guay & Harford, 2000; Jagannathan, Stephens, & Weisbach, 2000; and Skinner, 2008), the question of disappearing dividends (see for example DeAngelo, DeAngelo, & Skinner, 2004; Fama & French, 2001), and the relationship between minority protection and dividends (see for example Faccio, Lang, & Young, 2001; La Porta, Lopez de Silanes, Shleifer, & Vishny, 2000). Typically, the dividend payout is found to be a function of factors such as profitability of the company, stability of the earnings, rate of growth, free cash flows, and more recently, the governing structure of the company. In their survey of dividend policies, DeAngelo, DeAngelo and Skinner

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E-mail addresses: tb@fek.su.se (T. Brunzell), eva.liljeblom@hanken.fi (E. Liljeblom), anders.loflund@hanken.fi (A. Löflund), mika.vaihekoski@utu.fi (M. Vaihekoski)

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(2008) conclude that a simple asymmetric information framework does a good job at explaining observed payout policies. This framework emphasizes the need to distribute free cash flow in the presence of agency costs and security valuation problems. They also conclude that other motives and factors such as signaling, tax preferences, and clientele demands have at best minor influences, but that behavioral biases at the managerial level (such as overconfidence) and the idiosyncratic preferences of controlling shareholders plausibly have a first order impact.[1]

We contribute to the literature on studies of the relationship between controlling shareholders and dividend decisions by studying the determinants of whether a firm follows a more explicit dividend policy. While implicit dividend policies (most commonly the relationship between dividends and earnings, and the speed of adjustment to an assumed optimal level) have been subject of many studies, only a few papers have studied whether a company has an explicit defined dividend policy in place, and what factors are related to the choice of that policy (exceptions include Baker, Saadi, Dutta, & Gandhi, 2007; and Brav, Graham, Harvey, & Michaely, 2005).[2]

There are many reasons for why the question of whether the firm follows a clearly defined dividend policy[3] may be of interest. Firstly, it can be seen as an alternative approach to study whether signaling can be one of the motives for dividend distributions. Without expectations for future dividends, formulated by some systematic publicly announced dividend policy, deviations from such expectations cannot be identified and reacted upon. Thus, one could view a “dividend policy” as a necessary but not sufficient condition for dividends to convey information about future earnings. Secondly, a systematic and defined dividend policy may also be required by dominant corporate owners. The policy may solve agency problems between minority owners and large owners in firms with concentrated ownership (La Porta et al., 2000), and optimize taxation or satisfy large owners' preference for a more predictable dividend stream.

We contribute by providing empirical results on the existence of a dividend policy in listed firms and investigating factors affecting the choice of such a policy. Most notably, we study how the existence of a major shareholder impacts the decision. The data used in this study are from the Nordic markets, since there is more cross-sectional variety in ownership concentration levels and different ownership types than in the USA.[4] This gives us an especially fruitful setting for a study of the link between ownership and the existence of a defined dividend policy.[5] Our results are based on a survey conducted among board chairpersons of the companies listed on the Nordic stock exchanges. The survey results are combined with financial data on the actual characteristics and performance of firms, and data on the largest owners for each company including their type categorizations.

We find that 72% of the Nordic companies have an explicit dividend policy. Larger and more profitable companies are more likely to have a defined dividend policy in place. The dividend policy is mostly influenced by the considerations of the company's capital structure and future earnings. In estimations studying the

[1] They also note that the evidence strongly supports the view that managers of mature firms behave as if they have strong implicit contracts with their stockholders to not reduce dividends opportunistically.

[2] Brav et al. (2005) asked dividend payers what they attempt to target with their dividend policy, and whether the target is strict or flexible. 43% of the managers say that their dividend target is somewhat or very strict. In Baker et al. (2007), 46.7% of the respondents indicated that their firms have an explicit target dividend policy in the form of a payout ratio. A comparison of the results of Lintner (1956) and Brav et al. (2005) indicates that a change in the targets of a dividend policy has taken place. While Lintner (1956) reported that two thirds of the firms had a reasonably well-defined long-run payout ratio, Brav et al. (2005) report that only 28% of the respondents target dividend payout, and another 27% target growth in dividends per share. Nearly 40% targets dividends per share, 13% the dividend yield, while 6% of dividend-payers claim not to target dividends at all.

[3] A typical example of a defined dividend policy is publicizing dividend target payout ratios in annual reports. Additionally, the company may choose to disclose dividend policy targets in materials presented in meetings with investors and analysts. Some companies may prefer not to publish their commitments to a particular dividend policy even when they, in fact, internally follow a clearly defined dividend policy.

[4] The Nordic countries are Denmark, Finland, Iceland, Norway, and Sweden. The market capitalization value of the companies listed in these markets was slightly more than USD700 billion at the end of 2008 (World Federation of Stock Exchange statistics).

[5] We focus on dividends, not share repurchases, since prior studies indicate that the motives for and timing of these two forms of corporate payout are quite different. The survey results of Brav et al. (2005) indicate among other things that while dividend choices are made simultaneously with (or earlier than) investment decisions, share repurchase decisions are made later. The results of Jagannathan et al. (2000) indicate that dividends are used to distribute relative permanent cash-flow shocks while repurchases are related to more transient shocks. If that is the case, a long-run “payout policy”, if one is in place, is not likely to use repurchases as the distribution method. The results of Skinner (2008) support this in the sense that repurchases are found to adjust rapidly to earnings changes. Moreover, in the Nordic countries, share repurchases are still much less common than dividends.