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AN EMPIRICAL INVESTIGATION OF STOCK DIVIDENDS-IN-KIND

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Abstract

We investigate share price reactions to announcements of dividends payable in the common stock of corporations different from the issuing firm. We find that firms that declare these dividends (typically investment companies) experience positive abnormal returns upon announcement. We also find that such dividends are more likely to be declared when the shares to be distributed have peaked in value. Consistent with this finding, we document negative announcement-period abnormal returns for firms having their shares distributed. Additional tests reveal that prices respond more negatively when the information signal is strongest, when outside ownership is more dispersed, and when management is more entrenched.

I. Introduction

Several studies examine the managerial motives for and economic consequences of stock dividend declarations (Baker and Gallagher (1980), Brennan and Copeland (1988), Eisemann and Moses (1978), Grinblatt, Masulis, and Titman (1984), Lakonishok and Lev (1987), McNichols and Dravid (1990)). In this study we provide an analysis of a type of stock dividend not previously investigated. Specifically, we focus on stock dividends-in-kind (hereafter SDIK). SDIKs are common stock dividends declared by one company and payable in the shares of another company.¹ Our analysis does not include dividends associated with spin-offs, mergers, or acquisitions, since these events are of an entirely different nature.

We examine four primary research questions. First, what are the characteristics of firms that typically declare SDIKs (hereafter DECLARER firms) and why are the SDIKs declared? Second, do the firms that have their shares distributed (hereafter DECLAREE firms) have any characteristics in common? Third, how do the investors representing both classes of firms react to the SDIK

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¹SDIKs are special cases of property dividends.

announcements; that is, are there stock valuation effects for DECLARER and/or DECLAREE firms? Finally, if an equity valuation effect exists, what firm-specific factors appear to influence the price reactions? This last question allows us to use SDIKs as a unique venue for testing some of the commonly proposed theoretical relations among ownership structure, information effects, and firm value.

II. Firm Characteristics and Testable Hypotheses

DECLARER Firms

Our analysis reveals that almost 80 percent of SDIKs are declared by investment companies that do not pay regular cash dividends. Therefore, shareholders of these firms may view the dividends simply as cash dividend replacements (see Lakonishok and Lev (1987)). From the firm's perspective, however, some motivation must exist for SDIKs to be declared in lieu of cash dividends. One possible reason is tax related. Before its repeal in 1987, the General Utilities doctrine afforded SDIKs and comparable distributions preferential tax treatment. Under this ruling, a firm having appreciated assets could distribute the assets to stockholders with a "step-up" in basis. For tax purposes, no gain would be recognized from the distribution. Investors should view such an opportunity favorably; therefore, *ceteris paribus*, SDIK announcements should result in a positive average share price response for DECLARER firms.²

It is not clear, however, that firms would elect such distributions based solely on preferential tax treatment. Another possibility is that SDIKs are declared when the DECLARER firm believes that the DECLAREE firm's stock has reached its maximum value and the price will soon decline, or that the shares are overvalued. Assuming recipient shareholders can sell their shares at this maximum value, the average price response for DECLARER firms should be positive. On the other hand, if the distribution is made because the DECLAREE firm has been performing poorly, DECLARER shareholders may react negatively because they are being given a security with little value. This contention, of course, must be tempered with the realization that investors may view "something" as superior to "nothing." Accordingly, a positive stock price response under these conditions may still be plausible.

²Our expectation of a positive valuation effect for DECLARER firms assumes the dividend itself is unexpected or that the amount of the dividend is larger than expected. Our findings suggest that most DECLARER firms are small and receive little attention in the financial press. Thus, dividend announcements for these firms are more likely to contain "new information" and are more likely to affect share prices.

DECLAREE Firms

Information Effects. The declaration of an SDIK may indicate that DECLARER firm management believes (1) the DECLAREE firm's shares have peaked in value or (2) the firm has been performing poorly and there is little hope for the future. Both scenarios imply that future earnings may be poor, relative to past earnings. Accordingly, an SDIK announcement may send a negative signal to DECLAREE shareholders, resulting in a decrease in share prices at announcement. Assuming the information signal is accurate, post-announcement share price performance should be negative as well.

Management Ownership Concentration. Regardless of the motivation for SDIKs, they may enhance the relative power of DECLAREE management. Specifically, because a block of potentially valuable outside ownership is being dissolved, nonmanagement ownership becomes more dispersed, resulting in increased managerial power. Jensen and Meckling (1976) show that managers are more likely to engage in firm value-maximizing behavior when they control a substantial portion of their firms' shares. As management power increases, decreases in agency costs arising from an alignment of interests cause firm value to rise. Thus, the DECLAREE share price reaction should be positive.

More recently, however, Fama and Jensen (1983) argue that management may become entrenched at high levels of ownership. As management becomes more powerful they may be able to escape market discipline, thereby decreasing firm value. Therefore, DECLAREE reactions to SDIK announcements may depend upon management ownership concentration. In other words, cross-sectional price reactions to SDIKs may depend upon the degree to which DECLAREE management is entrenched.

Outside Ownership Concentration. The "free-rider" problem exists when a firm has many owners and no one is willing to endure the costs of monitoring management. Shleifer and Vishny (1986) state that the presence of a large minority shareholder may partially resolve such a problem. Therefore, firm value should decrease (increase) when a large block of ownership is dissolved (created), because of decreased (increased) monitoring. If SDIKs result in the dissolution of an important block of ownership, a negative effect is expected.

Pound (1988) presents two additional relations that may exist between outside ownership (defined as institutional ownership) and firm value. A negative relation may exist if institutional investors vote with management because they are coerced to maintain a business association. This relation may also obtain when institutional investors and management find such cooperation mutually beneficial. Therefore, the firm value effects of decreases in outside ownership concentration resulting from SDIKs may depend upon the type of institutional block that is dissolved.

TABLE 1. Selected Summary Statistics for DECLARER and DECLAREE Firms.

Variable	<i>N</i>	Mean	Median	25% <i>Q</i>	75% <i>Q</i>
Panel A. DECLARER Firms					
FIRMSIZE	38	105.05	85.57	69.63	111.95
DIVVAL	44	0.95	0.51	0.33	0.98
TOTALVAL	44	2.77	1.50	1.04	2.74
Panel B. DECLAREE Firms					
FIRMSIZE	44	1209.33	440.69	146.10	1055.42
SHRDIST	44	125,979	49,833	26,376	120,796
MGTOWN	42	12.14%	0.08	1.00%	18.00%
RELDIST	44	1.27%	0.0035	0.15%	1.04%

Notes: FIRMSIZE is the firm's market value of equity on the Friday before the dividend announcement, expressed in millions of dollars. DIVVAL is the per-share market value of the distribution, defined as the number of DECLAREE shares issued per DECLARER share held, multiplied by the market price of the DECLAREE shares on the Friday before the dividend announcement. TOTALVAL is the total value of the dividend distribution (expressed in millions of dollars), defined as the total number of DECLAREE shares distributed multiplied by the market price of the DECLAREE shares on the Friday before the dividend announcement. SHRDIST is the total number of DECLAREE shares distributed through the dividend. MGTOWN is the DECLAREE firm's percent management ownership before the dividend. RELDIST is the relative size of the SDIK distribution, which is SHRDIST divided by the number of DECLAREE shares outstanding.

III. Sample Selection and Empirical Method

Sample Selection

We searched *Moody's Dividend Record* from 1972 to 1989 to form a preliminary sample consisting of all firms that declared SDIKs. This sample was then used to search the *Wall Street Journal Index* for public announcements of SDIKs. To be included in the final sample, firms must have complete returns data available on the Center for Research in Security Prices (CRSP) NYSE/AMEX or NASDAQ return files. These criteria result in a final sample of thirty-eight DECLARER and forty-four DECLAREE stock dividend announcements. The discrepancy between the number of DECLARER and DECLAREE announcements is due to two factors. First, either firm may have released potentially contaminating information during the announcement period, which would eliminate the firm(s) from the analysis. Second, many DECLARER dividends are payable in shares of more than one DECLAREE firm (in a single announcement), so a one-to-one match for these dividends does not exist.

Table 1 presents selected summary statistics for the full samples of both DECLARER and DECLAREE firms. For DECLARER firms, the mean market value of equity before the announcement (FIRMSIZE) is approximately \$105

million. This is in contrast to the \$1.209 billion mean market value of equity for DECLAREE firms. Although both measures are positively skewed, the median values (\$85.57 million and \$440.69 million, respectively) confirm that firms declaring SDIKs are significantly smaller than firms having their shares distributed.

Table 1 also provides data on the monetary value of SDIKs. The mean market value of the SDIK (DIVVAL) is about ninety-five cents per share, and each SDIK results in an average of 125,979 DECLAREE shares being distributed (SHRDIST). The relative size of the distribution (RELDIST) represents a 1.27 percent mean (0.35 percent median) stake in the total shares of the DECLAREE firm. Given the large size of DECLAREE firms, this stake may represent a significant monetary interest. We calculate this interest, i.e., the average total value of the distribution (TOTALVAL), to be approximately \$2.77 million. Although this figure is positively skewed (median = \$1.50 million), SDIKs appear to be associated with substantial transfers of wealth from single blockholders to dispersed, perhaps less sophisticated, individual investors.

Empirical Method

Average daily common stock abnormal returns are measured around the SDIK announcement dates. We calculate abnormal returns (AR_{jt}) for the period beginning twenty-one days before and ending twenty days after the announcement date using the market model:

$$AR_{jt} = R_{jt} - (\hat{\alpha}_j + \hat{\beta}_j R_{mt}), \quad (1)$$

where R_{jt} is the return of security j for period t and R_{mt} is the return on the CRSP NYSE/AMEX or NASDAQ market index for period t . The estimated coefficients $\hat{\alpha}_j$ and $\hat{\beta}_j$ are calculated using the 160 trading days that end 21 days before the announcement date.

Tests of statistical significance are based on standardized abnormal returns, where the standard deviation of the sum of the AR_{jt} series from $t = T_1$ to $t = T_2$ is given by equation (2):³

³Our event study method follows that used by Mikkelsen and Partch (1988a, b), a correction of the method used by Patell (1976). The corrected test accounts for serial correlation in abnormal returns within event windows. The serial correlation is present because all of the abnormal returns are a function of the same OLS intercept and slope estimators.

$$S_{jT} = \left\{ \hat{\sigma}_j^2 \left[T + \frac{T^2}{N} + \frac{T^2(\bar{R}_{mT} - \bar{R}_m)^2}{\sum_{t=1}^N (R_{mt} - \bar{R}_m)^2} \right] \right\}^{1/2}. \quad (2)$$

The value $\hat{\sigma}_j^2$ is the mean square error of the market model regression for firm j , \bar{R}_m is the mean market index return over the estimation period, N is the number of returns in the estimation period, and \bar{R}_{mT} is the mean market index return during period T . We define the number of sample observations in the period from $t = T_1$ to $t = T_2$ as T , where $T = T_2 - T_1 + 1$.

Assuming the abnormal returns are multivariate normal and cross-sectionally independent, we test the null hypothesis that the mean abnormal return is zero with the following statistic (Z):

$$Z = \frac{1}{\sqrt{n}} \sum_{j=1}^n \sum_{t=T_1}^{T_2} \frac{AR_{jt}}{S_{jT}} \quad (3)$$

The statistic in equation (3) has an asymptotically unit normal distribution, and n denotes sample size.

IV. Results and Implications

Firm Characteristics and Motivation for SDIK Declarations

Two of our research questions involve assessing the common characteristics of DECLARER and DECLAREE firms and determining why SDIKs are declared. Thirty of the thirty-eight DECLARER firms are investment companies and eight are industrial firms. DECLAREE firms, on the other hand, are diverse both in size and industry. The only common characteristic we could identify for DECLAREE firms is the existence of consistently positive share price performance during the months before the SDIK announcement. Our data, and anecdotal evidence as well, suggest this may be an important factor in determining why SDIKs are declared:

Standard Shares Inc. said it will pay a dividend of 1.9 shares of MCA Inc. common stock for each 100 shares of Standard Shares held. . . . A spokesman said the payout is in keeping with company policy of giving to stockholders, through dividends, stock that has appreciated markedly. (*Wall Street Journal*, August 4, 1982)

Figure 1 presents a graph of the cumulative excess returns for DECLAREE firms before and after the SDIK announcements. Beginning 250 trading days before the SDIK announcement and ending 250 trading days after

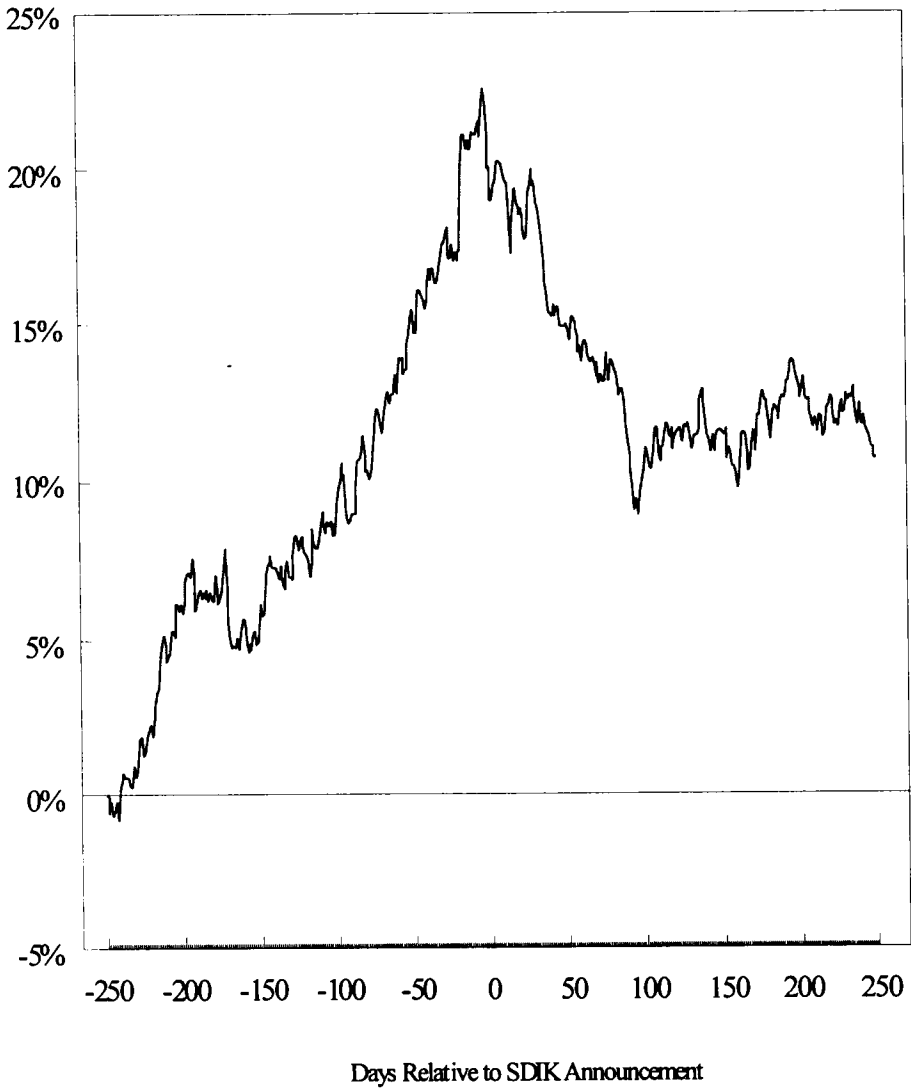


Figure I. Cumulative Excess Returns for the Sample of DECLAREE Firms Beginning 250 Days Before and Ending 250 Days After Announcements of Stock Dividends-in-Kind.

the announcement, we calculate the daily excess return (defined as the individual firm return minus the return on the CRSP value-weighted market index) for each firm. This provides 501 excess returns for each firm. These returns are used to compute an average cross-sectional excess return for each of the trading days. The average excess returns are cumulated geometrically for presentation in Figure I.

TABLE 2. Percentage Average Abnormal Returns (AR), Z-values (Z), and Cumulative Average Abnormal Returns (CAR) Around Announcements of Stock Dividends-in-Kind for the Complete Samples of DECLARER and DECLAREE Firms.

Event Day	DECLARER Firms			DECLAREE Firms		
	AR	Z	CAR	AR	Z	CAR
-10	-0.249	-1.329	-0.249	0.120	0.208	0.120
-9	0.334	0.233	0.085	0.057	0.069	0.177
-8	-0.157	-0.734	-0.072	0.256	0.565	0.433
-7	-0.092	-0.559	-0.164	-0.305	-1.063	0.128
-6	0.397	1.914*	0.233	-0.001	0.007	0.127
-5	-0.539	-2.263**	-0.306	-0.124	-0.392	0.003
-4	-0.368	-1.626	-0.674	0.775	2.564**	0.778
-3	0.000	-0.471	-0.674	0.390	1.253	1.168
-2	0.180	1.812	-0.494	-0.366	-1.550	0.802
-1,0	0.646	1.925*	0.152	-1.426	-3.398**	-0.624
1	0.337	1.258	0.489	0.582	1.697*	-0.042
2	-0.084	0.565	0.405	-0.601	-1.256	-0.643
3	-0.669	-2.972**	-0.264	-0.065	0.016	-0.708
4	-0.137	-1.001	-0.401	0.330	1.432	-0.378
5	0.175	0.877	-0.226	0.150	0.469	-0.228
6	-0.094	-0.164	-0.320	0.210	1.109	-0.018
7	0.126	0.322	-0.194	-0.114	-0.262	-0.132
8	-0.006	-0.657	-0.200	-0.027	-0.079	-0.159
9	-0.405	-2.054**	-0.605	-0.160	-0.367	-0.319
10	-0.093	-0.129	-0.698	-0.335	-1.130	-0.654

**Significant at the 5 percent level.

*Significant at the 10 percent level.

The pattern of cumulative excess returns indicates the average DECLAREE firm's price increased dramatically during the months before the SDIK announcement, then decreased significantly during the post-announcement period. In other words, the DECLARER firms appear to have distributed the DECLAREE shares when they were very near their peak values.⁴ The significant downpricing after the SDIK also suggests that market participants value the trading decisions of institutional holders highly, and therefore view SDIK announcements as negative signals of future DECLAREE firm performance. In sum, the evidence from Figure I is consistent with our prediction that SDIKs are likely to be declared when share prices reach their maximum value, thus sending a negative signal to DECLAREE holders.

⁴Because most DECLARER firms are investment companies that are likely to be well informed about the firms whose shares they hold, this accurate market timing is not surprising.

Valuation Effects and Additional Analysis—DECLARER Firms

To illustrate how SDIKs affect DECLARER share prices, we report average daily and announcement-period abnormal returns for these firms in Table 2. The announcement-period (days -1 and 0) average abnormal return of 0.646 percent ($Z = 1.925$) is significant at the .06 level.⁵ These findings indicate that DECLARER shareholders view SDIKs favorably, consistent with both the tax and signaling hypotheses presented earlier.

To explain the cross-sectional variation in announcement-period abnormal returns for DECLARER firms, we estimate the following ordinary least squares (OLS) regression model (t -statistics are in parentheses):

$$AR_{jT} = -0.00771 + 0.3644 \text{ DIV}_j, \quad (4)$$

(-1.114) (4.059)

In equation (4), AR_{jT} is the two-day abnormal return for firm j and DIV is the market value of the stock distribution scaled by the DECLARER firm's share price. The model is significant at the .001 level ($F = 16.476$) and has an adjusted R^2 of 0.333. Thus, the cross-sectional price response to SDIK announcements is a positive function of the market value of the SDIK, a result that is both intuitively and theoretically sound.

Valuation Effects and Additional Analysis—DECLAREE Firms

Table 2 also presents average daily and announcement-period abnormal returns for DECLAREE firms. DECLAREE firms experience an announcement-period (days -1 and 0) average abnormal return of -1.426 percent ($Z = -3.398$), significant at the 1 percent level. Moreover, the median announcement-period abnormal return is -1.70 percent, and 76 percent of the sample firms experience negative share price reaction during the announcement period. The strong negative average reaction is consistent with the models of Shleifer and Vishny (1986) and Pound (1988), and it suggests that the companies declaring SDIKs may have provided valuable monitoring of DECLAREE firms' management.

In addition to the negative DECLAREE price performance during the announcement period, we detect significant price changes both before and after the SDIK announcement. The average pre-period cumulative abnormal return from day -26 to day -2 is 3.67 percent ($p < 0.10$), while the average post-period cumulative abnormal return from day 1 to day 25 is -4.94 percent ($p < 0.05$). Thus, DECLAREE prices increased before the announcement, then decreased

⁵The results are not due to the influence of outliers and are robust to the use of either ordinary least squares or Scholes and Williams (1977) betas.

sharply after the announcement. These findings, along with the strong negative announcement-period response, are consistent with our contention (and the evidence from Figure 1) that DECLARER managers believed the DECLAREE share prices had peaked. Thus, the information signal sent by the SDIK announcement to DECLAREE shareholders is negative.

To determine which firm-specific factors influence price reactions to SDIKs, we investigate the cross-sectional relation between announcement-period abnormal returns and measures of management ownership concentration, information effects, and institutional ownership concentration. The relation between management ownership and abnormal returns is examined in models (1)–(3) of Table 3.⁶ Because the effect of the SDIK announcement may vary for different ranges of managerial ownership concentration (Fama and Jensen (1983)), we allow for shifts in the OLS regression slope. In models (1)–(3), MGT1, MGT2, and MGT3 are dummy variables multiplied by the DECLAREE firm's management ownership concentration before the distribution:⁷ D1 equals one if management ownership is less than 5 percent and zero otherwise; D2 equals one if management ownership is between 5 percent and 25 percent and zero otherwise; and D3 equals one if management ownership is greater than 25 percent and zero otherwise. Our sample includes seventeen firms with management ownership less than 5 percent, eighteen firms with management ownership between 5 percent and 25 percent, and nine firms with management ownership greater than 25 percent.

Models (1)–(3) show that DECLAREE share price reactions to SDIK announcements are increasingly negative as management becomes entrenched. In all models, the coefficient representing firms with management ownership greater than 25 percent (MGT3) is negative and statistically significant. The same relation holds in models (2) and (3) for firms with management ownership concentration between 5 percent and 25 percent (MGT2).⁸ The *F*-statistics of all models denote overall significance at the 1 percent level, and the adjusted *R*² values range from 0.236 to 0.415. Although such high explanatory power is uncommon in studies of this nature, our regression diagnostics do not suggest the findings are unduly influenced by outliers.

Additional analyses reveal that firms with management ownership of less than 5 percent have a mean abnormal return of 0.40 percent, and that roughly half of these firms experience share price decreases. For management ownership

⁶We also estimated the models presented in Table 3 using only one (continuous) management ownership variable. With this procedure, the coefficient estimate for management ownership concentration was negative and significant at the .001 level across all models. Coefficient signs and significance levels for the remaining variables were consistent with those of the original models.

⁷Management ownership information is extracted from proxy statement filings before the SDIK distribution.

⁸All test statistics are calculated with OLS standard errors. Using White's (1980) heteroskedasticity-consistent standard errors increases the statistical significance of all but one of the parameter estimates.

TABLE 3. Ordinary Least Squares Regressions of DECLAREE Announcement-period Abnormal Returns on a Set of Ownership Structure and Information-based Variables (*p*-values are in parentheses).

Coefficient	Model (1) (<i>n</i> = 44)	Model (2) (<i>n</i> = 44)	Model (3) (<i>n</i> = 44)
Intercept	-0.010 (0.17)	0.001 (0.96)	0.004 (0.59)
MGT1	0.548* (0.08)	0.432 (0.15)	0.208 (0.48)
MGT2	-0.081 (0.21)	-0.141** (0.04)	-0.117* (0.06)
MGT3	-0.061** (0.05)	-0.087** (0.01)	-0.090** (0.01)
FIRMSIZE	—	-0.004** (0.02)	-0.005** (0.01)
POSTPRICE	—	—	0.052** (0.02)
<i>F</i> -statistic	5.223	6.343	6.535
Adjusted <i>R</i> ²	0.236	0.348	0.415

Notes: MGT1 is management ownership for firms having management ownership less than 5 percent; MGT2 is management ownership for firms having management ownership between 5 percent and 25 percent; MGT3 is management ownership for firms having management ownership greater than 25 percent; FIRMSIZE is market value of equity (coefficient should be multiplied by 10E-3); and POSTPRICE is abnormal returns cumulated from day 1 to day 25.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

between 5 percent and 25 percent, sixteen of the eighteen firms experienced a negative price reaction. The mean abnormal return for this group is -1.80 percent, with individual values from -6.20 percent to 3.70 percent. Finally, eight of the nine firms with management ownership greater than 25 percent experienced negative price reaction. The mean abnormal return for these firms is -3.31 percent, with individual values from -6.13 percent to 0.10 percent. The abnormal returns for these three classes of firms are significantly different using a Mann-Whitney medians test ($p = 0.05$). Thus, these secondary analyses provide additional evidence that price reactions to SDIK announcements become increasingly negative as management ownership concentration increases (Fama and Jensen (1983)).

Models (2) and (3) in Table 3 expand our initial specification to control for the size, as proxied by market value of equity, of the DECLAREE firm (FIRMSIZE). Because large firms are likely to have more shareholders than small firms, FIRMSIZE may be viewed as a proxy for ownership dispersion (Demsetz and Lehn (1985)). As ownership dispersion (i.e., FIRMSIZE) increases, concentrated blocks of outside ownership become more important, and the

dissolution of these blocks may be viewed negatively. Thus, from a monitoring perspective, the coefficient for FIRMSIZE should be negative.

To the extent that less information about small firms is available to the market, however, FIRMSIZE may act as a proxy for information asymmetry. If this is the case, we would expect FIRMSIZE to have a positive coefficient, reflecting a stronger negative reaction to SDIK announcements for small firms. For this study, however, the reverse argument could be made. Specifically, most of the DECLARER observations are very small investment companies that ordinarily receive little media attention. Thus, the primary determinant of media coverage for SDIKs is the size and/or relevance of the DECLAREE firm. Where the DECLAREE firm is small as well, information about the SDIK generally is disclosed as a line-item in "Dividend News" or comparable lists. Where the DECLAREE firm is large, however, a complete news article generally conveys the SDIK information. Under these circumstances, price reactions may be expected to be more negative for large firms (i.e., a negative coefficient for FIRMSIZE) because the information is more readily available.

The evidence in Table 3 documents a significantly negative relation between abnormal returns and FIRMSIZE, and shows that the introduction of FIRMSIZE contributes greatly to the model's explanatory power. The results suggest that larger firms react more negatively to SDIK announcements, consistent with the information asymmetry argument presented above. The negative coefficient also suggests that FIRMSIZE may be a good proxy for ownership dispersion. That is, larger firms may have more dispersed owners and react more negatively to the dissolution of outside ownership blocks.

In model (3) we include a measure of potential information effects—the post-period cumulative abnormal return calculated from day 1 through day 25 (POSTPRICE).⁹ Because DECLARER shareholders receive stock rather than a cash dividend, they may choose to sell their shares, causing a short-term liquidity effect. This selling pressure would create an initial drop in the stock price, which, if no information is associated with the SDIK, would be reversed in the days following the announcement. If such a liquidity effect is present, firms with the most negative announcement-period returns should experience the greatest rebounds, and a negative relation between abnormal returns and POSTPRICE would be expected. If, however, DECLARER firms are correct that DECLAREE values have peaked, poor post-period stock price performance and a positive relation between abnormal returns and POSTPRICE would be expected. Table 3 reveals that the coefficient for POSTPRICE is positive and statistically significant. This indicates that DECLARER firms time stock dividends to coincide with peaks in DECLAREE firm values and that DECLAREE firms that experience the

⁹POSTPRICE was also calculated over days 1 to 50, days 1 to 75, and days 1 to 100. The sign of the coefficient estimate remained positive and statistical significance decreased as the window was lengthened.

TABLE 4. Selected Summary Statistics Regarding Institutional Ownership Characteristics of DECLAREE Firms.

Measure	Mean	Median
Number of institutional holders before announcement	79.64	35
Number of institutional holders after announcement	83.24	36
Number of institutions increasing their holdings after the announcement	31.36	13
Number of institutions decreasing their holdings after the announcement	35.00	18
Net change in the number of shares held by institutions	-209,020	-62,400
Proportion of institutions holding stakes larger than stake of DECLARER firm	31.42%	32.57%

Note: Data were extracted from SPECTRUM; they represent twenty-five of the forty-four DECLAREE firms.

most negative post-period performance are subject to the greatest penalties when negative signals (i.e., SDIKs) are initially sent.

Institutional Ownership Analysis—DECLAREE firms

Because institutional investors generally are regarded as sophisticated, they may provide superior monitoring of the firms whose shares they hold. Therefore, an examination of the nature of the institutional ownership of DECLAREE firms may help delineate between information effects and monitoring effects. Table 4 contains various measures of institutional ownership concentration, calculated using Spectrum III data. These data are available quarterly beginning January 1, 1979. Complete institutional ownership data for the quarter immediately preceding and the quarter immediately following the SDIK announcement are available for twenty-five of the forty-four sample firms.¹⁰

For the relatively small subsample of firms with available data, we find that the average number of institutional investors increases after the announcements from 79.6 to 83.2. This reveals that some institutional investors purchase shares after the announcement, perhaps believing the shares may be a "good buy." Although the number of institutional shareholders increases, the median number of institutions that decrease their holdings (18) exceeds the median number of institutions that increase their holdings (13). This indicates that more of the current institutional shareholders believe share prices may continue to decline. That the net change in the number of shares held by institutions as reported in Spectrum III decreases by an average of 209,020 shares also supports this contention. This summary information indicates that institutional shareholders may view DECLAREE firm prospects negatively.

¹⁰One of the twenty-five firms had a six-month window surrounding the SDIK announcement instead of a three-month window.

Table 4 also reveals that the blocks of DECLARER firms' shares being dissolved are larger than the blocks held by other institutions. In fact, on average only one-third of the institutions holding DECLAREE shares have stakes larger than the stake distributed by the dividend. Therefore, the monitoring provided by DECLARER firms before the SDIK announcement may have been substantial. To investigate the degree to which institutional monitoring influences DECLAREE share price responses, we estimate numerous models using various institutional ownership variables calculated using Spectrum III data. These variables include (but are not limited to) the measures in Table 4, the number of institutions with stakes greater than the DECLARER firms' stakes increasing (decreasing) their holdings after the announcement, the number of institutions closing (opening) their positions after the announcement, and the number of institutions with stakes larger than the DECLARER firms' stakes closing (opening) positions after the announcement. None of the proxies of institutional monitoring is significant at conventional levels. This result may be due to the limited sample size and the resulting OLS complications, or to our inability to capture the monitoring that the DECLARER firms had provided. In short, this additional evidence does not support the contention that DECLAREE firms' stock price reactions to SDIK announcements are due to the loss of important monitoring provided by DECLARER firms. Rather, it appears that SDIK announcements simply provide a negative signal to the market about the future prospects of DECLAREE firms.

V. Conclusions

In this study we investigate a unique type of stock dividend that is payable in the common shares of firms different from the issuing firm. We find that these dividends typically are declared by investment companies. The shares that are distributed exhibit significant price increases during the months before the dividend declaration, with prices decreasing after the distribution. This suggests SDIKs are declared when DECLARER firms believe the shares have reached their maximum value. The average price response for DECLARER firms is positive, consistent with both the signaling arguments and the pre-1987 preferential tax treatment of SDIKs.

We document a significantly negative average announcement-period price response for DECLAREE firms. Our tests suggest that the valuation effect of the SDIK depends upon the pre-dividend level of management ownership. Firms with low levels of management ownership concentration experience little change in firm value when managerial strength is enhanced through SDIK announcements. However, as management power and/or ownership dispersion increases, the price response becomes increasingly negative. The decreasing DECLAREE share price performance following SDIK announcements suggests share values had peaked.

Furthermore, firms with the most negative announcement-period reactions also have the worst post-period performance, indicating SDIKs send a negative signal about DECLAREE firm value.

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