HELSINGIN KAUPPAKORKEAKOULU
Laskentatoimen laitos

A SURVEY OF MANAGEMENT VIEWS ON DIVIDEND POLICY

Pro gradu-tutkielma
Jussi Korvenoja
Syyslukukausi 1999

Laskentatoimen laitoksen

laitosneuvoston kokouksessa 2 / 9 1999 hyväksytty

arvosanalla magna cum laude approbatur

KTT Teppo Martikainen KTT Jari Käppi

ABSRTRACT

The purpose of this thesis was to examine the dividend policy views of corporate managers of listed Finnish companies. The managers were asked to fill up a questionnaire containing questions about three topics: (1) the relationship between dividend policy and value, (2) explanations of dividend relevance including the bird-in-the-hand, signalling, tax-induced clientele/clientele effect and agency explanations and (3) how firms determine the amount of dividends to pay. These were topics were covered by 29 theoretical and empirical statements.

The second purpose of the thesis was to find out the factors that managers consider most important in determining their firm's cash dividend policy as well as to find out which companies use target payout ratio and what is the average target payout for Finnish companies. Also one goal was to compare the results with the results of earlier studies abroad.

The second chapter reviews the various messages being transmitted by the academic literature on dividends. First, the irrelevancy of dividends is being discussed. Next possible reasons for paying and not paying dividends are under consideration. Finally, behavioural models and especially Lintner's classic partial adjustment study are covered.

The survey design is provided on chapter three. The final sample consisted of 54 companies which were listed on the main list in Helsinki Stock Exchange. The response rate was satisfactory nearly 60 %. This chapter also contains detailed clarification of gathering the data as well as possible limitations of the study.

The fourth chapter reveals the results of the study. First, the demographic characteristics of the respondents and the use of target payouts in Finnish companies are presented. Next the issues involving dividend policy and the explanations of dividend relevance are shown. The descriptive statistics showing the importance level of each of 22 factors are presented after presenting how the firms set the amount of dividends that they pay. Finally, the sample is split into four groups using two different criteria. Then the opinions of these groups are compared to see if there are statistically significant differences between these groups.

The last chapter contains concluding remarks. About one half of the companies use target payout ratio and the average ratio is 40 %. Most of the respondents believed that dividend policy affects firm value which has been acknowledged by several foreign studies. The respondents generally had the highest level of agreement with statements involving signalling and they also believed that investors preference for dividends changes during investors' life-cycle. For other issues e.g. Bird-in-the-hand, agency and tax-preference explanations the respondents' opinions were uncertain. When the opinions of four groups were compared only few statements differed significantly.

The results show that the most important determinants of a firm's dividend policy were the level of current and past earnings. Also continuity of past dividends and expected future earnings were highly ranked.

KEYWORDS: target payout ratio, dividend, questionnaire, dividend survey, Bird-in-the-Hand, Agency Theory, clientele effect, and signalling.

CONTENTS

TABLES AND FIGURES

1. Introduction

There have been a long lasting debate of dividends for over four decades. Especially the effect of dividend policy on a corporations market value is a subject of long-standing controversy. Still the question of the optimal dividend policy if there is any remains unanswered. Many financial economists have set up theoretical models of corporate dividend behaviour. However, none of these models has well been able to explain observed behaviour.

The empirical evidence of these studies have been more or less in conflict with one to another. Some researchers find that dividends which are defined as the distribution of corporate earnings to the shareholders of the firm in proportion to their ownership, and more specifically, increases in dividends have a positive effect on shareholder's wealth. On the other hand, several studies argue that with introduction of taxes and transaction costs, the most desirable policy is to pay zero dividends. There are also theories which state that two arbitrarily chosen dividend policies have equivalent consequences, both in the absence of taxes and in their presence and, therefore, making the dividends irrelevant. As a result our understanding of why corporations pay dividends is currently unsatisfactory.

1.1 The motivation of the study

In Finland there are not many published papers dealing with the divided dilemma. Because the theory seems not be able to give us unambiguous solution to the dividend problem it is interesting to see how the management of Finnish corporations are viewing their dividend policy decisions. In Finland the total cash dividends to shareholders paid by listed companies have varied in recent years. During the final stages of last economic boom in 1989 companies paid close to 4 billion marks in dividends (Kauppalehti, 12.3.1999). During the recession the development of dividends were fairly moderate but after mid 1990's the cash dividends have grown steadily. In 1997 over 6,2 billion marks were paid in dividends and a year later 11,1 billion marks were distributed to shareholders in dividends (Kauppalehti, 12.3.1999). Almost 16 billion marks are

expected to be paid from last years profits in dividends in 1999 (Kauppalehti, 12.3.1999). The growth in dividend numbers is not only due to increased profitability and a trend to pay out more to shareholders but also because the number of publicly listed companies has risen. The expanding amounts of money involved in cash dividends should arise shareholders awareness of the possible consequences of different dividend policies.

1.2 The purpose of the study

The first objective in this paper is to examine the dividend policy views of corporate managers of listed Finnish companies. The managers are asked to fill up a questionnaire containing questions about three topics: (1) the relationship between dividend policy and value, (2) explanations of dividend relevance including the bird-in-the-hand, signalling, tax-preference, and agency explanations, and (3) how firms determine the amount of dividends to pay. To be more accurate, I ask managers to define the level of their agreement on 29 theoretical and empirical issues about dividend policy. Reviewing these issues is important to determine to what extent corporate managers agree with the various messages being transmitted by the academic literature on dividends.

The second purpose of this thesis is to provide insight into the dividend decision making in Finnish listed companies. I want let managers reveal their critical decision variables what they consider most important factors in determining their firm's cash dividend policy. To be more specific, I ask managers to value 22 different factors that can be expected to have important influence on firm's dividend policy.

To help understand the large variety of dividend policies that exist I will focus on different theoretical issues. However, the object is not to find out whether there is a optimal dividend policy which maximises shareholders wealth rather to contribute theoretical background to the different aspects that managers might take into account while making their firm's dividend decisions.

Due to the fact that this study is very closely related to one study from British markets by Allen (1992) and four other studies conducted in United States[1] the third objective is to compare the determinants and the views of divided policy today in Finland with the results of earlier studies abroad. This gives an excellent opportunity to see whether there are any cultural differences in the divided phenomenon from one country to another as Frankfurter (1992) claims.

1.3 Terminology

Through out this paper I will be using words shareholder and stockholder interchangeably. Also, a term maximising shareholder's wealth will be used. Maximising principle states that corporate managers should maximise the market value of the firm (the price of the stock) in order to maximise shareholder's wealth.

1.4 The structure of the study

The rest of the thesis is organised as follows. In the succeeding section I will discuss several theoretical views whether firms should pay dividends or not and how firms determine the amount of dividends that they pay. In the section 3 the research design of the study is supplied. The results of the questionnaire and comparison with related studies are presented in section 4. The final section offers the concluding remarks and suggestions for further study.

[1] J. Lintner (1965), K. Baker, E. Farelly and B. Edelman (1985), K. Baker and G. Powell (1998,1999)

2. Dividend Policy: Theory

2.1 Dividend neutrality

As mentioned in introduction dividends have puzzled scientists for nearly four decades. Miller and Modigliani (1961) were one of the first to deal with the problem in the finance literature. In their paper they created an ideal economy to examine the effects of differences in dividend policy on the current price of shares. The ideal economy was characterised by perfect capital markets, rational behaviour and perfect certainty.

Next, I will list the precise meaning of these assumptions in accordance with Miller and Modigliani (1961):

- In perfect capital markets, no buyer or seller of securities is large enough to affect the market price of a security.
- All traders have equal and costless access to information available.
- There are no brokerage fees or other transaction costs when securities are sold, bought or issued.
- Also, the taxes are excluded in the perfect capital markets.

Rational behaviour means that investors always prefer more wealth to less and are indifferent as to whether the gain increment to their wealth takes the form of cash payments or an increase in the market value of their holdings of shares.

Perfect certainty implies that the future investment program and the future profits of every corporation are known by every investor. With the help of these assumptions Miller and Modigliani (1961) were able to draw following conclusions in the following part.

2.1.1 Irrelevancy of dividends

In the ideal world Miller and Modigliani (1961) were able to conclude that the current value of the firm is independent of its current dividend decision. What is gained by stockholders in increased dividends is offset exactly by the terminal value of their stock. The firm can choose any dividend policy without affecting the stream of cash flows received by shareholders. It could determine to pay dividends in excess of cash flows from operations and still be able to undertake any planned investment. The extra funds needed are supplied by issuing new equity. On the other hand, it could elect to pay dividends less than the amount of cash left over from the operations after making the investments. The excess cash would be used to repurchase shares. This form of reasoning helps to understand Miller and Modigliani's proposition that value of the firm is unaffected by the company's dividend policy. In addition to this they showed that the value must also be unaffected by any future dividend decisions as well which is discussed next.

2.1.2 Irrelevancy of dividends under uncertainty

Miller and Modigliani (1961) took a further step from the ideal world of certainty to one of uncertainty where the total returns, investments or dividends can no longer be treated as known figures. Instead investors must regard them as random variables. The best estimate for total return is only the probability distribution of possible returns. Despite the uncertainty about these elements they showed that dividend irrelevance conclusion need not be modified.

They proved it with the assistance of two hypothetical firms which are believed by current investors to have identical future streams of total earnings and total investments. The same is assumed to hold for total future dividend payments as well. The current dividend payout is the only possible way the firms differ from one to another. According to Miller and Modigliani (1961) the terminal values of the firms under symmetric market rationality can depend only on prospective future earnings, investments and

dividends which are assumed to be identical. Thus, the end-of-period values of the two firms must be the same.

Shown that differences in current dividend do not affect current value must the beginning-of-period values of the companies be equal. Reaching a point where current and future values between the firms are identical follows it logically that the current valuation is unaffected by differences in dividend payments in any future period and thus that dividend policy is irrelevant for the determination of market prices under uncertainty as well. The value of the firm depends only on the distribution of future cash flows provided by investment decisions which are completely independent of dividend policy as Miller and Modigliani (1961) stress.

The irrelevance position solely argues that a change in dividend policy, given investment policy, alters only the timing of the future dividends not their present value or the total returns to shareholders. The postponement of dividends is a matter of indifference to a rational investor who prefers capital gains as much as dividends.

2.1.3 Supporting evidence

Modigliani and Miller's pathfinding paper appears to be supported by some empirical studies. Black and Scholes (1974) applied a methodology which allowed them to test whether expected returns on high yield common stocks differ from expected return on low yield common stocks either before or after taxes. They argue that to test the effects of dividend yield on stock returns is the best method for testing the effects of dividend policy on stock prices.

They constructed 25 portfolios with different divided yields and by investigating these portfolios they were able to conclude that "investor has little to go on in deciding how to take yield into account in making his investment decisions. He doesn't know whether high yield stocks have higher or lower expected returns than low yield stocks with the same risk." They also demonstrated that dividend yield results carry over to payout ratios as well. Because it was impossible to show that different dividend yields lead to

differences in stock prices, follows that it is impossible to show that a change in dividend policy has any definite, long-term effect on stock prices.

Black and Scholes (1974) made their conclusions based on returns without taking into account any taxes that the investor might pay on dividends or realised capital gains. This suggests that the results have a direct connection to tax-exempt investors only. A tax-exempt investor may not gain significantly by emphasising high yield stocks over low yield stocks, other things being equal. Moreover, they showed that any investor who is trying to maximise the expected after-tax return for given level of risk may ignore dividends and concentrate instead on improving his portfolio diversification. It is much more likely that he can reduce his risk by improving his diversification than that he can increase his expected return by emphasising stocks with a given level of dividend yield.

An alternative method for testing the relationship between dividend policy and the capitalised value of the firm was developed by Jose and Stevens (1989). They investigated how equilibrium dividend policy characteristics, along with their time-series properties affect a firm's Tobin q ratio[2] in the long run. They criticise the empirical tests which apply short run measures and dividend yield for ignoring basic dividend policy characteristics such as the firm's average long run payout ratio, payout ratio trend, stability of dividends and the stability of the payout ratio. The long run equilibrium used to measure q avoids short term event measurement problems and potential disequilibrium adjustments that may have affected the results of previous studies Jose and Stevens (1989) continue. The Tobin's q ratio exceeds one in equilibrium if management of a firm's assets and liabilities attracts market premium. By using capital market valuation of a firm's rents, q implicitly incorporates systematic risk and captures potential preferences of investors for the dividend policy of the firm without specifying a valuation model. Tax laws, accounting methods, and potential deviations of nominal and real values are assumed to be discounted appropriately in an efficient market and captured by q.

[2] A firm's Tobin q ratio is defined as the market value divided by replacement value of firms assets which measures capitalised excess value achieved by the management of the firm's assets.

The time series regressions for the payout ratio, dividends per share, and yield of each 362 firms were executed to estimate the respective trend and stability measures. The findings suggested that market valuation premiums are associated with stable and positive dividend per share trends, regardless of the payout ratio level. This in turn supports the classic irrelevance of dividend policy hypothesis that the levels and trends of payout ratios are not associated with market value premiums.(Jose and Stevens, 1989)

2.2 Against dividends

In their 1961 article Miller and Modigliani developed a world which is definitely not comparable with the situations in the real world. If attention is turned to the real world situations, empirical evidence is found that market imperfections and inefficiencies make the dividend policy to matter to corporate managers.

2.2.1 Dividends and taxes

Taxes represent substantial market imperfections and there are considerable differences between tax laws in distinct countries. In U.S. where most of the dividend research has been conducted, the taxation regarding dividends and capital gains has fluctuated extensively in past. Before the Tax Reform Act of 1986 there was a dramatic difference between the taxation of dividends and capital gains. At that time the net income of the large, publicly held corporations were subject to progressive tax rates that rather quickly reached 46 % Without minor exceptions investors that received any dividends paid by corporation from its current or accumulated past after-tax profits, were also taxed at progressive rates under the personal income tax laws. In 1986 the maximum income rates peaked at 50 % but the rates had been as high as 92 % during and immediately after the World War II according to Miller (1986).

An individual investor avoided personal income taxes if a corporation did not pay dividends, but retained the after-tax earnings in the firm. The retained earnings increase

the value of the shares because no dividends are paid which follows that there is no drop in value at the ex-dividend day. On the presumption that the share sold at a price greater than its original price, the accrued capital gains were subject to capital gain tax. The rates applied to realised capital gains were never higher than those on ordinary income. Typically maximum rates on capital gains were for much of the post war era around 25 %, so the maximum spread between the top rate on ordinary income and on capital gains could have been as much as 67 percentage points says Miller (1986). Taken together, the era before tax reform placed a substantial penalty on dividends as opposed to retained earnings/capital gains.

The Tax Reform Act of 1986 equalised the explicit tax rates of two types of income. However, this state was only a transitory period because this gap started to open up again due to changes in the U.S. tax code in 1990 and in 1993. In the middle of 1990's the tax rate on capital gains for most shareholders was 28 %, whereas dividends were taxed at ordinary income rates which varied from 31 % for investors earning above $55,100 up to 39,6 %. (Brealey and Myers, 1996 p. 432)

Later the Taxpayer Relief Act of 1997 created several different tax rates that depend on holding period and taxpayer's marginal tax rate. The maximum tax rate on capital gains was further reduced from 28 % to 20 % for individuals in the top tax rate bracket and, for certain lower income taxpayers, from 15 % to 10 %. As under prior law, net short term capital gains[3] remained taxable at ordinary income tax rates (15 % to 39,6 %). Capital gains from the sale of assets held more than a year but not more than 18 months are taxed at a maximum rate of 28%. And, finally long-term gains are taxed at a maximum rate of 20 % with the exception that if they were taxed as ordinary income subject to tax at a 15 % rate, the rate applied to capital gains would be 10 %. (http://www.henderco.com/cgains.html)

It has been argued by several authors that capital gains contain a valuable timing option when a firm retains earnings as opposed to paying dividends. A stockholder may defer the capital gains tax until the actual sale of stock. For an extreme cases when appreciated securities are given as gifts to charitable causes or if the person dies, the

capital gains tax may be avoided altogether. In these cases the effective present value of capital gains taxes is zero.

The above proposition is attacked by Miller and Scholes (1978) who argue it is possible for investors to construct comparable shield against paying taxes on dividends. Their reasoning was that a stockholder borrows a sufficient amount of funds to produce one dollar of interest expense for each dollar of dividend income. The amount borrowed is invested in a single payment annuity or some other type of tax favoured investment. The interest expense is offset against dividend income, so the investor pays no immediate tax. The capital gain on the investment of the borrowed funds is sheltered. If this gain is postponed until the time of death, no capital gains tax would be paid. This would lead towards the neutrality of dividends.

However, this genius idea by Miller and Scholes (1978) has been critized by difficulties to carry it out. At that time as Feenberg (1981) points out there were regulations that limit to what extend interests are deductible and the special circumstances under which this could occur applied to recipients of about 2,5 % of dividend income. Furthermore, performing such actions would include transaction costs which make it even more questionable.

2.2.2 Tax induced clienteles

The concept of tax induced clienteles lies on assumption that an individual investor tries to maximise multi-period utility and faces a problem of allocating resources over time and between different securities. With such market imperfections as transaction costs and taxes, the investor will select the optimal level of consumption and the optimal investment portfolio in view of the influence of these factors on net returns and the level of wealth. The higher an individual's tax bracket, the more likely he or she is to want the firm to invest cash flows internally instead of paying dividends. The low tax bracket shareholders have a higher opportunity cost for internally generated funds which raises

[3] Short term capital gains consists of profits from the sale or exchange of a capital asset held for one year or less.

the cost of deferring dividends. Thus, they want to receive dividends and not spend all capital on real investments. (Copeland and Weston, 1988 p. 563)

Elton and Gruber (1970) attempted to measure potential tax induced clientele effect by observing the average price decline when the stock goes ex-dividend. They argued that in a rational market the fall in price on the ex-dividend day should reflect the value of dividends vis-à-vis capital gains to the marginal shareholder. The evidence found suggests that on ex-dividend days stock prices fall by an amount smaller than the dividend per share which is consistent with the view that investors value dividends less than capital gains because of the differential taxation of dividends and capital gains. Furthermore, they found that the price change relative to the dividend per share was positively correlated with the dividend yield, which could be expected if investors in high tax brackets hold low dividend yield stocks and vice versa. This is confirming evidence for tax-induced clientele effect in accordance with Elton and Gruber (1970).

However, Kalay (1982) has argued that it is not possible to infer investor clientele tax rates from the size of average price decline when the stock goes ex-dividend. This is because the average price decline would be bounded by transaction costs, not marginal tax rates.

As Elton and Gruber (1970) note there is a reason to believe that shareholders with different personal tax rates will not unanimously agree on the firm's investment and dividend decisions. This lack of unanimity can be diminished somewhat if investors self-select into tax induced clienteles with low tax bracket individuals purchasing shares of high-dividend firms and vice versa. However, as Pettit (1977) points out these tendencies may be more than offset once transactions costs of buying and selling securities to meet time preferences are introduced. An individual with higher marginal tax rate on dividends may still choose a portfolio with high dividend paying characteristics if desires for current consumption weigh heavily in the decision process and if transactions costs make portfolio liquidation an expensive medium for securing the desired level of consumption.

The purpose of Pettit's (1977) article was to provide the first direct evidence on the relative demand for dividend paying securities by individual investor induced by the transactions costs incurred in allocating resources over time and the differences in the rates at which capital gains and dividends are taxed. Variables measuring the individual's time preferences, tax rate structure and portfolio risk were used to explain the cross sectional variability of investors' portfolio dividend yields. Pettit included in his study 914 responses covering respondents demographic attributes, methods of making investment decisions as well their expectations for returns from investments in securities. From these responses he selected variables to represent the explanatory variables in the equation to be estimated. The data also included portfolio position for each individual.

The model he created assumes that investors plan their portfolio decisions based on tax rate differences on dividends and capital gains and the time preferences in the face of transaction costs. The evidence suggests that there is a significant tax induced dividend clientele effect because a significant portion of observed cross-sectional variation in individual portfolio dividend yields can be explained. However, Pettit (1977) notes that the identified relationship in no means suggests that the market price of a security is determined by the dividend policy followed by the firm. In fact, no one firm is able to benefit by a shift in its dividend policy. This is in line with Miller and Modigliani (1961) who suggested following: "If, for example, the frequency distribution of corporate payout ratios happened to correspond exactly with the distribution of investor preferences for payout ratios, then the existence of these preferences would clearly lead ultimately to a situation whose implications were different in no fundamental respect from the perfect market case. Each corporation would tend to attract to itself a `clientele´ consisting of those preferring its particular payout ratio, but one clientele would be entirely as good as another in terms of the valuation it would imply for the firm."

Litzenberger and Ramaswamy (1979) studied the effect of personal taxes and dividends on capital asset prices. The model that they use is an extension of the single period Capital Asset Pricing Model (CAPM) that was derived by Brennan (1973) under the assumptions of unlimited borrowing and lending at the risk free rate of interest and

unrestricted short sales. Their model accounts for a progressive tax scheme and both wealth and income related constraints on borrowing. The latter constraint serves to limit the interest deductions individuals can utilise to the amount of dividend income their portfolios generate. Those individuals whom this constraint is binding would find increased dividends desirable in that such increases serve to effectively relax the constraint.

The equilibrium relationship indicates that the before tax expected return on a security is linearly related to its systematic risk and to its dividend yield. Moreover, the results imply that there is a strong positive relationship between before tax expected returns and dividend yields of common stocks which means that investors require additional before tax return and investors' tax brackets do influence their portfolio choices. They also find evidence consistent with existence of a clientele effect.

A year later Litzerberger and Ramaswamy (1980) re-examined the effects of tax-induced investor clienteles on capital asset prices. They extended a model of asset prices in the presence of short selling restrictions together with simplified taxation scheme with individuals in diverse but constant marginal tax brackets. The implication of the model is that the differences in the tax brackets in the presence of short selling restrictions would induce dividend clienteles with he tendency of low tax bracket individuals to hold high yielding stocks as originally argued by Elton and Gruber (1970). In line with their earlier paper the results seem to support the existence of the tax clientele CAPM.

They also accounted the effect of non-paying stocks by fitting a dummy variable in the econometric model. This procedure was accomplished to see whether the required return on non-paying stocks is higher than would be predicted by the tax clientele CAPM. In a capital market where short selling is restricted, non-dividend paying stocks would have to pay a premium to attract investors to absorb the stock, which strengthens Litzerberger and Ramaswamy's belief that taxes divide investors into clienteles.

Blume (1980) also investigated stock returns and dividend yields. He presents evidence which suggests that the relationship between returns realised on common stock and

dividend yield is substantially more complicated than implied in prior work of Friend and Puckett (1964) or Black and Scholes (1974). Blume uses an alternative measure of dividend yield which is the ratio of dividends paid over the previous twelve months to the price at the beginning of these twelve months. He argues that the yield he uses has greater forecasting accuracy than the Black-Scholes measure if companies tended to adjust dividend levels quickly to maintain a fixed payout ratio and the price-earnings ratio is relatively sticky. Black and Scholes took as their yield measure the realised dividend yield of portfolios selected by ranking securities by the sum of dividends per share paid during the previous year divided by price per share at the end of the year.

Blume estimated the cross-sectional regressions with quarterly returns for time period from 1936 to 1976. The estimates reveal a positive and significant relationship between the quarterly realised rates of return and both the beta coefficients and the anticipated quarterly dividend yields. Blume was the first to suggest that there might be a non-linear relationship between dividend paying and non-dividend paying stocks. He also searched for possible explanations and concluded that "Tax effect, at least by themselves, would seem unable to explain the finding that over the thirty years beginning in 1947 and end in 1976, the quarterly returns on non-paying stocks exceeded, on average, the returns on low-yielding stocks. A tax system in which dividends are taxed in aggregate at a greater rate than capital gains would imply that expected before-tax returns should increase smoothly with increases in dividend yields, not first decrease and then increase." Rather he believed that market participants often underestimated over this period the subsequent growth of dividends for high-yielding stocks relative to low-yielding stocks.

A re-examination of whether shareholders with higher dividend yields receive higher risk-adjusted rates of return to compensate for the heavier taxes on dividend payments than long-term capital gains was presented by Miller and Scholes (1982). The message of their paper was that any yield-related effects associated with short-term measures must arise from sources other than the long-run tax differential. Therefore, they strongly critique the results obtained from studies using such measures.[4]

[4] Studies which apply short-run (ex-dividend day) measures of dividend yield: Long 1978; Litzenberger and Ramaswamy 1979,1980; Blume 1980; Hess 1982;

Miller and Scholes (1982) used various short-run measures of dividend yield to test yield-related tax effects. The perfect-foresight definition of dividend yield returned estimated coefficients that were in the plausible range for a tax effect and appeared to be estimated with great precision. Next, they tested level-revised dividend yield variable which eliminated information bias by exploiting the declaration date of dividends. Compared to perfect-foresight the estimated tax effect coefficient dropped substantially but remained highly significant and still within the plausible range for a tax effect. After that they lagged firms' dividend yields for 12 and 36 months. For the former no significant coefficient emerged whereas the latter received highly significant positive coefficient.

This made them to conclude that the relation between returns and dividend yields is sensitive to the definition of dividend yield. They argue that the differences in estimated yield effects appear to reflect differences in the degree to which the various short-run measures of expected dividend yield introduce unwanted information effects. Finally, they applied a method for correcting those measures for their information effects and found no significant remaining relation between returns and expected dividend yields or at least nothing that could be considered a yield-related tax effect. (Miller and Scholes, 1982)

A study from Poterba and Summers (1984) suggests that taxes are important determinants of security market equilibrium and deepen the puzzle of why firms pay dividends. Their paper uses British data to examine the effects of dividend taxes on investors' relative valuation of dividends and capital gains. British data as well as U.S. data offer great potential to study the relationship between dividends and stock price movements because there have been radical changes in terms of dividend tax policy during last four decades.[5]

Poterba and Summers (1984) used daily data on a small sample of firms and monthly data on a much broader sample to inspect if taxes affect the valuation of dividends. The small sample consisted of the share prices and dividends of 16 large UK firms. For each firm in the sample they included all ex-dates between 1955 and 1981 corresponding to

[5] See Poterba and Summers (1984) study for evolution of the British tax system.

cash dividend payments which were taxable as ordinary income and not accompanied by any dividend rights, stock options or other special features. Their broader data set contained monthly observations on prices, dividend payments and market indices for 3.500 UK firms during the same time period.

Using both daily and monthly data on British securities Poterba and Summers (1984) document that changes in dividend taxation have a substantial effect on the premium which investors require to induce them to receive returns in the form of dividends. However, they point out that while daily share price movements are likely to yield the most precise evidence on dividend valuation, they may be contaminated by tax arbitrage or other unusual patterns around ex-days. But still the finding that dividend taxes are recognised by investors and affect the ex ante returns which they demand only deepens the puzzle of why firms pay dividends conclude Poterba and Summers.

In late 1980's a dividend imputation tax credit scheme was introduced in Australia. This allowed Clarke (1992) to analyse the ex-dividend day behaviour of Australian share prices before and after the imputation. Clarke's study extends a work of Brown and Walter (1986) who were sceptical of concluding that the evidence they found of dividends being discounted by the Australian equities market was solely tax driven. With the introduction of dividend imputation Clarke argues that if the pricing of Australian equities is dominated by the actions and preferences of Australian resident investors then an increase in the observed average drop-off ratio across equities would be expected as proposed by the tax clientele hypothesis.

Data for the period 1973-1984 were obtained form the data file used by Brown and Walter in their 1986 paper and the complimentary data for the period 1985-1988 including ex-dividend dates, dividend amounts and percentage of franking were collected from number of publications provided by the Melbourne Stock Exchange and the Stock Exchange Research Pty. Ltd.

The results of the tests indicate that time period before tax imputation reflected a market wide preference for capital gains over dividends. After introducing the imputation system there have been changes in the average drop-off ratio. However, the results

obtained suggest that the drop-off ratios decreased on average which was contrary to expected changes arising from the new tax regimes for dividends and capital gains. Clarke's inference from this is that the results are in conflict with tax-induced clientele effect.

2.2.3 Taxes in Finland

In the U.S. shareholders' returns are taxed twice. First, companies pay corporate taxes for their earnings and then earnings are further taxed in the hands of shareholders who pay either income or capital gains taxes. The applied system is called two tiers of tax and is relatively rare according to Brealy and Myers (1996, p. 435). Companies in Finland operate under very different tax system.

In Finland dividends are not taxed twice. All companies pay corporate taxes at equal rate of 28 %. If companies distribute any dividends the shareholders are taxed for divided income but they may deduct from this tax bill their share of the corporate tax that the company has paid. Because the dividend income is taxed at fixed rate of 28 %, the corporate taxes exactly offset the dividend income taxes. For example:

> A company earns pre-tax profits of 10 euros per share. Then the company pays corporate tax at 28 %, the profit is 7,20 euros per share. The company now declares a net dividend of 7,20 euros and sends each shareholder a check for this amount. This dividend is accompanied by a tax credit saying that the company has already paid 2,80 euros of tax on the shareholders behalf. Thus shareholders are treated as if each received a total, or gross, dividend of 7,20 euros + 2,80 euros and paid tax of 2,80 euros. If the shareholder's tax rate is 28% , like it is in Finland, there is no more tax to pay and the shareholder retains the net dividend of 7,20 euros.

Compared to US the capital gains are taxed similar way in Finland. Companies pay every year corporate tax on their profits. If the after tax profits are retained in the

company, a shareholder can realise the return by selling off his stocks. The shareholder pays tax at rate of 28 % if the selling price is higher than the price when the stocks were acquired. In Finland as well as in US capital gains are taxed twice; first at corporate level and then at personal level when the stocks are actually sold. Due to the tax imputation system applied on dividends the Finnish tax system favours dividend payments. Considering this fact more Finnish companies should be seen distributing earnings in dividends if they take the tax position of their shareholders into account. However, as I have demonstrated not very convincing evidence of tax effect has been found from US markets despite shifts in tax policy. Thus, I would expect taxes to have moderate effect on Finnish corporate managers when deciding corporate dividend policy.

2.3 To pay dividends

Indeed, dividends are universally paid and, therefore, they must be somehow desirable. There are four popular theories that attempt to explain investors demand for dividends.

2.3.1 The Bird-in-the-Hand explanation

One argument in favour of existence of relationship between firm value and dividend payout is that dividends are less risky and, hence, more valuable to investors than retained earnings. Thus, firm should set a high dividend payout ratio and offer a high dividend yield to maximise stock price. In these "bird-in-the-hand-models" investors prefer dividends because cash in hand is better than promise of future capital appreciation. These models also assume symmetric information between insiders and outsiders of the company as well the existence of perfect markets.

The first models were introduced by Gordon and Shapiro (1956), Gordon (1963) and Walter (1963). All these models contain two different rates of return to evaluate future income. One is an opportunity rate for investor and the other is for the firm. Higher opportunity rate for investor implies that a firm should pay all of its cash flow as

dividends because investor is able to receive better return for his capital elsewhere. If the opportunity rates were reversed, would the firm adopt a zero percent dividend payout rate. Investor is indifferent when the opportunity rates are equal as far as the dividend policy is concerned.

Bird-in-the-hand models are critized for having a few logical problems. Frankfurter (1992) argues that the models are unable to explain different dividend policies that exist. He also continues that, if the opportunity rate for the investor is higher than for the firm why should investor just insist receiving all earnings in dividends rather he should sell all his stocks and invest money some where else where the better rate of return is earned. Third, either 100% or 0% payout, or indifference, does not well satisfy the definition of dividend policy. Finally, Bhattacharya (1979) also argued that the reasoning underlying the bird-in-the-hand explanation for dividend relevance is fallacious. The riskiness of the cash flows from firm's investments is the factor which determines the risk of the firm. An increase in dividend payout today will be followed by an equivalent drop in the ex-dividend price of the stock. It will not increase the value of the firm by reducing the riskiness of future cash flows.

2.3.2 The clientele effect

The idea that on the market there could be several different investor classes, clienteles which prefer dividends differently was recognised by Modigliani and Miller (1961). Their argumentation was based on the assumption that market imperfections divide investors into clienteles who desire systematically dividends and ones who do not.

The natural clientele for high-payout stocks is found among a part of small investors who place a special value on the steady earnings that "income stocks" provide. As John and Williams (1985) among others, describe the persons that are most often categorised to belong to this group of investors are orphans, widows or retired persons who seek a steady source of cash to live on. Moreover, trusts and non-profit organisations may prefer high payouts and high dividend yields because dividends can be used to finance consumption, where as capital gains are additions to principal which cannot be spent.

The institutional constraint position is expressed in detail by Graham and Dodd (1951) and Gordon and Bradford (1979) and is supported by Long's (1978) examination of the returns on the dual series common stock of one firm.

Contrary to high dividend paying stocks there is a clientele for so called growth, low dividend paying companies as well. Modigliani and Miller (1961) call these investors young accumulators who prefer companies that pay lower dividends, reinvest more of their earnings and provide a greater percentage of their total returns in the form of capital gains.

It is true that in some cases legal restrictions may prevent institutions from selling its shares but for the part of a sizeable number of investors such limitations do not apply. All these investors are able to manufacture home-made dividends by selling a small part of their securities and, therefore, individual is indifferent between cash dividend and selling a part of his portfolio. For example, consider that the company retains all its cash flows and pays zero dividend. The value of the company on the ex-dividend day is exactly the same as before. If some investors require more dividends they could time to time sell off a small fraction of their holdings to manufacture home-made dividends. In that case every investor is able receive as much dividends as they desire and the preference for certain type of dividend paying firm becomes irrational. There are several constraints like transaction costs and taxes which make it questionable if self-made dividends work in the real world.

Shefrin and Statman (1984) tried to explain dividend clientele effect with a framework based on self control theory. Self control theory suggests that an investor who wishes to secure long-run wealth against excess current consumption might employ a rule that prohibits spending from capital. Such an individual may be better off by allowing current consumption to be determined by the dividend payout from his stock portfolio. In self control framework dividends and sale of stock for income cannot be treated as perfect substitutes because allowing oneself the discretion of selling stock for current consumption may cause the portfolio to be consumed more quickly than is consistent with one's long-term goals. The theory also suggest that the proportion of the portfolio

devoted to dividend paying stock will increase when investor moves from the saving stage of the life cycle to the dissaving stage.

Shefrin and Statman (1984) advance another plausible reason why investors display distinct preference for cash dividends. They argue that consumption from dividends may be preferred to consumption from capital for people who are averse to regret. They continue that some stockholders are reluctant to sell shares (manufacture home-made dividends) because of the change of having to sell the shares at temporarily depressed prices. On the other hand, the firm faces eventually the same sort of problem if it has to visit the capital market to finance the dividends by issuing shares but a counter argument is that the firm can choose the most appropriate time to sell.

According to Shefrin and Statman (1984) self control theory and a wish to avoid regret can explain why investors divide into clienteles who prefer high yield stocks and ones who desire low dividend yield stocks. To test these hypothesis they use an empirical study of Lease, Lewellen and Schlarbaum (1976) which analyses the demographic characteristics and portfolio compositions of a wide variety of individual investors. As they assumed the percentage of portfolio in income securities rises as people get older. The two groups of young investors devote 27 % and 34 % of their portfolios to income stocks. For older working men , the proportion of the portfolio devoted to dividend income rises to 39 %. Finally, the retired groups invest 56 % and 57 % of their stock in income generating securities and, they also value the importance of steady dividend income very high. These findings are consistent with self-control theory which explains why people in the saving stage of life cycle hold portfolios with lower dividend yields than those held by people in the dissaving stage of the life cycle. The relatively high percentage of young investors investing in income securities is explained by the interaction of self-control theory and regret aversion according to Shefrin and Statman (1984).

The clientele effect is a possible explanation for management reluctance to alter established payout ratios because such changes in dividend policy might cause current marginal shareholder to switch companies, which would involve brokerage costs, and, possibly, capital gains taxes (Soter, Brigham and Evanson, 1996).

2.3.3 The agency cost theory

The agency cost theory is another popular view of dividend relevance, which was advanced by Jensen and Meckling (1976), and further extended by Rozeff (1982) and Easterbrook (1984). Agency theory assumes that the market is dominated by informational asymmetry between the share holders and managers of the firms. Most of the finance literature about dividends presumes that managers are perfect agents of shareholders and their main principle is to maximise shareholder's wealth, however, in a case of agency theory a contrary opinion is taken. The managers are not perfect agents instead they have conflicting interests with outside shareholders and they have propensity to pursue their own interests as often as possible argues Easterbrook (1984) among others.

The conflicting interests arise if the managers are not the residual claimants to the firm's income stream. For instance, assume that owner-managers sell off part of their ownership in a company. The outside shareholders will charge, *ex ante*, for the possibility that the management misuses the earnings (make short-run operating decisions, consume excessive perquisites or cause the firm to grow beyond the optimal size) by increasing their personal wealth at the expense of new equity owners. To decrease the *ex ante* charge, it is in the best interests of shareholders and managers to build mechanisms that give managers incentive to act as better agents if such costs are less than the ex ante charge that outsiders would be forced to request. Such devices include monitoring, bonding and *ex post* readjustment mechanisms. Costs which are borne by applying these methods are agency costs. (Copeland and Weston, 1988 p. 567)

Easterbrook (1984) classifies agency costs as monitoring costs and opportunity costs. He argues that monitoring of management is costly for individual shareholder who is only able to recapture a portion of the potential reduction in agency costs. This is likely to lead an underinvestment in monitoring. Easterbrook concludes that shareholders would be better off if monitoring were completed by exogenous institutions.

The second source of agency costs is risk aversion on the part of managers. The stockholders who hold well diversified portfolios of stocks are not concerned about any firm specific risks. However, managers often have a considerable part of their personal prosperity tied up in their company. If the company fails to meet all obligations and goes bankrupt, the managers not only lose their jobs but all wealth invested in the firm's stocks as well. Thus, managers have an incentive to minimise bankruptcy possibility by choosing projects that are safe but create lower income streams than riskier investments, in other words, investing suboptimally.

Investing suboptimally is not the only tool for managers to lower the total risk of the firm. To change debt to equity ratio is an alternative method. Decreasing the amount of debt management is able to decrease the liabilities to creditors which lowers the possibility of bankruptcy. Lower risk is awarded by debtholders' lower demands on the rate of return. The decreased total risk enrich creditors at the expense of shareholders and, therefore, shareholders would like to induce managers to take more risks.

2.3.3.1 Methods of reducing agency costs

There exists several different ways to accomplish agency cost reduction. Jensen and Meckling (1976) find it efficient to increase managers ownership stake in the firm. Increasing their ownership to a extreme case where managers own 100% of the stocks can equity agency costs be reduced to zero. A notion should be mentioned here that the higher the level of the manager ownership the less diversified their wealth becomes and the possibility of underinvestment becomes greater. Thus, using increased managerial stock ownership to control agency costs is not costless. As managers' wealth becomes more poorly diversified, they will require increasing amounts of compensation.

Another way, and the one which is the most relevant in this study, is to pay out more dividends in order to reduce agency costs. Higher dividends reduce the resources under management's control and thereby decrease their power to waste cash on organisation inefficiencies Rozeff (1982), Easterbrook (1984). Jensen (1986) finds the conflicts of interests between shareholders and managers over payout policies to be severe when

organisation creates substantial free cash flow. Free cash flow is a cash flow in excess of that required to fund all projects that have positive net present value when discounted at the relevant cost of capital.

Paying larger dividends reduces internal cash flow subject to management discretion. Both monitoring problem and the risk-aversion problem become less significant if the firm consistently has to raise external equity from the capital market. When the firm issues new shares the managers will be under greater scrutiny by investment bankers, suppliers of new capital and law enforcers. The greatest advantage of keeping firms constantly in the market for capital is that the providers of capital are very good monitors of managers which decreases the monitoring costs for old equity owners and ensures that managers act in the best interest of outside shareholders. (Easterbrook, 1984)

High dividends represent only one way to distribute excess cash flows to owners. Other possible solutions are special dividends or open market share repurchase programs and even in some more extreme cases of excess capital, large tender offers for firm's own stock financed with new borrowings Soter, Brigham and Evanson (1996).

Jensen and Meckling (1976) suggest a third way to diminish equity agency costs which is to use more debt financing. When the firm issues more debt, including bonds, commercial papers, and syndicated bank loans the total equity financing reduces. This leads to a situation where manager-stockholder conflicts have become less important reducing the need for monitoring. However, as Jensen and Meckling point out bondholders are concerned that stockholders may seek to expropriate their wealth by increasing their risk through risky corporate investment decisions which gives rise to debt agency costs.

Both equity and debt agency costs lower the value of the firm. To minimise these cost the managers can choose a least costly financial policy mix. This creates a balance between the interest of debtholder and shareholders. The firm which needs more money from capital markets can adjust its the debt to equity ratio at the same time so that neither shareholders nor debtholders are able to take advantage of the other group.

2.3.3.2 Testing of agency theory

Easterbrook (1984) was aware of the fact that designing an empirical test for agency-cost explanation is challenging because of the variables that enter the theoretical model are not directly measurable. Problems arise claims Frankfurter (1992) when these variables are replaced with proxy variables which do not properly measure the theoretical ones. Frankfurter also criticise agency theory for containing a set of assumptions which are more or less unrealistic. For example:

- Individuals are assumed to act exclusively in their own self-interest, but may enter contracts to modify the agent's behaviour. With the exception of the manager's compensation contract, these contracts are not explicit.
- A manager obtains utility solely from income and disutily from effort, and these two elements are fully separable. Thus, disutily of effort does not change with income.
- The manager is risk averse, but stockholders are risk takers
- Monitoring systems exist and are informative, not noisy, providing shareholders information about management's effort.
- Even in repeated agency relationships, the periods are independent. Thus, learning is tempered, or would be non-existent.

Despite the arguments that cast a shadow above the agency theory, Easterbrook (1984) continues arguing that dividend increases are not unambiguous signals of future earnings. Investors may interpret higher payout ratio either as a signal that the company is able meet higher dividend obligations due to increased expected cash flows or a lack of investment opportunities forces the company to distribute excess cash flows to shareholders. It is this unambiguousness which enables the tests on agency theory.

According to Easterbrook the presence of new fund raising would indicate that dividends did not represent disinvestment. It also would isolate the set of firms whose managers were not able to rely wholly on internally generated funds and for which, therefore, dividends might reduce agency costs. Lower agency costs would then attract

investors to bid up the price of the stock for those firms which simultaneously pay dividends and raise new money. It is not the dividends *per se* which is important rather it is the increased frequency of trips to capital markets caused by dividends.

In their study of shareholders reaction to dividend cuts and omissions Ghosh and Woolridge (1988) analysed to existence of agency theory. The agency theory predicts a stock price decline on announcement of a dividend cut or omission because a reduction in dividend payout generates internal funds for investment purposes, thereby reducing trips to the capital market and consequently increasing agency costs. Their final sample consisted of 930 dividend cuts and omissions between 1962 and 1984. A standard event-study technique was employed to measure the valuation effects of announcements of dividend cuts or omissions. The results confirm that firms reducing their dividends suffer large losses in value around the announcement day which is consistent with the implication of agency theory. However, the results also imply existence of signalling theory (will be handled more thoroughly later) and, in fact, data indicate that announcement effects of dividend cuts or omissions are greatly influenced by the negatively perceived dividend signals. Even managerial announcements that funds generated from lower cash distributions are intended to support profitable investment opportunities only produce a weakly offsetting effect. (Ghosh and Woolridge, 1988)

In 1989 Crutchley and Hansen presented findings of an empirical test of agency theory. Their study examines corporate leverage and dividend policies as well as managers' common stock ownership behaviour. The data consists of 603 industrial firms and the sample period is 1981-1985. As discussed earlier agency theory suggests that managers choose the policy mix of manager stock ownership, outside leverage, and dividends to minimise agency costs. Crutchley and Hansen (1989) found evidence that firms with greater earnings volatility leads to lower leverage. Also found, however, is that greater earnings volatility is associated with greater managerial ownership and with larger dividends. The study also finds that larger firms not only use more leverage, but they also pay out larger dividends and their managers have lower equity ownership. In addition, it is found that lower diversification cost not only induces greater equity ownership by managers but also induces lower dividends and lower debt ratios. These findings provide evidence supporting the agency theory and are in line with the

proposition that managers make financial policy trade-offs to control agency costs in an efficient manner according to Crutchley and Hansen (1989).

Lang and Litzenberger (1989) tested the potential agency problems regarding substantial free cash flows. They attempted to distinguish a group of firms which overinvest by accepting marginal investment projects with negative net present values. The study divides firms into overinvestors and a mixed group of value maximizers and marginal overinvestors on the basis of Tobin's q ratio.[6] Lang and Litzenberger (1989) argued that a firm is overinvesting if the average Tobin's q ratio is less than unity. It is assumed that a firm's investments are scale expanding and exhibit decreasing marginal efficiency of capital. They also continue that announcements of dividend changes by overinvesting firms will change investors' expectations about the size of the firms' future investment in negative NPV projects. An increase in the dividend will, all else being equal, lessen the overinvestment and increase the market value of the firm according to Lang and Lizenberger (1989). This is what they call overinvestment hypothesis.

The results show that the average return is significantly larger for firms with inferior investment opportunities than for firms with superior investment opportunities, where investment opportunities are measured by Tobin's q. This is consistent with the overinvestment hypothesis and thus, is in line with agency theory. Dividend increases for overinvesting firms signal information that in future less negative NPV projects will be undertaken.

The Easterbrook hypothesis that growing firms simultaneously raising capital and increasing their dividend rate rise more in value than firms that simply increase their dividend rate was tested by Born and Rimbey (1993). In their paper they examine the relation between prior financing activity and the market response to initial dividends to determine the validity of Easterbrook model. Born and Rimbey emphasise that prior financing helps to distinguish firms with opportunities from those that are divesting, because raising capital requires third parties to invest financial and reputational capital in the issuer's securities which increases the frequency of outside audits and puts the firm under greater surveillance. Born and Rimbey (1993) extend the Easterbrook model

[6] see the definition of Tobin's q ratio p.12.

by assuming a positive relation between the amount of prior financing and the shareholder response to subsequent dividend policy changes. Assuming external financing signals growth firms, a greater amount of financing should provide stronger certification. Holding the relative amount of the subsequent dividend surprise constant, they expect a stronger market response to dividend policy announcements by firms with the strongest prior growth certification, yielding a positive relation between prior financing and the shareholders response to the dividend announcement.

The results were obtained inspecting 490 firms during the time period from 1962 through 1989. The sample consisted of 16 firms which had resumed a cash payment policy and 474 firms which had initiated cash dividends. For each of these firms the date of the public announcement of the dividend event and the amount, type, and date of any pre-dividend financing activities were identified. Born and Rimbey (1993) found that the announcement is generally associated with positive abnormal returns. This holds for firms that engage in financing, suggesting the dividend is not redundant information. The abnormal returns are positively related to the extent of the dividend surprise. The evidence consistent with Easterbrook's agency cost model that strong prior certification of growth leads to a stronger initial dividend response is supported by a perception that as the amount of pre-declaration financing rises, the subsequent shareholder wealth response to the dividend announcement rises. (Born and Rimbey, 1993)

2.3.4 Financial signalling

At present, dividend signalling is well known among the academics. These signalling models as well as agency theory assume that there is informational asymmetry between insiders and outsiders or, in other words, managers have a superior knowledge about the firm's future prospects compared to the outside shareholders. Managers may then use various signalling devices to convey this information to the public. Two of the most important signalling devices available are earnings and divided figures.

How do dividends and asymmetric information fit together? It was in their 1961 article where Miller and Modigliani recognised that in the real world a change in the market

price often follows a change in the dividend rate. On the basis of that fact, they reasoned that dividends changes might contain information about future fortunes of the firm which enables market participants to predict future earnings more accurately. They also continue that when a firm follows a policy of dividend stabilisation, investors will have a good reason to interpret that announcing a change in the dividend payout rate indicates a change in management's views of the firm's future profitability.

The first empirical tests were directed to test whether dividends have the potential to convey information about the future earnings of the firm. Watts (1973) hypothezed this problem that knowledge of current and past dividends enables a better prediction of future earnings than is possible with current and past earnings alone. In other words, if dividends convey information in addition to the information conveyed by earnings, the additional information must be reflected in the difference between actual current dividends and the expectation of current dividends conditional on current earnings.

Watts estimated this difference (unexpected change in dividends) for 310 firms during the period 1946 to 1967 and conducted two tests. In the first test, he regressed future earnings on unexpected changes in dividends and found average coefficients to be positive with low t -statistics which implies positive but weak relationship. The second test was performed to show if there is a relationship between the sign of the unexpected change in the current dividend and the sign of detrended future earnings changes. The sign test also implies the positive relationship between current dividends changes and changes in future earnings. Both tests indicated positive but weak relationship and, therefore, Watts concluded that, in general, if there is any information in dividends, it is very small. Not even monopolistic access to that information would enable one to make above-normal returns after transaction costs so the information in dividends must be trivial.

Watts was aware of the fact that his study was subject to two biases. First, the use of monthly, rather than daily, stock price data makes it difficult to distinguish between the effect of dividend and other contemporaneous information releases. Second, the potential noise in the dividend expectation model reduces the power of the tests.

Studying two potential corporate signals: dividend changes and "extraordinary" components of accounting income numbers, Gonedes (1978) reported similar results. In his study Gonedes takes conventional perspective which assumes that investors behave as if income numbers reflect information about the unobservable characteristics of firms' decisions. The evidence he shows is inconsistent with the view that dividends or extraordinary-item signals reflect information beyond that reflected in contemporaneous income signals or other existing sample evidence.

Bhattacharya (1979) develops a model that can be used to explain why firms may pay dividends despite the tax disadvantage of doing so. The framework is based on the idea that dividends are taxed at the ordinary income tax rate, whereas capital gains are taxed at a lower rate. The tax rate difference incurs signalling costs which can be traded off against valuable information associated with dividends decreasing information asymmetry. If investors believe that firms that pay greater dividends per share have higher values, then an unexpected dividend increase will be taken as a favourable signal of expected cash flows.

The other sources of information such as annual reports, accountants' reports or earnings forecasts are ignored because they are fundamentally unreliable and can not communicate the profitability information without involving moral hazard according to Bhattacharya (1979). Because the dividends are exogenously costly for firms requiring cash, it is expensive for less successful firms (they would have to raise external funds) to mimic the credible signal. For example, a firm that simultaneously pays cash dividends and borrows may be giving a different signal than if it had made the same dividend payment without borrowing. Hence the signalling value of dividends is positive and can be traded off against the tax loss associated with dividend income.

First empirical studies which employ daily return data instead of monthly stock returns were Charest (1978) and Aharony and Swary (1980). The latter trying to isolate the information reflected in both earnings and dividends and then consider the remainder of the information conveyed by dividend announcements. Charest reported that the announcement of a dividend increase generates an excess return of about 1%, but he made no attempt to remove the effect of contemporaneous earnings announcements.

Thus, he concludes that his evidence does not necessarily reveal the presence of information in dividend announcements.

For controlling contemporaneous information Aharony and Swary (1980) examine only quarterly dividend and earnings announcements conveyed to the public on different dates within any given quarter. The announcement dates had to be separated by at least eleven trading days. Documented results indicate significant average excess return of about 1% over the two-day announcement period for companies increasing their dividends. The companies that reduced their dividends sustained, on average, negative abnormal returns and in absolute terms the decreases were much greater than for those increasing dividends.

Combining all evidence Aharony and Swary summed up that announcements of quarterly dividend changes provide information beyond that already provided by corresponding quarterly earnings numbers contribute support for the information content of the dividend hypothesis. When dividend increases are announced before or after earnings increases, stockholders realise abnormal returns in the day surrounding both dividend and earnings announcement dates which implies that dividend and earnings announcements are not perfect substitutes. In addition, their study also supports the semi-strong form of the efficient capital market hypothesis. There is no leakage of information conveyed by earnings numbers prior to the dividend announcement, and the full impact of the announcement is concentrated in the two-day announcement period.

The stock price reaction to dividend announcements is re-examined by Asquith and Mullins (1983). Their analysis as well as Aharony and Swary's uses daily data to allow explicit identification and control of other simultaneous information. A naive dividend expectation model which assumes that any change in dividends is unexpected, was applied to a sample of 168 firms that paid no dividends either during their entire corporate histories or for at least ten years. Asquith and Mullins (1983) argue that dividends should be most visible at initiation and if the dividend initiation is unexpected, the market reaction on the announcement day should capture the full effect.

They continue to argue that the present value of various hypothesised effects[7] may already be incorporated in stock prices when subsequent dividends are announced. If the dividends are partially forecast, the effect of subsequent dividend announcements should reflect only the communication of incremental information plus any unexpected changes in the hypothesised effects. Thus, investigating initial, unanticipated dividends should give a clearer view of the true impact of dividends on shareholder's wealth. (Asquith and Mullins, 1983)

Asquith and Mullins' results show that during the two-day announcement period shareholders earn an excess return of 3,7 % which is associated with significant t-statistic. Moreover, for almost 70 % of the firms that were examined there is a positive market reaction to the announcement of initial dividend. In accordance with Asquith and Mullis the most striking fact is that the result support the hypothesis that any negative wealth effect dividends generate (either through changes in tax-induced clienteles or through increased future financing costs for the firm) is, on the average, more than offset by the positive value investors place on being paid a dividend.

Asquith and Mullins also tested the possibility that the results obtained might be the result of information other than the announcement of an initial dividend. They identified all other events that occurred within +/- 10 days of any dividend announcements. After that they performed the same test as earlier and found that an initial dividend announcement results positive excess returns even when there is no other information released simultaneously which, in turn, suggests that the market's positive reaction to the dividend announcement is not due to other events.

Next they examined the market's reaction to subsequent dividend announcements which showed that subsequent increases are small compared to the initial increase. They found potential difficulties why inferring that initiating a dividend policy has a positive present value over and above that observed with subsequent dividend increases is somewhat problematic. First, there is no control for the size of the dividend. Presumably if

[7] Factors that have positive wealth effect: establishing a mechanism for communicating managerial information, reducing institutional constraints on investors and benefits associated with the view that investors prefer returns in the form of cash dividends.
Factors that have negative wealth effect: the additional tax burden, the adjustment cost incurred by changes in clienteles and any other costs (for example administrative costs, transaction costs associated with issuing new equity) incurred paying dividends. (Asquith and Mullins, 1983)

dividends are a signalling device, the size of the dividend is a measure of the magnitude of the signal. Initial dividends may be larger than subsequent increases and this may explain the larger excess returns. Second, the naive expectations model may be a more accurate reflection of investors' expectations at the time of dividend initiation. Once a dividend policy is in place, the past sequence and timing of dividend changes may provide information that allows investors to construct a better forecasting model. If dividend increases are expected and received as good news, the naive expectation model for subsequent increases measure only the average reaction to the unexpected portion of the increase, which is less than the full effect of a partially forecast dividend increase. (Asquith and Mullins 1983)

The paper of Miller and Rock (1985) deals with the effects of optimal investment/financing/dividend decisions under asymmetric information. In their analysis Miller and Rock show that the cost of signalling is caused by the fact that the familiar Fisherian criterion for optimal investment becomes time inconsistent. That is the firm no longer invests in real assets until the marginal internal rate of return equals the appropriately risk-adjusted rate of return on securities. According to Miller and Rock if the market really were to believe that the firm's decisions conformed to the classical criterion, those stockholders planning to sell shares after the dividend announcement could bribe the firm's decision maker to cut back investment and pay the funds out as a dividend. Those not planning to sell might offer a counter-bribe to keep the decision maker impartial. They continue to show that potential bribing power of sellers induces the departure from the full-information optimum. The informationally consistent signalling equilibrium exists under asymmetric information and the trading of shares restores the time consistency of investment policy, but the price for restoring that consistency appears to be underinvestment, relative to the optimum achievable full information and/or no trading according to Miller and Rock (1985).

A study of Kose and Williams (1985) identifies a signalling equilibrium with taxable dividends under information asymmetry. Their key argument why firms pay dividends with their primarily adverse personal taxes while less costly technologies for releasing inside information exist, is that dividends are serve as a positive signal which is properly understood by the investment public. In this equilibrium, corporate insiders with more

valuable private information optimally distribute larger dividends and receive higher prices for their stock whenever the demand for cash by both their firm and its current stockholders exceeds its internal supply of cash. For the firms with more valuable inside information the premium paid in the market for stocks with marginally larger dividends, and thereby the reduction in dilution for current shareholders, just compensates stockholders for the incremental personal taxes on dividends. Thus, many firms distribute dissipative dividends, rather than repurchasing shares, while others distribute dividends and simultaneously sell new shares.

Furthermore, Kose and Williams (1985) reasoned that corporate insiders recognise the relationship between repeated dividends and their firm's reputation and optimally smooth dividends over time relative to corporate cash inflows. That would explain why insiders might optimally pay a current dividend even if neither the firm nor its stockholders currently demand cash.

Ofer and Siegel (1987) document a relationship between announcements of unexpected changes in financial policy and unexpected changes in firm performance. They use a new methodology that combines analysis of stock price movements and earnings forecast data. The applied method allowed them to gain insight into the characteristics of the information that is being released by changes in a particular financial policy variable. The particular methodology in accordance with Ofer and Siegel (1987) has several advantages over previous studies that attempt to establish a direct link between changes in corporate financial policy and subsequent performance of the firm. First, the financial analysts' forecasts of earnings have been shown to be a better proxy for market expectations than time-series models. Second, the effect of unexpected dividend changes on expectations of market participants are able to be examined directly. Finally, while other studies use *ad hoc* models of expected dividends in order to construct unexpected dividends, Ofer and Siegel use instrumental-variables techniques to eliminate the expected component of dividend changes.

By combining price-reaction data with expectations data Ofer and Siegel (1987) provide evidence that analysts revise their forecasts following the announcement of an unexpected dividend change by an amount positively related to the size of the

unexpected dividend change. Also, they found support that the change in the dividend policy contains information about the expected level of cash flows and the change in the stock price around the announcement will reflect the market value of this information which is consistent with the evidence from other dividend-signalling models.

Further literature on the valuation impact of unanticipated dividend changes is presented by Ghosh and Woolridge (1988). Their study explores some implications and extensions of information content hypothesis. First, a test of the relationship between the valuation effect of a dividend change and selected firm-specific variables[8] is performed by a multiple regression model which identifies the factors that contribute significantly to the capital loss suffered by shareholders when firms decide to cut or omit dividends. In addition, the interaction of simultaneous changes in dividends, earnings, and other variables that have potential valuation effect is investigated.

The conclusions were drawn based on 930 dividend cuts and omissions. The findings indicate that the significant influence of relevant firm-specific variables on the two-day event-period excess returns induced by dividend reductions supports the hypothesis that the stock price adjustment to dividend changes occurs in response to the information content of these decisions. Results indicate that the valuation effect induced by dividend cuts and omissions is greater for smaller firms and firms with lower variance of returns. A smaller effect is discovered for firms that suffer poor price performance and release unfavourable news items during the period preceding the dividend cut.

The results, after controlling for contemporaneous announcements of growth prospects and stock dividends, show that even managerial announcements that funds generated from lower cash distributions are intended to support profitable investment opportunities produce a weakly offsetting effect for shareholders wealth. A simultaneous payment of stock dividends was reported to have a positive and stronger effect on the capital loss induced by dividend cuts. This finding concluded by Ghosh and Woolridge (1988) is consistent with the notion that the value of a signal is a

[8] Firm-specific explanatory variables include: (1) percentage change in dividends, (2) cumulative stock returns, (3) firm size, (4) risk as measured by equity beta and (5) residual variance of the security from the market model.

function of costs associated with it since stock dividends are costlier than press announcements of profitable investment opportunities.

Evidence on the relation between dividend policy changes and subsequent earnings is provided by Healy and Palepu (1988). They examined whether there are significant changes in firms' earnings performance surrounding either a dividend initiation or omission and, if so, whether these changes are consistent with the market reaction to the dividend policy changes. Their analysis differs from Watts' paper in two ways. First, dividend announcement returns are used as a measure of dividend information rather than unexpected dividends and second, their sample consists of extreme dividend changes, initiations and omissions. The latter has been critizied for not being relevant to all dividend policy changes.

Healy and Palepu (1988) studied 131 firms that pay for the first time or start to pay dividends after a hiatus of at least ten years and 172 firms that omit dividend payments for the first time in their history or after paying continuously for at least ten years. All the dividend changes tested took place between 1969 and 1980. The results from statistical tests indicate that firms initiating dividends experience earnings growth starting at least a year before the dividend announcement. The earnings growth continues in the year of the dividend announcement and for two subsequent years. The comparable test for omitting firms show that dividend omissions follow significant earnings declines up to two years before. However, these declines do not persist beyond the announcement year. This is consistent with the proposition that these dividend decisions are preceded by systematic earnings patterns.

Tests of earnings performance after dividend policy changes show that firms that initiate or omit dividends have significant increases and decreases, respectively, in earnings for at least one year afterward. The earnings changes are positively related to the two-day abnormal stock price reaction at the dividend initiation or omission announcement. They obtained these results after controlling for the earnings changes in prior years, and information on future earnings available before the dividend announcement. The conclusions are consistent with the hypothesis that dividend initiations or omissions convey information on future earnings performance.

Finally, they analysed the market reaction to earnings announcements after the dividend policy change to assess whether the market anticipates these earnings from the dividend announcement. They found that the magnitude of the stock price reactions to earnings announcements following the dividend initiation or omission is significantly less than usual, indicating that the market anticipates these earnings changes at the date of the dividend announcement. These findings provide further confirmation for information hypothesis and are consistent with the proposition that managers consider past and present performance as well as future earnings when changing corporate dividend policy.

Benartzi, Michaely and Thaler (1997) investigated whether changes in dividends signal the future or the past. Unlike earlier studies, Watts (1973) who relied on a limited number of firm years and Healy and Palepu (1988) who also rely on a small number of data points and only consider the extreme cases of initiations and omissions, Benartzi, Michaely and Thaler employ a large number of firms and events. They examined 255 dividend decreases and 4249 dividend increases.

The proceeds of the study reveal that there is a very strong lagged and contemporaneous correlation between dividend changes and earnings,[9] but not much evidence of a positive relationship between dividend changes and future earnings changes is found which indicates that the predictive value of changes in dividends seems minimal. In the two years following dividend increases they found that earnings changes are unrelated to the sign and magnitude of the dividend change. The only strong predictive power they found is that dividend cuts reliably signal an increase in future earnings. Thus, they concluded changes in dividends signal permanence of the current increase in earnings and are consistent with Lintner's view which suggests that firms increase dividends only when management believes that earnings have increased permanently.

The most recent study which explores competing theories regarding the information content of dividends is presented by Kaestner and Liu (1998). Unlike other previous studies this study simultaneously test three different hypotheses: (1) the single-signal

[9] If a firm increases dividends, earnings have already gone up.

cash-flow signalling hypothesis; (2) the free-cash flow hypothesis and, (3) multiple-signal cash-flow signalling hypothesis. The empirical testing is completed with two types of dividend announcements: dividend initiations (DI) and specially designated dividends (SDD). Kaestner and Liu (1998) argue that the use of two types of dividend announcements allows them to draw richer set of inferences from their results since the circumstances that motivate the payment of these dividends are different. They emphasise the distinct circumstances as follows: "...with regard to the free cash flow hypothesis, an initiation of a 'regular' dividend represents a strong commitment by management to pay dividends and is an indication of the managerial decision to distribute free cash, leading to a reduction of agency problems. An unexpected specially-designated dividend, however, is less likely to be perceived as a commitment to distribute free cash in the future, although specially-designated dividends are in some cases a prelude to the initiation of a regular dividend. Thus, the relevance of the free-cash flow hypothesis is expected to be greater for the DI sample than the SDD sample. "

They also highlight that all firms in the DI sample are initially paying a zero dividend, and to the extent that there are investor clienteles for dividends, all firms in DI sample would be expected to have similar clienteles. Therefore, empirical tests of the free-cash flow and cash-flow signalling models that use a sample of firms paying an initial dividend, should be relatively free of the confounding influences of dividend clientele effects according to Kaestner and Liu (1998).

To test multiple-signal cash-flow hypothesis more appropriately Kaestner and Liu introduce a new statistical methodology to analyse the pattern of insider trading. In these multi-signal models the change in the firm's dividend policy cannot be evaluated independently of other management's actions (insider trading) or firm characteristics. The information content is firm specific and the same type of dividend announcement may be viewed as good or bad news by market depending on the firm's characteristics. In the case of dividend increases the model predicts that insider buying prior to the announcement will be viewed as good news by the market, and insider selling as bad news.

The investment opportunities available to the firm according to Kaestner and Liu are as well critical firm characteristics that determines the direction of the stock price reaction to an announcement of a change in dividends. For the firms that have initiated dividend payments the stock price response should be positive for the firms with inferior investment opportunities, and negative for the firms with superior investment opportunities. Thus, in the case of a dividend initiation, insiders in firms with inferior investment opportunities would be expected to be net buyers of shares, while insiders in firms with superior investment opportunities would be expected to be net sellers of shares.

The empirical evidence obtained is consistent with previous studies and provide strong support for cash-flow signalling hypothesis. The size of the dividend payment had a positive and significant effect on the stock price. This was true for both dividend initiations and specially-designated dividend payments. However, the relationship between the size of the dividend change and the stock price response tend to be stronger in the DI sample than in the SDD sample. This result suggests that the market views dividend payments as a significant source of information about the future prospects of the firm.

In further tests they found additional support for the cash-flow signalling hypothesis, but only weak support for multiple-signal model. They predicted a negative stock price response for firms with very high values of Tobin's q, but they were not able to find any significant findings. Although Tobin's q sometimes had a negative and significant effect on the stock price response, the abnormal return remained positive even for firms with very large values of Tobin's q. After adding insider trading into the model consistent abnormal buying among insiders of low q firms, and abnormal selling among insiders of high q firms could not be found prior to the dividend announcement.

The presence of the FCF hypothesis was tested with the help of Tobin's q as well. They found that the investment opportunities of the firm were significantly related to the stock price response. According to Kaestner and Liu (1998) market views a dividend announcement by firms with relatively poor investment opportunities more favourably as compared to firms with relatively good investment opportunities. Moreover, they

found that the announcement of a regular dividend such as a dividend initiation (DI) is viewed by the market as a more credible action to distribute free cash which was expected due to the different nature of these two types of dividend payments. They interpreted this finding that management in firms with inferior investment opportunities are signalling to the market that they will distribute free cash instead of investing in projects with a negative NPV which is consistent with agency theory.

2.4 Behavioural Models

The theory of dividends have inspired many researcher to develop and test many theoretical and mathematical models but not as much time and effort have been directed towards models explaining dividend behaviour. One of the earliest and oft referred studies of corporate dividend policy is Lintner's (1956) classic partial adjustment study.

Lintner based his study on 28 carefully selected listed companies. The selection of the company was determined by fifteen observable factors and characteristics that appeared to reflect or might be expected to have an important bearing on dividend payments and policy. All 28 companies were titled to belong to industrial sector, because the companies in this sector had greater diversity of dividend policy and the relatively greater knowledge of dividend policies among other important groups. The companies were purposely chosen to represent variety of situations and to build in opportunities for significant suggestive contrasts between the policies of companies similar in several respect but differing in other important characteristics.(Lintner, 1956)

Interviews among the firms were completed in order to identify the factors which entered most actively into decisions when the dividend rates were changed, as well as in all cases when a change in dividends might have been under intense consideration even though no change was made. On the basis of the interviews, Lintner observed that all firms agreed that the existing dividend rate played a central role in the decision-making process. The existing rate was regarded as a critical factor both chancing the rate and how large the change in dividend payments should be. Major changes in earnings or

levels of earnings "out of line" with existing dividend rates were the most important determinants of the company's dividend decision according to Lintner's study.

The results also suggested that managers believed investors to prefer a reasonably stable or moderately growing dividends. Thus, managers sought to avoid making changes in their dividend rates that might have to be reversed within a year or so. To minimise this possibility a common practice was to change the payout ratio towards a long term target payout ratio less than current earnings figures implied.

The periodic partial adjustment toward a target payout ratio can be characterised that a company has set a certain percentage that the company aims to pay to shareholders from its net earnings in the long run. It is an ideal situation towards which the company should move, but no means obligatory requirement. If there are changes in the current earnings, the company does not necessarily need to pay out the earnings in a proportion of this ratio instead it may choose to adjust the dividends only some part. For example, consider following:

> There are two similar companies which have been paying 3 euros per share on reasonably stable earnings on 5 euros per share. Suppose that earnings increase to a level of 10 euros, then the full adjustment of dividends for both companies would be indicated by dividend increase to a level of 6 euros per share. Instead of adjusting perfectly to earnings changes the company may choose a lower rate of adjustment. In that case the dividend would be increased 3,75 euros in the first year and on 4,5 euros in the second and 5 euros in the third year. The company with more aggressive adjustment rate would increase the dividends to 4 euros in the first year and 5,5 euros in the second year.

Raising the dividends in aforementioned manner managers smooth short run dividends to avoid taking any reverse action. If the earnings decline under transitory period managers do not have to cut dividends assuming that dividends do not yet fully reflect

the level of the previous higher earnings and the current payout ratio is below the new, lower target payout ratio.

Using aggregated data on corporate earnings and dividends, Lintner tested his proposition empirically and found that the partial adjustment model predicted dividend payments more accurately than "naive" models. Lintner finds that the model explains 85% of the changes in dividends for his sample of companies. The average speed of adjustment is approximately 30% per year and the target payout is 50% of earnings.

Further support for the superiority of Lintner's partial adjustment model was found by Fama and Babiak (1968). In addition to Lintner's proposition, they investigated several other alternative dividend behaviour models using a sample of 201 firms with 17 years of data and concluded that Lintner's model predicts dividends better than other models and managers increase dividends only after they are reasonably sure that they can permanently maintain them at the new level. For Lintner's model they reported a mean speed of adjustment of 32% and the average target ratio of 52%. Later research on the partial adjustment model by Fama (1974) indicated results in line with studies of Lintner (1956) and, Fama and Babiak (1968).

A study by Partington (1984) confirmed that firms apparently targeted dividend payout ratios. Using a survey of 93 large companies, Partington determined that approximately 60% of the firms had a clearly stated target payout ratio and the objective was to hand out about half of the firm's earnings as dividends. Around one third of all firms had revised their targets considerably over the time period of 1965-1980 according to Partington.

A survey of management views on dividend policy was conducted by Baker, Farelly and Edelman (1985). Their objectives were to compare the determinants of dividend policy with Lintner's model and to examine management's perception of certain specific theoretical issues as well as to determine whether managers in different industries share similar views about the determinants of dividend policy. The tests were performed with 318 useably responses to 15 closed-end statements about major determinants of corporate dividend policy and 18 closed-end statements about theoretical issues.

The anticipated level of a firm's earnings and the pattern of past dividends were considered most important by the three industry groups[10] when ranked by the mean response. The evidence provided is in accordance with Lintner's results that bottom line earnings are the predominant element which determines current changes in dividends and the other important factors which have more or less consciously and rationally influenced the decision are the growth and earnings prospects of the particular company (Lintner, 1956). The availability of cash was not directly acknowledged by Lintner but Baker, Farelly and Edelman found it as third important factor in determining dividend policy. A fourth major determinant was concern about maintaining or increasing stock price.

The respondents general belief about issues involving dividend policy supports the statements that a firm should avoid making changes that might soon have to be reversed and should strive to maintain an uninterrupted record of dividend payments. Respondents commonly agreed that a firm should have a target payout ratio and should periodically adjust the payout toward the target. The attitudes on theoretical issues revealed that managers' opinions leaned towards the existence of information hypothesis. The level of agreement that the reasons for dividend policy changes should be adequately disclosed to investors was ranked very high. Other two statements associating with signalling effects were also generally agreed. The statements concerning dividend clientele effect produced somewhat mixed agreement but the existence of possible effect could not be rejected either.

The final objective of their study was to compare the industry influence on management's attitudes. Baker, Farelly and Edelman reported that the opinions from the utility industry differed significantly from other two industries. They explained that the differences between the utilities and the other firms may be due to regulation on the utility industry which creates incentives for management to adopt a different payout policy than nonregulated firms.

[10] Firms were selected from three industry groups which were utility, manufacturing and wholesale/retail.

The interactions between the investment, financing and dividend decisions of the 1,000 largest U.S. firms were surveyed by Pruitt and Gitman (1991). The evidence provided suggest that current and past years' profits, the year-to-year variability of earnings, and the growth in earnings have the strongest influence on the amounts of dividends paid. Pruitt and Gitman also found that prior years' dividends are an important influence on current dividends. This finding is completely in line with Lintner's (1956) behavioural model and the observations of Baker, Farelly and Edelman (1985). The inference from this is that respondents attempt to maintain a high degree of consistency in the level of their firm's dividends. In addition, Pruitt and Gitman found that managers make the dividend decision independently of the firm's investment and financing decisions.

The article of Baker, Farelly and Edelman (1985) was updated by Baker and Powell (1998) and, Baker and Powell (1999). By renewing and extending the previous survey research on dividend policy they wanted to provide longitudinal comparisons between 1983 and 1997 on the determinants of dividend policy as well add our understanding of why firms pay cash dividends. Their study of the factors influencing dividend policy decisions concentrated on three research questions: What factors are most important in influencing the dividend policy of firms paying cash dividends? Have these factors changed over time? and Do the views of managers about dividend determinants differ between a high payout, regulated industry and moderate payout, less regulated industries?

The sample of firms consisted of 603 U.S. corporations that were listed on the New York Stock Exchange (NYSE) by 1994 and had paid a cash dividend in at least one year during the 1994-1995 period. The inferences were drawn on 198 useable responses which showed that the level of current and expected future earnings as well as the pattern or continuity of past dividends were ranked the most important factors among all industry groups. Apparently most respondents believed that a firm's dividend policy can affect its stock price because the concern about maintaining or increasing stock price was seen third important factor. Other important dividend policy determinants were the concern that a change may provide a false signal to investors and the stability of cash flows.

The second research question addressed if these factors had changed over time. Baker and Powell compared the results in 1983 to their observations and concluded that the key determinants were much the same which suggest that the most important factors of dividend policy have remained comparably stable over time.

Their final interest was to see whether there appears to be any differences between these three types of industries.[11] Baker and Powell reported that such differences seem to have decreased over time. Mainly this is due to regulatory changes which have forced utilities to function on competitive markets. This, in turn, has brought the risk level of utilities closer to other industries and explains why fewer differences appear to exist than in 1983.

Baker and Powell (1999) used the same set of firms as on their earlier paper to extend investigation how corporate managers view dividend policy. Chief financial officers of these firms were asked to identify their level of agreement on 26 theoretical and empirical issues about dividend policy. The largest contribution of this study was to provide additional support for previous empirical work. Primarily the respondents agreed that a change in dividend policy affects the value of the firm which has already been acknowledged by Baker, Farelly and Edelman (1985). Most of the respondents were proponents of dividend relevance and signalling effect was found to be the strongest candidate for explaining this relevance. The statements involving the tax-preference explanations received somewhat mixed agreements and the opinions towards Bird-in-the-Hand explanation were for the most part neutral.

2.4.1 Dividends as residual

Evidence that the managers base their dividend payout on rather well established practices and policies according to Linter's study indicates that managers do not treat dividends as a passive residual. The residual theory posits that if dividends were seen as a by-product would managers first invest all cash to acceptable investment opportunities available to the firm and then distribute rest of the cash to the shareholders. Under

[11] Again the industry types were utilities, manufacturing and retail/wholesale

profitable investment opportunities the percentage of dividend payout would likely to be zero and, on the more mature markets where the firm is unable to find advantageous projects could the dividend payout reach 100%. Lintner's study proposes that firm with abundant investment opportunities will pay a fair share of its current earnings to the shareholders as dividends and the projects that could not be financed with the funds available after dividends would go through a re-examination. If these projects still appeared to generate a rate of return above the company's cost of capital, would the firm be justified to rise outside capital. As a result Lintner concluded that the pattern of dividend behaviour has very little direct effect on investment requirements.

The residual theory of dividends was under examination in the study of Ghosh and Woolridge (1988). They emphasise that when managers have adequate internal funds to support capital projects, the dividend payout plays a critical role in the implementation and realisation of the investment program. In the absence of any drop in earnings, a dividend cut or omission may be interpreted as a favourable signal to profitable growth opportunities, generating an upward stock price adjustment according to Ghosh and Woolridge (1988). They found some weak evidence for residual theory hypothesis that growth-motivated, nonearnings-induced dividend cuts/omissions increase shareholders wealth. The regressed coefficient had predicted sign but it was not significant.

3. Survey design

3.1 Sample

The sample of the survey consists of 91 Finnish corporations listed on the Helsinki Stock Exchange. More specifically they all are publicly quoted on the main list.[NA1][12] Only one company was left out of the survey because it was not listed at the end of 1998. The reason why I only chose companies from the main list is that the companies on the other lists are relatively small and their ownership structure is less diversified. In case of the small companies, there is a change that the manager owns a substantially large stake of the company and the dividends decisions may be influenced by manager's personal interests. As far as I am concerned, the possible bias can be avoided by using larger companies with better diversified ownership structure.

3.2 Survey

I used a mail survey to obtain information about respondents' views on specific dividend policy issues and factors influencing dividend policy decisions. The five-page questionnaire form consisting three parts was modelled after the mail questionnaires developed by Baker, Farelly and Edelman (1985) and Baker and Powell (1998) and Baker and Powell (1999). Most of the questions were direct translations from English to Finnish but especially questions regarding taxes had to be reformed to fit better in Finnish tax environment.

In the first part the recipients were asked to indicate their personal opinion about the theoretical issues of dividend policy. These issues were categorised into five broad explanations of dividend policy: (1) the dividend irrelevance/relevance explanation, (2) the bird-in-the-hand explanation, (3) the tax-preference explanation, (4) the signalling explanation, and (5) the agency cost explanation. In addition, respondents were asked about how firms set dividend payments and their preference to institutional ownership. Also their awareness about stock repurchases as an alternative method to pay dividends

[12] Others are New Market -, Pre- and I-lists

was under examination. The first part included 29 closed-end statements and the respondents were given a five-point response scale where -2 = strongly against, -1 = somewhat against, 0 = neutral, 1 = somewhat agree, and 2 = strongly agree.

The second part of the questionnaire focuses on the factors which are most important in influencing the dividend policy of firms paying cash dividends. Respondents were asked to state their general opinion about 21 different factors on a four-point scale where the level of importance varies from no importance = 1, low importance = 2, moderate importance = 3 and, high importance = 4.

In the last section I asked recipients to identify their firm so that if a second round of mailing is needed I could avoid sending the survey to those firms which already have answered. Also, position or profession title of the respondents as well as a long-term target payout ratio (if any) on the scale from 0% to 100% were questioned. At the end of the questionnaire I asked if the respondent is actively involved in determining their firm's dividend policy and then I offered to return the results from the study to all firms that have replied to the survey.

3.3 Gathering the data

After presenting the question form for final acceptance to Professor Martikainen (HSE), I mailed a cover letter requesting participation in this study along with a stamped, self-addressed return envelope and the survey to Investor Relation (IR) Directors of the 91 firms in the beginning of April 1999. Before mailing the letters I attempted to get a personal contact with all of the IR-directors by calling them directly in order increase the response rate. A list which included all IR-persons of the corporations in Helsinki Stock Exchange was obtained from LTT Reasearch Ltd[13]. The cover letter requested that if the recipients were not actively involved in determining their firm's dividend policy or the particular person can not be reached the survey should be given to someone in their company who was involved. Finally, I emphasised possible biases a low response rate

[13] LTT-Tutkimus Oy

would cause and then I requested respondents to return to questionnaire as soon as possible but no later than April 21st, 1999.

By April 21st the survey has resulted 36 responses producing a response rate of 39,6 %. After the deadline I once again called up the firms which yet had not responded and asked them to fill the question form. The second set of mailing took place in April 26th, 1999. The survey was sent to all firms that had not replied excluding firms which had refused to participate to the survey.

A month later May 19th I had received 21 more responses yielding a response rate of 62,6 % which can be considered satisfactory. Three of these 57 returned questionnaires had to be excluded from the final sample due to poorly filled questions. Some respondents did not answer every question, however, their incompleteness was not as systematic. Therefore, the rate of usable responses was little lower **59,3 %**.

3.3 The limitations of the study

There are several limiting aspects in this research which should be noted. First, I mailed the survey according to my telephone conversation with each company. Despite several attempts I could not always reach the particular person which may lower the personal commitment to the survey.

Second, I acquired the views about dividend policy from one manager within each firm. However, most often it is not only one director who makes the dividend decisions, instead, there also are other participants involved as well. Because identifying all these participants is impractical, I used IR-director or other individual familiar with the firm's dividend policy as a proxy for dividend policy makers.

Third, when taking the initial contact with the managers it became clear that they were extremely concerned about the length of the study and the effort it would require. I did not want discourage potential respondents by adding lengthy, time consuming open-ended questions. Thus, I chose only to use closed-ended questions and limit the length to

five pages. Therefore, the survey involved a trade-off between the quantity of responses and the quality of information needed.

Fourth, a potential disadvantage oh the mail survey is that the researcher cannot be sure that the proper person supplied the information. There is always a possibility that a business executive may ask his secretary to fill out a form which requests his opinions. Also, unhonestly or in careless manner filled out question forms may bias the results.

Finally, the research findings could be affected by nonresponse bias. I used several precautionary steps to reduce this possibility. I tried to get individual managers personally involved by calling them directly. Also, personalised mailings and assurance of confidentiality of responses were applied. On the cover letter I informed respondents that possible low response rate would not allow to perform any statistical tests and the generalisation of results would be impossible.

4. The results

4.1 Demographic characteristics

The target respondent was a person who is actively involved in decisions concerning company's dividend policy. The most common position or title of the respondents was CFO/Finance Director (31,5 percent), followed by Chief Accountant (24,1 percent) and President/Vice President (20,4 percent). The more complete list of titles is in the Table 1 below.

	Number	Percentage
Chief Financial Officer/ Finance Director	17	31,5 %
Chief Accountant	13	24,1 %
President/ Vice president	11	20,4 %
IR Director	4	7,4 %
Controller	3	5,6 %
Other	4	7,4 %
Anonymous	2	3,7 %
Total	54	100,0 %

Table 1

Although I tried to emphasise the certain qualifications of the respondents on the cover letter and in the telephone conversations only 65,8 percent of these respondents said that they were actively involved in determining their firm's dividend policy. One reason for low percentage could be that the question was not well-worded. It is the board of directors who proposes dividend pay out to shareholders who then vote to accept it. The idea behind the question was rather to find out if this person was actively involved preparing this proposition concerning firm's dividend policy.

4.2 The use of target payout ratios

Every respondent was requested to state their firm's long term target payout ratio if they had any. Half of the firms (27) reported using a target payout. This is very similar to Partington (1984) who reported 59 percent for his Australian sample and a British study of Allen (1992) in which about 52 percent of the firms targeted payout ratios.

Most of the firms announced a single figure e.g. 50 % but some firms reported a range for their target payout e.g. 25 %-30 %. When the average target payout ratio was estimated I first calculated a arithmetic mean for these ranges. The average target payout between these firms was 40 percent. This estimate is upward biased because not all firms reported their target payout from net earnings after-tax basis. However, the error is small and does not change any general conclusions of the target payout. Values reported range from 25 up to 70 percent but they are heavily concentrated on a range between 30 %-50 %. The more detailed distribution of reported target payout ratios is shown in Table 2.

Frequency of use of target payouts

Payout classification	Number	Percentage
Firms using target payouts	27	50 %
Firms not using target payouts	27	50 %
Total	54	100 %
Target payout ratio		
<19,9%	0	0,0 %
20%-29,9%	2	7,4 %
30%-39,9%	9	33,3 %
40%-49,9%	8	29,6 %
50%-59,9%	7	25,9 %
60%-69,9%	0	0,0 %
70%-79,9%	1	3,7 %
>80%	0	0,0 %
Total	27	100,0 %
Average target payout ratio	40,0 %	
Std.dev	0,098	
Max target payout ratio	70,0 %	
Min target payout ratio	25,0 %	

Table 2

In Allen's (1992) study the distribution of target payout ratios were between a range from 0 % to 75% and the mean target payout was 34 %. A recent study of the payout policies of large UK companies by the Bank of England (1990) reported an average payout ratio of 35,8 %. In the Lintner's study (1956) the ratios varied from a low of 20 % to a high of 80 %, with 50 % the most common figure and the most of the other companies aiming at 40 % or 60 %. Also, Partington (1984) reported similar results. His sample of firms had a mean payout ratio of 49 %.

Table 3 shows the use of target payments across industrial sectors in order to assess any systematic differences across industries. By taking a quick over look there does not appear to be any association between the use of targets and industry sectors.

	Number of firms	Percentage	Use target payouts	Percentage	Not use target payouts	Percentage
Banking/Finance and Insurance	4	7,4 %	1	3,7 %	3	11,1 %
Investment	4	7,4 %	3	11,1 %	1	3,7 %
Transport	3	5,6 %	0	0,0 %	3	11,1 %
Trade	5	9,3 %	3	11,1 %	2	7,4 %
Other Services	3	5,6 %	3	11,1 %	0	0,0 %
Metal and Engineering	8	14,8 %	5	18,5 %	3	11,1 %
Forest Industry	2	3,7 %	1	3,7 %	1	3,7 %
Multi-Business	5	9,3 %	2	7,4 %	3	11,1 %
Energy	2	3,7 %	1	3,7 %	1	3,7 %
Food Industry	8	14,8 %	3	11,1 %	5	18,5 %
Construction	1	1,9 %	0	0,0 %	1	3,7 %
Telecommunications	5	9,3 %	3	11,1 %	2	7,4 %
Chemicals	2	3,7 %	0	0,0 %	2	7,4 %
Media and publishing	1	1,9 %	1	3,7 %	0	0,0 %
Other industries	1	1,9 %	1	3,7 %	0	0,0 %
Total	54	100,0 %	27	100,0 %	27	100,0 %

Table 3

The three respondents from Other Services reported uniform usage of target payout ratios contrary to Transport where the three respondents denied using target payouts. Otherwise any systematic pattern of using target payouts could not be observed.

4.3 Issues involving dividend policy

Exhibit 1 provides the respondents' opinions about 29 closed-end statements relating to dividend policy. I computed descriptive statistics for each of the 29 closed-end statements and ranked each statement by its mean score. If two or more statements received the same mean score then the ranks of these statements were added together and divided by the number of statements having the same mean score. For example, statements T2, T3 and T6 (T is used to describe a theoretical statement and the statement number refers to the order in which the statements appeared in the questionnaire) had the same mean score of 1,04 and their ranks would have been 4, 5 and 6. I added their ranks (15) and divided it with the number of statements (3) to get the final rank (5) for the statements.

I also divided the sample into two different groups depending on whether respondent is actively involved deciding firm's dividend policy. This was done to see if there are differences in answers between these two groups.

4.3.1 The relationship between dividend policy and value

My first research question involved the relationship between dividends and value. Miller and Modigliani (1961) suggest that dividend policy has no effect on the value of the corporation in the world without taxes, transaction costs or other market imperfections. Table 4 shows that almost 90 percent of the respondents agreed that a change in dividend policy affects firm value (T1) and somewhat less 70 percent believed that dividend policy also affects its cost of capital (T9).

More than 80 percent agreed that a firm's investment, financing, and dividends decisions are interrelated (T8) which was supported by the view that over one half of the respondents strongly disagreed and more than 80 percent disagreed that a firm should view cash dividends as a residual after financing desired investments from earnings (T7). This is evidence that managers do not treat dividends as a passive residual as originally proposed by Lintner (1956) and, therefore, the argument suggested by Miller and Modigliani (1961) that the dividend decision is a residual decision does not gain much support. Also Baker, Farelly and Edelman (1985) found that financing decisions should not be independent of a firm's dividend decisions and dividend payouts are not seen as by-products. This was later confirmed when Baker and Powell (1998) re-examined the previous study. They found that more than 88 percent of the respondents believed that a firm's investment, financing, and dividend decisions are related. Dividends as residual, however, received somewhat mixed agreements in their study.

In Finland corporate managers emphasise that a firm should formulate its dividend policy to produce maximum value for shareholders (T6) because almost 50 percent strongly agreed this maximising principle. More than 70 percent of the total respondents agreed that an optimal dividend policy strikes balance between current dividend and future growth that maximises stock price (T5). Baker and Powell (1998) report even

stronger agreement and conclude that these findings are clearly contrary to Miller and Modigliani's (1961) proposition that in a real world without taxes no optimal dividend policy exists.

	Disagree		Neutral		Agree				
	-2	-1	0	1	2	Mean	Std.dev	Rank	
1. A change in dividend policy affects	**0,0 %**	**3,7 %**	**7,4 %**	**61,1 %**	**27,8 %**	**1,13**	**0,70**	**2**	**All**
firm value.	0,0 %	5,7 %	8,6 %	57,1 %	28,6 %	1,09	0,78	2	I
	0,0 %	0,0 %	5,3 %	68,4 %	26,3 %	1,21	0,54	4	N
8. A firm's investment, financing, and	**1,9 %**	**11,1 %**	**5,6 %**	**37,0 %**	**44,4 %**	**1,11**	**1,06**	**3**	**All**
dividends decisions are interrelated	2,9 %	14,3 %	2,9 %	31,4 %	48,6 %	1,09	1,17	3	I
	0,0 %	5,3 %	10,5 %	47,4 %	36,8 %	1,16	0,83	5	N
6. A firm should formulate its dividend	**3,7 %**	**13,0 %**	**7,4 %**	**27,8 %**	**48,1 %**	**1,04**	**1,20**	**5**	**All**
policy to produce maximum value for	5,7 %	14,3 %	5,7 %	31,4 %	42,9 %	0,91	1,27	7	I
shareholders.	0,0 %	10,5 %	10,5 %	21,1 %	57,9 %	1,26	1,05	3	N
5. An optimal dividend policy strikes a balance	**0,0 %**	**9,6 %**	**19,2 %**	**46,2 %**	**25,0 %**	**0,87**	**0,91**	**8**	**All**
between current dividends and future growth	0,0 %	2,9 %	23,5 %	41,2 %	32,4 %	1,03	0,83	5	I
that maximises stock price.	0,0 %	22,2 %	11,1 %	55,6 %	11,1 %	0,56	0,98	14	N
9. A firm's dividend policy affects its cost	**3,8 %**	**15,4 %**	**9,6 %**	**46,2 %**	**25,0 %**	**0,73**	**1,12**	**10**	**All**
of capital.	5,7 %	20,0 %	2,9 %	51,4 %	20,0 %	0,60	1,19	14	I
	0,0 %	5,9 %	23,5 %	35,3 %	35,3 %	1,00	0,94	8,5	N
7. A firm should view cash dividends as a	**53,7 %**	**29,6 %**	**7,4 %**	**5,6 %**	**3,7 %**	**-1,24**	**1,06**	**29**	**All**
residual after financing desired investments	57,1 %	25,7 %	2,9 %	8,6 %	5,7 %	-1,20	1,21	29	I
from earnings.	47,4 %	36,8 %	15,8 %	0,0 %	0,0 %	-1,32	0,75	29	N

Table 4

4.4 Explanations of dividend relevance

The second research objective was to find out which theoretical explanation of dividends, if any, managers tend to favour. The set of explanations included four popular explanations of dividend policy: tax/income clientele effect, the bird-in-the-hand, agency cost and signalling explanations.

4.4.1 Clientele effect explanation

The tax-induced clientele effect suggests that shareholders are attracted to certain types of divided paying stocks according to individuals' tax circumstances. The higher the investor's tax rate on dividends compared to capital gains, the more likely he or she is to want a firm retain its earnings and invest them internally to capture most of the earnings in form of capital gains.

There also are other explanations why investors may divide into clienteles and prefer different payout policies. A steady stream of income from dividends to live on and psychological reasons to avoid "dip into capital" as well as the inconvenience reasons are often favoured explanations.

The possibility of a dividend clientele effect was first suggested by Miller and Modigliani (1961). It provides one potential explanation of companies' observed reluctance to alter their dividend payout ratios. The result would be that shareholders would incur transactions costs in rearranging their portfolios to achieve desired income streams. Table 5 displays the results of six statements covering tax-preference and clientele effect explanations.

	Disagree		Neutral		Agree				
	-2	-1	0	1	2	Mean	Std.dev	Rank	
17. A firm should be responsive to the	**1,9 %**	**3,8 %**	**22,6 %**	**58,5 %**	**13,2 %**	**0,77**	**0,80**	**9**	**All**
dividend preferences of its shareholders	0,0 %	2,9 %	20,6 %	61,8 %	14,7 %	0,88	0,69	8	I
	5,3 %	5,3 %	26,3 %	52,6 %	10,5 %	0,58	0,96	13	N
28. Dividend preferences vary between	**0,0 %**	**11,8 %**	**23,5 %**	**47,1 %**	**17,6 %**	**0,71**	**0,90**	**11**	**All**
shareholders depending on their age.	0,0 %	6,1 %	27,3 %	51,5 %	15,2 %	0,76	0,79	11	I
	0,0 %	22,2 %	16,7 %	38,9 %	22,2 %	0,61	1,09	12	N
19. Stocks that pay high dividends attract	**0,0 %**	**14,3 %**	**26,5 %**	**36,7 %**	**22,4 %**	**0,67**	**0,99**	**13**	**All**
tax-exempt entities.	0,0 %	12,9 %	22,6 %	38,7 %	25,8 %	0,77	0,99	10	I
	0,0 %	16,7 %	33,3 %	33,3 %	16,7 %	0,50	0,99	17,5	N
21. Investors prefer that a firm retains funds	**1,9 %**	**17,0 %**	**18,9 %**	**43,4 %**	**18,9 %**	**0,60**	**1,04**	**15**	**All**
over paying dividends if dividends are	2,9 %	25,7 %	14,3 %	42,9 %	14,3 %	0,40	1,12	17	I
taxed heavier than capital gains.	0,0 %	0,0 %	27,8 %	44,4 %	27,8 %	1,00	0,77	8,5	N
20. Investors are attracted to firms that have	**1,9 %**	**17,0 %**	**22,6 %**	**49,1 %**	**9,4 %**	**0,47**	**0,95**	**18**	**All**
dividend policies appropriate to the	0,0 %	20,6 %	23,5 %	44,1 %	11,8 %	0,47	0,96	16	I
investors' particular tax circumstances.	5,3 %	10,5 %	21,1 %	57,9 %	5,3 %	0,47	0,96	19	N
18. A firm cuts dividends in future if taxes on	**9,6 %**	**15,4 %**	**21,2 %**	**46,2 %**	**7,7 %**	**0,27**	**1,12**	**21**	**All**
dividends are raised.	11,8 %	20,6 %	17,6 %	41,2 %	8,8 %	0,15	1,21	22	I
	5,6 %	5,6 %	27,8 %	55,6 %	5,6 %	0,50	0,92	17,5	N

Table 5

The results lean towards existence of clientele effect. Most respondents, approximately 70 percent, believed that a firm should be responsive to the dividend preferences of its shareholders (T17) and that dividend preferences vary between shareholders depending on their age (T28). This finding is in line with Shefrin and Statman (1984) who found that preference for certain type of dividend paying stocks changes during investor lifecycle. Management's responsiveness to its shareholder preferences was only slightly agreed on study of Baker, Farelly and Edelman (1985). However, later Baker and Powell (1998) report somewhat stronger agreement.

The rest four statements (T18, T19, T20 and T21) account for tax-induced clienteles. It was not very surprising that the responses varied around neutral because results from empirical tests have been mixed. Although the taxation is quite different in US the results show a lot of similarities and the inconclusiveness is striking. The most common response was either somewhat agree or disagree or neutral. An interesting fact is the firms reluctance to cut dividends in future if taxes on dividends are raised (T18). This

strongly suggest that even though managers try to acknowledge shareholders preferences the signalling effects and especially negative effects weigh on scale more than tax effects.

4.4.2 The Bird-in-the-Hand explanation

The survey contained two statements explaining the Bird-in-the-Hand theory: investors prefer certain, current dividends to possibly higher but riskier future dividends (T23) and investors prefer certain dividend stream to uncertain price appreciation (T22). The responses produced mixed results on these statements. In fact, over one quarter of the respondents had a neutral opinion about either statement while others either somewhat agreed or disagreed . The detailed results are in Table 6.

		Disagree		Neutral		Agree				
		-2	-1	0	1	2	Mean	Std.dev	Rank	
23.	Investors prefer certain, current	**3,7 %**	**24,1 %**	**27,8 %**	**38,9 %**	**5,6 %**	**0,19**	**0,99**	**23**	**All**
	dividends to possibly higher but	5,7 %	25,7 %	28,6 %	37,1 %	2,9 %	0,06	1,00	23	I
	riskier future dividends.	0,0 %	21,1 %	26,3 %	42,1 %	10,5 %	0,42	0,96	20	N
22.	Investors prefer certain dividend stream	**9,3 %**	**24,1 %**	**25,9 %**	**29,6 %**	**11,1 %**	**0,09**	**1,17**	**24**	**All**
	to uncertain price appreciation.	11,4 %	28,6 %	25,7 %	20,0 %	14,3 %	-0,03	1,25	24	I
		5,3 %	15,8 %	26,3 %	47,4 %	5,3 %	0,32	1,00	22	N

Table 6

Generally these findings are consistent with Baker and Powell (!998) study where not very strong support have been found, not one way or the other.

4.4.3 The agency explanation

With two statements involving the explanation of agency cost theory (T24 and T25) I wanted to test whether managers feel obliged to pay out dividends to reduce agency costs and to act as better agents in the view of outside shareholders. More than 50 percent agreed that the payment of dividends serves as a bonding mechanism to encourage managers to act in the interest of outside shareholders (T25). This suggest that there may be a relationship between dividend payment and agency theory. However, the other statement that the payment of dividends forces a firm to seek more external financing, which subjects the firm to scrutiny of investors (T24) commanded a high level of disagreement.

The results are contrary to previous findings e.g. Baker and Powell (1998) found that over 90 percent of managers believed that dividend payments drive a firm to capital market and put the firm under greater surveillance. Although the responses whether managers act as better agents because of dividend payments received more mixed agreements they did not discard the agency explanation for paying dividends. The complete distribution of answers is provided in Table 7.

		Disagree		Neutral		Agree				
		-2	-1	0	1	2	Mean	Std.dev	Rank	
25.	The payment of dividends serves as a	**3,9 %**	**17,6 %**	**27,5 %**	**41,2 %**	**9,8 %**	**0,35**	**1,02**	**20**	**All**
	bonding mechanism to encourage managers	3,0 %	18,2 %	24,2 %	45,5 %	9,1 %	0,39	1,00	18	I
	to act in the interest of outside shareholders.	5,6 %	16,7 %	33,3 %	33,3 %	11,1 %	0,28	1,07	23,5	N
24.	The payment of dividends forces a firm	**13,7 %**	**41,2 %**	**25,5 %**	**19,6 %**	**0,0 %**	**-0,49**	**0,97**	**28**	**All**
	to seek more external financing, which	14,7 %	47,1 %	23,5 %	14,7 %	0,0 %	-0,62	0,92	28	I
	subjects the firm to scrutiny of investors.	11,8 %	29,4 %	29,4 %	29,4 %	0,0 %	-0,24	1,03	27	N

Table 7

4.4.4 The signalling explanation

Five statements involved information content or signalling effects (T2, T3, T10, T11 and T12). The respondents showed the highest level of agreement (over 90 percent) with the notion that a firm should adequately disclose to investors its reasons for changing dividend policy (T12). More than 70 percent strongly agreed with the statement. Investors regard dividend changes as signals about a firm's future prospects (T2) and a firm's stock price usually rises when a firm unexpectedly increases its dividend or pays dividend for the first time (T3) both obtained equal high agreement. Respondents opinions leaned towards that investors use dividend announcements as information to assess a firm's stock value (T10). The responses varied about whether dividend increases are ambiguous.

A study of Baker, Farelly and Edelman (1985) ranks informing investors of dividend policy changes second highest of all. Also, Baker and Powell (1998) find it with highest rank among the statements concerning signalling. The other statements also seem follow quite consistently the same pattern as in recent studies. Taking all the evidence the responses suggest that managers generally believe that dividend changes provide new information to the market and investors use this information for assessing security value. The final results for signalling explanation are seen in Table 8

		Disagree		Neutral		Agree				
		-2	-1	0	1	2	Mean	Std.dev	Rank	
12.	A firm should adequately disclose to	**0,0 %**	**3,7 %**	**3,7 %**	**20,4 %**	**72,2 %**	**1,61**	**0,74**	**1**	**All**
	investors its reasons for changing	0,0 %	5,7 %	2,9 %	17,1 %	74,3 %	1,60	0,81	1	I
	dividend policy.	0,0 %	0,0 %	5,3 %	26,3 %	68,4 %	1,63	0,60	1	N
2.	Investors regard dividend changes	**0,0 %**	**9,3 %**	**7,4 %**	**53,7 %**	**29,6 %**	**1,04**	**0,87**	**5**	**All**
	as signals about a firm's future	0,0 %	11,4 %	5,7 %	48,6 %	34,3 %	1,06	0,94	4	I
	prospects.	0,0 %	5,3 %	10,5 %	63,2 %	21,1 %	1,00	0,75	8,5	N
3.	A firm's stock price usually rises when a firm	**0,0 %**	**1,9 %**	**13,0 %**	**64,8 %**	**20,4 %**	**1,04**	**0,64**	**5**	**All**
	unexpectedly increases its dividend or pays	0,0 %	2,9 %	11,4 %	65,7 %	20,0 %	1,03	0,66	6	I
	dividend for the first time.	0,0 %	0,0 %	15,8 %	63,2 %	21,1 %	1,05	0,62	6	N
10.	Investors use dividend announcements as	**0,0 %**	**10,4 %**	**25,0 %**	**56,3 %**	**8,3 %**	**0,63**	**0,79**	**14**	**All**
	information to assess a firm's stock value.	0,0 %	9,4 %	15,6 %	65,6 %	9,4 %	0,75	0,76	12	I
		0,0 %	12,5 %	43,8 %	37,5 %	6,3 %	0,38	0,81	21	N
11.	Dividend increases are ambiguous because	**3,8 %**	**15,1 %**	**17,0 %**	**47,2 %**	**17,0 %**	**0,58**	**1,06**	**16**	**All**
	they can suggest future growth or a	2,9 %	20,6 %	8,8 %	47,1 %	20,6 %	0,62	1,13	13	I
	lack of investment opportunities.	5,3 %	5,3 %	31,6 %	47,4 %	10,5 %	0,53	0,96	15,5	N

Table 8

4.4.5 Setting dividend payments

Another object of my interest was how the firms set the amount of dividends that they pay. Also preference for ownership structure and acceptance of stock repurchase as an alternative method to pay dividends were questioned. Six statements involved with setting a dividend payment. Apparently managers believed that firm should target payout ratios because over 80 percent agreed that a firm should have a target dividend payout ratio and periodically adjust the payout towards the target (T13). Also, the continuity of dividends were considered relatively important. These two findings confirm the results obtained by Lintner (1956) and Baker, Farelly and Edelman (1985). On the other hand, the evidence surprisingly does not support the managerial perception reported by Lintner (1956) and Baker, Farelly and Edelman (1985) as well as Baker and Powell (1998) that a firm should strive to maintain steady or modestly growing dividends (T16) or that a firm should avoid changing its regular dividend if that change might have to be reversed in a year or so (T14). A low rank for statement (T16) could be partly explained by poorly formed question where "modestly" was not properly translated.

The market places greater value on stable dividends than stable payout ratios (T4) and a firm's new capital investment requirements generally have little effect on modifying its pattern of dividends (T26) showed high level of disagreement. The latter finding is inconsistent with Lintner's study whereas former is supported by Lintner's observation that most stockholders prefer a reasonably stable payout rate and that market puts a premium on stability or gradual growth in rate.

The firms were also asked if they would like to see institutional investors to own a large stake of their company (T27). The idea was to divide firms into two groups (those who prefer institutional investors and ones who do not) and compare the responses between these groups. Unfortunately, almost 50 % were indifferent whether their stocks are owned by institutions or small investors or they may consider both important and, therefore, have a neutral opinion.

Managers beliefs about a stock repurchase as an alternative method to pay dividends (T29) were inquired. The views were relatively evenly distributed but leaned towards moderate level of agreement. A complete list of answers are seen in Table 9.

		Disagree		Neutral		Agree				
		-2	-1	0	1	2	Mean	Std.dev	Rank	
13.	A firm should have a target dividend payout	**3,7 %**	**3,7 %**	**11,1 %**	**48,1 %**	**33,3 %**	**1,04**	**0,97**	**5**	**All**
	ratio and periodically adjust the payout	5,7 %	5,7 %	17,1 %	42,9 %	28,6 %	0,83	1,10	9	I
	toward the target.	0,0 %	0,0 %	0,0 %	57,9 %	42,1 %	1,42	0,51	2	N
15.	A firm should strive to maintain an	**7,4 %**	**14,8 %**	**9,3 %**	**38,9 %**	**29,6 %**	**0,69**	**1,26**	**12**	**All**
	uninterrupted record of dividend	11,4 %	14,3 %	11,4 %	37,1 %	25,7 %	0,51	1,34	15	I
	payments.	0,0 %	15,8 %	5,3 %	42,1 %	36,8 %	1,00	1,05	8,5	N
29.	A stock repurchase is an alternative	**14,8 %**	**14,8 %**	**7,4 %**	**33,3 %**	**29,6 %**	**0,48**	**1,44**	**17**	**All**
	method to pay dividends.	14,3 %	20,0 %	5,7 %	37,1 %	22,9 %	0,34	1,41	21	I
		15,8 %	5,3 %	10,5 %	26,3 %	42,1 %	0,74	1,48	11	N
27.	We would like to see institutional investor	**0,0 %**	**11,3 %**	**47,2 %**	**28,3 %**	**13,2 %**	**0,43**	**0,87**	**19**	**All**
	to own a large stake of our company.	0,0 %	17,6 %	41,2 %	26,5 %	14,7 %	0,38	0,95	19	I
		0,0 %	0,0 %	57,9 %	31,6 %	10,5 %	0,53	0,70	15,5	N
14.	A firm should avoid changing its regular	**16,7 %**	**18,5 %**	**13,0 %**	**29,6 %**	**22,2 %**	**0,22**	**1,42**	**22**	**All**
	dividend if that change might have to	14,3 %	22,9 %	2,9 %	31,4 %	28,6 %	0,37	1,48	20	I
	be reversed in a year or so.	21,1 %	10,5 %	31,6 %	26,3 %	10,5 %	-0,05	1,31	25	N
16.	A firm should strive to maintain steady or	**7,7 %**	**40,4 %**	**15,4 %**	**26,9 %**	**9,6 %**	**-0,10**	**1,18**	**25**	**All**
	modestly growing dividends.	11,8 %	44,1 %	11,8 %	26,5 %	5,9 %	-0,29	1,17	26	I
		0,0 %	33,3 %	22,2 %	27,8 %	16,7 %	0,28	1,13	23,5	N
4.	The market places greater value on stable	**9,6 %**	**28,8 %**	**30,8 %**	**26,9 %**	**3,8 %**	**-0,13**	**1,05**	**26**	**All**
	dividends than stable payout ratios.	15,2 %	21,2 %	27,3 %	30,3 %	6,1 %	-0,09	1,18	25	I
		0,0 %	42,1 %	36,8 %	21,1 %	0,0 %	-0,21	0,79	26	N
26.	A firm's new capital investment requirements	**9,4 %**	**49,1 %**	**17,0 %**	**22,6 %**	**1,9 %**	**-0,42**	**1,01**	**27**	**All**
	generally have little effect on modifying	11,4 %	48,6 %	17,1 %	20,0 %	2,9 %	-0,46	1,04	27	I
	its pattern of dividends.	5,6 %	50,0 %	16,7 %	27,8 %	0,0 %	-0,33	0,97	28	N

Table 9

4.5 Factors influencing dividend policy decisions

The second objective of the study was to identify the factors which are most important in influencing the dividend policy of the firms paying cash dividend. Table 9 presents descriptive statistics showing the importance level of each of 22 factors considered by managers in setting their firm's dividend policy. The factors are ranked according to their mean response and the statistics also present how high managers who are actively involved in the process as well as those who are not involved value the factors.

	Factor	None 1	Low 2	Moderate 3	High 4	Mean	Std.dev	Rank	
1.	Level of current and past earnings	**0,0 %**	**9,3 %**	**38,9 %**	**51,9 %**	**3,43**	**0,66**	**1**	**All**
		0,0 %	11,4 %	34,3 %	54,3 %	3,43	0,70	1	Involved
		0,0 %	5,3 %	47,4 %	47,4 %	3,42	0,61	1	Not involved
16.	Needs of current shareholders such as the desire for current income	**1,9 %**	**9,3 %**	**53,7 %**	**35,2 %**	**3,22**	**0,69**	**2**	**All**
		2,9 %	5,7 %	60,0 %	31,4 %	3,20	0,68	2	Involved
		0,0 %	21,1 %	36,8 %	42,1 %	3,21	0,79	3	Not involved
12.	Continuity of past dividends	**0,0 %**	**13,0 %**	**53,7 %**	**33,3 %**	**3,20**	**0,66**	**3**	**All**
		0,0 %	17,1 %	48,6 %	34,3 %	3,17	0,71	3	Involved
		0,0 %	5,3 %	63,2 %	31,6 %	3,26	0,56	2	Not involved
2.	Expected future earnings	**3,7 %**	**16,7 %**	**44,4 %**	**35,2 %**	**3,11**	**0,82**	**4**	**All**
		5,7 %	14,3 %	40,0 %	40,0 %	3,14	0,88	4	Involved
		0,0 %	21,1 %	52,6 %	26,3 %	3,05	0,71	7	Not involved
21.	Prestige associated paying dividends	**0,0 %**	**18,9 %**	**52,8 %**	**28,3 %**	**3,09**	**0,69**	**5**	**All**
		0,0 %	23,5 %	47,1 %	29,4 %	3,06	0,74	6	Involved
		0,0 %	10,5 %	63,2 %	26,3 %	3,16	0,60	5	Not involved
10.	Concern about maintaining or increasing stock price	**5,6 %**	**9,3 %**	**57,4 %**	**27,8 %**	**3,07**	**0,77**	**6**	**All**
		5,7 %	5,7 %	57,1 %	31,4 %	3,14	0,77	5	Involved
		5,3 %	15,8 %	57,9 %	21,1 %	2,95	0,78	8	Not involved
20.	Desire to pay out, in the long run, a given fraction	**1,9 %**	**24,1 %**	**38,9 %**	**35,2 %**	**3,07**	**0,82**	**7**	**All**
		2,9 %	25,7 %	37,1 %	34,3 %	3,03	0,86	7	Involved
		0,0 %	21,1 %	42,1 %	36,8 %	3,16	0,76	4	Not involved
18.	Expected rate of return on assets	**3,7 %**	**20,4 %**	**51,9 %**	**24,1 %**	**2,96**	**0,78**	**8**	**All**
		5,7 %	22,9 %	48,6 %	22,9 %	2,89	0,83	9	Involved
		0,0 %	15,8 %	57,9 %	26,3 %	3,11	0,66	6	Not involved
11.	Concern that a dividend change may provide a false signal to investors	**3,7 %**	**29,6 %**	**40,7 %**	**25,9 %**	**2,89**	**0,84**	**9**	**All**
		0,0 %	34,3 %	40,0 %	25,7 %	2,91	0,78	8	Involved
		10,5 %	21,1 %	42,1 %	26,3 %	2,84	0,96	9	Not involved
3.	Investment considerations such as the lack of profitable investment opportunities	**3,7 %**	**35,2 %**	**46,3 %**	**14,8 %**	**2,72**	**0,76**	**10**	**All**
		2,9 %	28,6 %	54,3 %	14,3 %	2,80	0,72	10	Involved
		5,3 %	47,4 %	31,6 %	15,8 %	2,58	0,84	13	Not involved
9.	Concern about maintaining a target capital	**17,0 %**	**24,5 %**	**43,4 %**	**15,1 %**	**2,57**	**0,95**	**11**	**All**
		14,3 %	22,9 %	51,4 %	11,4 %	2,60	0,88	11	Involved
		22,2 %	27,8 %	27,8 %	22,2 %	2,50	1,10	15	Not involved

15. Projections about the future state of	**16,7 %**	**31,5 %**	**37,0 %**	**14,8 %**	**2,50**	**0,95**	**12**	**All**
the economy	20,0 %	34,3 %	34,3 %	11,4 %	2,37	0,94	14	Involved
	10,5 %	26,3 %	42,1 %	21,1 %	2,74	0,93	10	Not involved
13. Stability of cash flows	**17,0 %**	**24,5 %**	**50,9 %**	**7,5 %**	**2,49**	**0,87**	**13**	**All**
	20,6 %	26,5 %	47,1 %	5,9 %	2,38	0,89	13	Involved
	10,5 %	21,1 %	57,9 %	10,5 %	2,68	0,82	11	Not involved
19. Desire to conform industry dividend	**13,0 %**	**33,3 %**	**46,3 %**	**7,4 %**	**2,48**	**0,82**	**14**	**All**
practice	17,1 %	31,4 %	45,7 %	5,7 %	2,40	0,85	12	Involved
	5,3 %	36,8 %	47,4 %	10,5 %	2,63	0,76	12	Not involved
4. Financing considerations such as	**18,5 %**	**33,3 %**	**38,9 %**	**9,3 %**	**2,39**	**0,90**	**15**	**All**
the cost of raising external funds	22,9 %	31,4 %	40,0 %	5,7 %	2,29	0,89	16	Involved
	10,5 %	36,8 %	36,8 %	15,8 %	2,58	0,90	14	Not involved
7. Legal rules and constraints such as	**32,0 %**	**28,0 %**	**14,0 %**	**26,0 %**	**2,34**	**1,19**	**16**	**All**
paying dividends would impair	42,4 %	15,2 %	12,1 %	30,3 %	2,30	1,31	15	Involved
	11,8 %	52,9 %	17,6 %	17,6 %	2,41	0,94	18	Not involved
17. Characteristics of current	**24,1 %**	**31,5 %**	**35,2 %**	**9,3 %**	**2,30**	**0,94**	**17**	**All**
shareholders such as their tax	25,7 %	34,3 %	34,3 %	5,7 %	2,20	0,90	17	Involved
positions	21,1 %	26,3 %	36,8 %	15,8 %	2,47	1,02	17	Not involved
8. Control issues such as the firm's	**31,5 %**	**29,6 %**	**31,5 %**	**7,4 %**	**2,15**	**0,96**	**18**	**All**
ownership structure	42,9 %	25,7 %	22,9 %	8,6 %	1,97	1,01	20	Involved
	10,5 %	36,8 %	47,4 %	5,3 %	2,47	0,77	16	Not involved
6. Liquidity constraints such as	**35,8 %**	**28,3 %**	**28,3 %**	**7,5 %**	**2,08**	**0,98**	**19**	**All**
the availability of cash	40,0 %	25,7 %	25,7 %	8,6 %	2,03	1,01	18	Involved
	27,8 %	33,3 %	33,3 %	5,6 %	2,17	0,92	19	Not involved
22. A possibility to repurchase firm's	**35,2 %**	**29,6 %**	**27,8 %**	**7,4 %**	**2,07**	**0,97**	**20**	**All**
own shares	40,0 %	22,9 %	31,4 %	5,7 %	2,03	0,98	19	Involved
	26,3 %	42,1 %	21,1 %	10,5 %	2,16	0,96	20	Not involved
14. Preferences to pay dividends	**43,4 %**	**35,8 %**	**15,1 %**	**5,7 %**	**1,83**	**0,89**	**21**	**All**
instead of undertaking risky	48,6 %	34,3 %	14,3 %	2,9 %	1,71	0,83	22	Involved
reinvestment	33,3 %	38,9 %	16,7 %	11,1 %	2,06	1,00	21	Not involved
5. Contractual constraints such as	**48,1 %**	**30,8 %**	**13,5 %**	**7,7 %**	**1,81**	**0,95**	**22**	**All**
restrictions on debt	51,4 %	31,4 %	11,4 %	5,7 %	1,71	0,89	21	Involved
	41,2 %	29,4 %	17,6 %	11,8 %	2,00	1,06	22	Not involved

Table 10

The most important influence on the dividend policy was the level of current and past earnings (F1). This had a mean rating of 3,43 which suggest that it is very important factor for managers. Expected future earnings (F2) with a mean score of 3,11 was ranked fourth highest. Evidence suggest that past, current as well future earnings weigh heavily when managers form firms cash dividend policy. Comparing the results with

recent research the similarity is overwhelming. Anticipated level of firm's future earnings was the most highly ranked determinant in Baker, Farelly and Edelman's study. The evidence provided by Pruit and Gitman (1991) suggest that current and past year's profits among two other factors relating to earnings have the strongest influence on dividends paid. Baker and Powell (1998) who report that factors have changed little since the 1983 dividend survey find level of current and expected future earnings the most critical factor.

Clearly unexpected result was that the needs of current shareholders such as the desire for current income (F16) was ranked second highest with a mean score of 3,22. This factor has not been directly acknowledged by any of the previous studies and Baker and Powell (1998) find it only ninth important determinant.

The next most important factor with average response of 3,2 was the continuity of past dividends (F12). A high rank for pattern or continuity of past dividends was reported to have a significant influence in several studies.[14]

A fifth factor cited as important in determining dividend policy is the prestige associated paying dividends (F21). It had a mean response of 3,09. It is interesting to see that Finnish managers value this factor so high. Baker and Powell (1998) found that factor to have very little effect on influencing company's dividend policy. In fact, the factor was second last in their survey. On the other hand, Kose and Williams (1985) reasoned that corporate insiders recognise the relationship between repeated dividends and their firm's reputation and optimally smooth dividends over time relative to corporate cash inflows. That would explain why insiders might optimally pay a current dividend even if neither the firm nor its stockholders currently demand cash.

Although differences exist in dividend theories and empirical results about the relationship between dividend policy and firm value, the results provide more confirmation for managers belief that dividend policy can affect a market value of the firm because concern about maintaining or increasing stock price (F10) was ranked sixth with average score of 3,07. The finding is consistent with the pattern of responses

in earlier studies. Baker, Farelly and Edelman (1985) as well as Baker and Powell (1998) both find this factor among top four major determinants.

More or less unexpected was that liquidity constraints such as the availability of cash (F6) was ranked fourth lowest. Based on previous research I would have expected this factor to be a top achiever. Availability of cash and liquid funds have previously been highly ranked (see, for example, Baker, Farelly and Edelman, 1985; Allen, 1992; and Baker and Powell, 1998). Also, the stability of cash flows (F13) was somewhat lower place than expected because cash flows provide the basis for paying dividends. Management can have more confidence in maintaining a stable dividend policy or avoid the potential of having unexpected changes in dividends by having stable cash flows. On the other hand, managers in Finland seem to think that market appreciates stable payout ratios more than stable dividends and this explains the low rank of the factor.

Despite the fact that over 50 percent of the respondents believed that a stock repurchase is an alternative method to pay dividends only one third announced that a possibility to repurchase firm's own shares (F22) has a moderate or high importance in influencing firm's dividend policy.

4.6 Industry influence on dividend policy

To inspect industry influence I split the sample into two groups. One group contains a set of firms which can be considered operating in mature, stable markets and the other contains the firms which are operating in developing markets. The complete distribution of different industries are seen in Table 11.

[14] Lintner (1956), Baker, Farelly and Edelman (1985), Pruitt and Gitman (1991), Allen (1992) and Baker and Powell (1998)

Mature industries	Developing industries
Investment	Banking/Finance
Transport	and Insurance
Other Services	Trade
Metal and Engineering	Multi-Business
Forest Industry	Food Industry
Energy	Telecommunications
Construction	
Chemicals	
Media and publishing	
Other industries	

Table 11

Next these two groups were divided into two subgroups depending on whether the respondent is actively involved in determining their firm's dividend policy or not. Table 12 shows how the firms were divided into these four groups.

	Not Involved	Involved	Total
Developing industries	9	18	27
Stable industries	10	17	27
Total	19	35	54

Table 12

4.6.1 Estimating differences between the groups

I used regression model to test if the responses to empirical and theoretical issues involving dividend policy differ significantly between these four groups. The regression formula is as follows:

$$y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 \qquad (1)$$

if $x_1 = x_2 = 0 \Rightarrow y = \beta_0$

$x_1 = 1$ and $x_2 = 0 \Rightarrow y = \beta_0 + \beta_1$

$x_1 = 0$ and $x_2 = 1 \Rightarrow y = \beta_0 + \beta_2$

$x_1 = 1$ and $x_2 = 1 \Rightarrow y = \beta_0 + \beta_1 + \beta_2 + \beta_3$.

where x_1 is 0 if the firm belongs to the developing industry group and 1 if it belongs to the mature industry group, and x_2 is 1 if the respondent is actively involved in deciding firm's dividend policy or 0 if he is not involved. The last term $x_3 = x_1 x_2$ is 1 if the firm operates in mature industries and the respondent is actively involved in dividend policy issues, otherwise the term is 0.

The average response of manager not involved with decision making and operating in developing industries is estimated by parameter β_0. Estimated parameter β_1 shows the difference in responses between firms in x_1 groups, and parameter β_2 returns the difference in responses between managers who are actively involved and those who are not. The effect whether the responses of active managers differ in both mature and developing industries is caught by β_3.

4.6.2 Regression results

The results of the regression tests show that the responses of the actively involved managers in mature and developing industry groups differ significantly at the 0,05 level

for only 2 of the 29 statements (T21 and T22). This evidence suggests that a firm's industry type has little influence on the views that managers have about theoretical and empirical issues involving dividend policy. The complete summary of the regression results is seen in Exhibit 2.

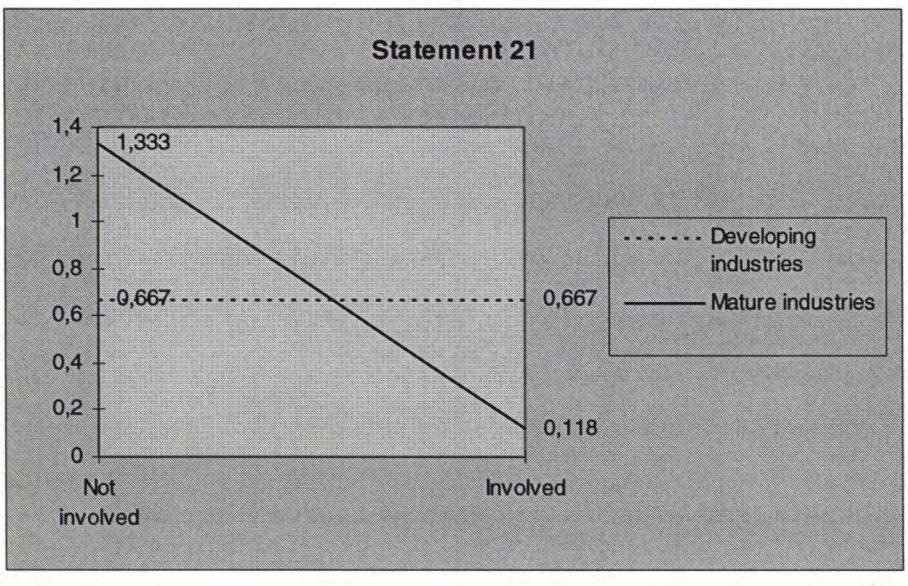


Figure 1

Investors prefer that a firm retains funds over paying dividends if dividends are taxed heavier than capital gains (T21) received uniform agreement among developing industries. However, on mature industries agreement varies significantly and the effect of management's involvement in dividend decisions lowers the agreement considerably (Figure 1). On the other hand, it is somewhat expected that in the developing industries firms are more likely to retain funds in the company because of the nature of their business. The value of the firm is heavily concentrated on the future earnings power of the firm and the firm needs cash to finance future investments.

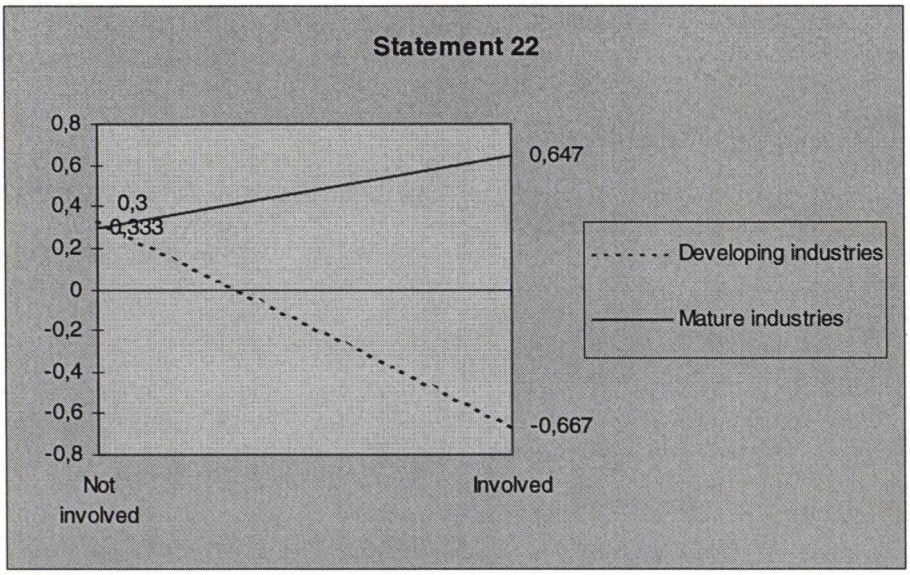


Figure 2

Investors prefer certain dividend stream to uncertain price appreciation (T22) was the other statement which agreement differs significantly among the four groups of firms (Figure 2). In developing industries managers who are actively involved in dividend policy issues disagreed that investors prefer certain dividend stream. Logically the finding is not surprising because increasing the dividend today will not increase a firm's value by value by reducing the riskiness of future cash flows.

4.7 Targeting payout ratio

Comparable procedure was accomplished to see whether there are differences in firms using a target payout ratio and those who are not using. The distribution how the firms are divided into four groups are seen in Table 13.

	Not Involved	Involved	Total
Target payout ratio	6	21	27
No target payout ratio	13	14	27
Total	19	35	54

Table 13

The regression statistics show that at 0,05 level of significance none of the groups differs from others according to their mean response to the statements. At significance level of 0,1 three statements (T8, T11 and T26) received statistically significant values. The complete set of statistics is seen on the Exhibit 2.

Taken together, regardless of breaking the sample into different groups using two independent methods the regression results were not able to show any systematic differences among these groups of firms. This evidence suggests that managers who are actively involved in determining their firm's dividend policy as well those who are not view the theoretical and empirical issues transmitted by the academic literature in the same manner regardless of the industry type. Also similar results were obtained when sample was split into groups based on using a target payout ratio which further confirms the findings that managers have uniform opinions about the statements.

5. Concluding remarks

The objective of the paper was to examine the dividend policy views of corporate managers of listed Finnish companies and also to provide insight into the dividend decision making in these companies. Several conclusions about dividend policy may be drawn from the findings of this survey.

First, one half of the companies reported that they use target payout ratios which is very similar compared to findings from other foreign studies. However, the average target payout ratio was a little lower (40 %) than expected. This could be due to a fact that Finnish companies have traditionally had high debt to equity ratio and now the companies may try to avoid increasing leverage. By reducing dividend payments/target payout the companies are able to finance their investments from earnings and probably to pay back outside debt which gives a better cushion for uncertain future.

Second, the relationship between dividend policy and value was under examination. Most of the respondents believed that dividend policy affects firm value which has been acknowledged by several foreign studies.

Third, of the four explanations for dividend relevance examined in this study, the respondents generally had the highest level of agreement with statements involving signalling. The respondents typically were most uncertain (neither agreed nor disagreed) about the statements involving the Bird-in-the-Hand and agency explanations of dividend relevance. Respondents generally agreed that investors divide into clienteles and their dividend preferences vary depending on their age. However, managers were uncertain about tax-induced clientele explanation.

Fourth, the results show that managers' views on setting dividend payments today are consistent with those reported by managers interviewed by Lintner (1956) and Baker, Farelly and Edelman (1985). In particular, the respondents were highly concerned that a firm should have a target dividend payout ratio and periodically adjust the payout toward the target. Also, the results show that managers were concerned about the continuity of dividends.

The second objective of the study was to identify the factors which are most important in influencing the dividend policy of the firms paying cash dividend. The evidence from this paper largely confirms previous evidence about the determinants of dividend policy. The most important factors influencing dividend policy in this survey were highly similar to those found by Lintner (1956) and Baker, Farelly and Edelman (1985).

The results show that the most important determinants of a firm's dividend policy were the level of current and past earnings. Also continuity of past dividends and expected future earnings were highly ranked. Among six highest factors there were two unexpected factors. Needs of current shareholders such as the desire for current income and prestige associated paying dividends were surprise factors if compared to related studies abroad. Also the results confirm the finding that managers believe that dividend policy can affect the value of the firm because concern about maintaining or increasing stock price was ranked sixth highest.

Finally, I tested the opinions of the respondents from four different groups depending on whether managers are actively involved in dividend decision making and whether their company is operating on stable or developing markets. The results show few statistically significant differences among the 29 statements. I repeated the regression analysis by splitting the sample using different criteria. The companies were divided into four groups based on respondents involvement and whether a company uses target payout ratio or not. This time none of the statements differs significantly among these four groups.

Exhibit 1

	-2	-1	0	1	2	Mean	Std.dev	Rank	
12. A firm should adequately disclose to	**0,0 %**	**3,7 %**	**3,7 %**	**20,4 %**	**72,2 %**	**1,61**	**0,74**	**1**	**All**
investors its reasons for changing	0,0 %	5,7 %	2,9 %	17,1 %	74,3 %	1,60	0,81	1	I
dividend policy.	0,0 %	0,0 %	5,3 %	26,3 %	68,4 %	1,63	0,60	1	N
1. A change in dividend policy affects	**0,0 %**	**3,7 %**	**7,4 %**	**61,1 %**	**27,8 %**	**1,13**	**0,70**	**2**	**All**
firm value.	0,0 %	5,7 %	8,6 %	57,1 %	28,6 %	1,09	0,78	2	I
	0,0 %	0,0 %	5,3 %	68,4 %	26,3 %	1,21	0,54	4	N
8. A firm's investment, financing, and	**1,9 %**	**11,1 %**	**5,6 %**	**37,0 %**	**44,4 %**	**1,11**	**1,06**	**3**	**All**
dividends decisions are interrelated	2,9 %	14,3 %	2,9 %	31,4 %	48,6 %	1,09	1,17	3	I
	0,0 %	5,3 %	10,5 %	47,4 %	36,8 %	1,16	0,83	5	N
6. A firm should formulate its dividend	**3,7 %**	**13,0 %**	**7,4 %**	**27,8 %**	**48,1 %**	**1,04**	**1,20**	**5**	**All**
policy to produce maximum value for	5,7 %	14,3 %	5,7 %	31,4 %	42,9 %	0,91	1,27	7	I
shareholders.	0,0 %	10,5 %	10,5 %	21,1 %	57,9 %	1,26	1,05	3	N
2. Investors regard dividend changes	**0,0 %**	**9,3 %**	**7,4 %**	**53,7 %**	**29,6 %**	**1,04**	**0,87**	**5**	**All**
as signals about a firm's future	0,0 %	11,4 %	5,7 %	48,6 %	34,3 %	1,06	0,94	4	I
prospects.	0,0 %	5,3 %	10,5 %	63,2 %	21,1 %	1,00	0,75	8,5	N
3. A firm's stock price usually rises when a firm	**0,0 %**	**1,9 %**	**13,0 %**	**64,8 %**	**20,4 %**	**1,04**	**0,64**	**5**	**All**
unexpectedly increases its dividend or pays	0,0 %	2,9 %	11,4 %	65,7 %	20,0 %	1,03	0,66	6	I
dividend for the first time.	0,0 %	0,0 %	15,8 %	63,2 %	21,1 %	1,05	0,62	6	N
13. A firm should have a target dividend payout	**3,7 %**	**3,7 %**	**11,1 %**	**48,1 %**	**33,3 %**	**1,04**	**0,97**	**5**	**All**
ratio and periodically adjust the payout	5,7 %	5,7 %	17,1 %	42,9 %	28,6 %	0,83	1,10	9	I
toward the target.	0,0 %	0,0 %	0,0 %	57,9 %	42,1 %	1,42	0,51	2	N
5. An optimal dividend policy strikes a balance	**0,0 %**	**9,6 %**	**19,2 %**	**46,2 %**	**25,0 %**	**0,87**	**0,91**	**8**	**All**
between current dividends and future growth	0,0 %	2,9 %	23,5 %	41,2 %	32,4 %	1,03	0,83	5	I
that maximises stock price.	0,0 %	22,2 %	11,1 %	55,6 %	11,1 %	0,56	0,98	14	N
17. A firm should be responsive to the	**1,9 %**	**3,8 %**	**22,6 %**	**58,5 %**	**13,2 %**	**0,77**	**0,80**	**9**	**All**
dividend preferences of its shareholders	0,0 %	2,9 %	20,6 %	61,8 %	14,7 %	0,88	0,69	8	I
	5,3 %	5,3 %	26,3 %	52,6 %	10,5 %	0,58	0,96	13	N
9. A firm's dividend policy affects its cost	**3,8 %**	**15,4 %**	**9,6 %**	**46,2 %**	**25,0 %**	**0,73**	**1,12**	**10**	**All**
of capital.	5,7 %	20,0 %	2,9 %	51,4 %	20,0 %	0,60	1,19	14	I
	0,0 %	5,9 %	23,5 %	35,3 %	35,3 %	1,00	0,94	8,5	N
28. Dividend preferences vary between	**0,0 %**	**11,8 %**	**23,5 %**	**47,1 %**	**17,6 %**	**0,71**	**0,90**	**11**	**All**
shareholders depending on their age.	0,0 %	6,1 %	27,3 %	51,5 %	15,2 %	0,76	0,79	11	I
	0,0 %	22,2 %	16,7 %	38,9 %	22,2 %	0,61	1,09	12	N
15. A firm should strive to maintain an	**7,4 %**	**14,8 %**	**9,3 %**	**38,9 %**	**29,6 %**	**0,69**	**1,26**	**12**	**All**
uninterrupted record of dividend	11,4 %	14,3 %	11,4 %	37,1 %	25,7 %	0,51	1,34	15	I
payments.	0,0 %	15,8 %	5,3 %	42,1 %	36,8 %	1,00	1,05	8,5	N
19. Stocks that pay high dividends attract	**0,0 %**	**14,3 %**	**26,5 %**	**36,7 %**	**22,4 %**	**0,67**	**0,99**	**13**	**All**
tax-exempt entities.	0,0 %	12,9 %	22,6 %	38,7 %	25,8 %	0,77	0,99	10	I
	0,0 %	16,7 %	33,3 %	33,3 %	16,7 %	0,50	0,99	17,5	N

		-2	-1	0	1	2	Mean	Std.dev	Rank	
10.	Investors use dividend announcements as	**0,0 %**	**10,4 %**	**25,0 %**	**56,3 %**	**8,3 %**	**0,63**	**0,79**	**14**	**All**
	information to assess a firm's stock value.	0,0 %	9,4 %	15,6 %	65,6 %	9,4 %	0,75	0,76	12	I
		0,0 %	12,5 %	43,8 %	37,5 %	6,3 %	0,38	0,81	21	N
21.	Investors prefer that a firm retains funds	**1,9 %**	**17,0 %**	**18,9 %**	**43,4 %**	**18,9 %**	**0,60**	**1,04**	**15**	**All**
	over paying dividends if dividends are	2,9 %	25,7 %	14,3 %	42,9 %	14,3 %	0,40	1,12	17	I
	taxed heavier than capital gains.	0,0 %	0,0 %	27,8 %	44,4 %	27,8 %	1,00	0,77	8,5	N
11.	Dividend increases are ambiguous because	**3,8 %**	**15,1 %**	**17,0 %**	**47,2 %**	**17,0 %**	**0,58**	**1,06**	**16**	**All**
	they can suggest future growth or a	2,9 %	20,6 %	8,8 %	47,1 %	20,6 %	0,62	1,13	13	I
	lack of investment opportunities.	5,3 %	5,3 %	31,6 %	47,4 %	10,5 %	0,53	0,96	15,5	N
29.	A stock repurchase is an alternative	**14,8 %**	**14,8 %**	**7,4 %**	**33,3 %**	**29,6 %**	**0,48**	**1,44**	**17**	**All**
	method to pay dividends.	14,3 %	20,0 %	5,7 %	37,1 %	22,9 %	0,34	1,41	21	I
		15,8 %	5,3 %	10,5 %	26,3 %	42,1 %	0,74	1,48	11	N
20.	Investors are attracted to firms that have	**1,9 %**	**17,0 %**	**22,6 %**	**49,1 %**	**9,4 %**	**0,47**	**0,95**	**18**	**All**
	dividend policies appropriate to the	0,0 %	20,6 %	23,5 %	44,1 %	11,8 %	0,47	0,96	16	I
	investors' particular tax circumstances.	5,3 %	10,5 %	21,1 %	57,9 %	5,3 %	0,47	0,96	19	N
27.	We would like to see institutional investor	**0,0 %**	**11,3 %**	**47,2 %**	**28,3 %**	**13,2 %**	**0,43**	**0,87**	**19**	**All**
	to own a large stake of our company.	0,0 %	17,6 %	41,2 %	26,5 %	14,7 %	0,38	0,95	19	I
		0,0 %	0,0 %	57,9 %	31,6 %	10,5 %	0,53	0,70	15,5	N
25.	The payment of dividends serves as a	**3,9 %**	**17,6 %**	**27,5 %**	**41,2 %**	**9,8 %**	**0,35**	**1,02**	**20**	**All**
	bonding mechanism to encourage managers	3,0 %	18,2 %	24,2 %	45,5 %	9,1 %	0,39	1,00	18	I
	to act in the interest of outside shareholders.	5,6 %	16,7 %	33,3 %	33,3 %	11,1 %	0,28	1,07	23,5	N
18.	A firm cuts dividends in future if taxes on	**9,6 %**	**15,4 %**	**21,2 %**	**46,2 %**	**7,7 %**	**0,27**	**1,12**	**21**	**All**
	dividends are raised.	11,8 %	20,6 %	17,6 %	41,2 %	8,8 %	0,15	1,21	22	I
		5,6 %	5,6 %	27,8 %	55,6 %	5,6 %	0,50	0,92	17,5	N
14.	A firm should avoid changing its regular	**16,7 %**	**18,5 %**	**13,0 %**	**29,6 %**	**22,2 %**	**0,22**	**1,42**	**22**	**All**
	dividend if that change might have to	14,3 %	22,9 %	2,9 %	31,4 %	28,6 %	0,37	1,48	20	I
	be reversed in a year or so.	21,1 %	10,5 %	31,6 %	26,3 %	10,5 %	-0,05	1,31	25	N
23.	Investors prefer certain, current	**3,7 %**	**24,1 %**	**27,8 %**	**38,9 %**	**5,6 %**	**0,19**	**0,99**	**23**	**All**
	dividends to possibly higher but	5,7 %	25,7 %	28,6 %	37,1 %	2,9 %	0,06	1,00	23	I
	riskier future dividends.	0,0 %	21,1 %	26,3 %	42,1 %	10,5 %	0,42	0,96	20	N
22.	Investors prefer certain dividend stream	**9,3 %**	**24,1 %**	**25,9 %**	**29,6 %**	**11,1 %**	**0,09**	**1,17**	**24**	**All**
	to uncertain price appreciation.	11,4 %	28,6 %	25,7 %	20,0 %	14,3 %	-0,03	1,25	24	I
		5,3 %	15,8 %	26,3 %	47,4 %	5,3 %	0,32	1,00	22	N
16.	A firm should strive to maintain steady or	**7,7 %**	**40,4 %**	**15,4 %**	**26,9 %**	**9,6 %**	**-0,10**	**1,18**	**25**	**All**
	modestly growing dividends.	11,8 %	44,1 %	11,8 %	26,5 %	5,9 %	-0,29	1,17	26	I
		0,0 %	33,3 %	22,2 %	27,8 %	16,7 %	0,28	1,13	23,5	N
4.	The market places greater value on stable	**9,6 %**	**28,8 %**	**30,8 %**	**26,9 %**	**3,8 %**	**-0,13**	**1,05**	**26**	**All**
	dividends than stable payout ratios.	15,2 %	21,2 %	27,3 %	30,3 %	6,1 %	-0,09	1,18	25	I
		0,0 %	42,1 %	36,8 %	21,1 %	0,0 %	-0,21	0,79	26	N
26.	A firm's new capital investment requirements	**9,4 %**	**49,1 %**	**17,0 %**	**22,6 %**	**1,9 %**	**-0,42**	**1,01**	**27**	**All**
	generally have little effect on modifying	11,4 %	48,6 %	17,1 %	20,0 %	2,9 %	-0,46	1,04	27	I
	its pattern of dividends.	5,6 %	50,0 %	16,7 %	27,8 %	0,0 %	-0,33	0,97	28	N

		-2	-1	0	1	2	Mean	Std.dev	Rank	
24.	The payment of dividends forces a firm	**13,7 %**	**41,2 %**	**25,5 %**	**19,6 %**	**0,0 %**	**-0,49**	**0,97**	**28**	**All**
	to seek more external financing, which	14,7 %	47,1 %	23,5 %	14,7 %	0,0 %	-0,62	0,92	28	I
	subjects the firm to scrutiny of investors.	11,8 %	29,4 %	29,4 %	29,4 %	0,0 %	-0,24	1,03	27	N
7.	A firm should view cash dividends as a	**53,7 %**	**29,6 %**	**7,4 %**	**5,6 %**	**3,7 %**	**-1,24**	**1,06**	**29**	**All**
	residual after financing desired investments	57,1 %	25,7 %	2,9 %	8,6 %	5,7 %	-1,20	1,21	29	I
	from earnings.	47,4 %	36,8 %	15,8 %	0,0 %	0,0 %	-1,32	0,75	29	N

Exhibit 2

		Stable/Developing industries			Target/No target payout		
		Coeff.	***t Stat***	***P-value***	***Coeff.***	***t Stat***	***P-value***
1. A change in dividend policy affects	*Beta 0*	1,222	5,334	0,000	1,154	5,839	0,000
firm value.	*Beta 1*	-0,022	-0,070	0,944	0,060	0,220	0,827
	Beta 2	0,111	0,396	0,694	0,179	0,510	0,612
	Beta 3	-0,488	-1,243	0,220	-0,394	-0,918	0,363
2. Investors regard dividend changes	*Beta 0*	1,111	3,748	0,000	1,077	4,393	0,000
as signals about a firm's	*Beta 1*	-0,211	-0,517	0,608	0,137	0,403	0,688
future prospects.	*Beta 2*	-0,111	-0,306	0,761	-0,244	-0,558	0,579
	Beta 3	0,329	0,648	0,520	-0,018	-0,034	0,973
3. A firm's stock price usually rises when a firm	*Beta 0*	1,222	5,605	0,000	0,923	5,145	0,000
unexpectedly increases its dividend or pays	*Beta 1*	-0,322	-1,072	0,289	0,220	0,882	0,382
dividend for the first time.	*Beta 2*	-0,222	-0,832	0,409	0,410	1,285	0,205
	Beta 3	0,381	1,021	0,312	-0,601	-1,542	0,129
4. The market places greater value on stable	*Beta 0*	-0,444	-1,255	0,216	-0,154	-0,517	0,607
dividends than stable payout ratios.	*Beta 1*	0,444	0,910	0,367	0,237	0,553	0,583
	Beta 2	0,209	0,477	0,635	-0,179	-0,339	0,736
	Beta 3	-0,147	-0,239	0,812	-0,094	-0,144	0,886
5. An optimal dividend policy strikes a balance	*Beta 0*	0,556	1,840	0,072	0,615	2,531	0,015
between current dividends and future growth	*Beta 1*	0,000	0,000	1,000	0,099	0,293	0,771
that maximises stock price.	*Beta 2*	0,444	1,202	0,235	-0,215	-0,467	0,643
	Beta 3	0,063	0,118	0,906	0,751	1,358	0,181
6. A firm should formulate its dividend	*Beta 0*	1,667	4,197	0,000	1,077	3,214	0,002
policy to produce maximum value for	*Beta 1*	-0,767	-1,401	0,167	-0,148	-0,319	0,751
shareholders.	*Beta 2*	-0,889	-1,828	0,074	0,590	0,989	0,327
	Beta 3	1,048	1,542	0,129	-0,614	-0,843	0,403
7. A firm should view cash dividends as a	*Beta 0*	-1,556	-4,307	0,000	-1,231	-4,074	0,000
residual after financing desired investments	*Beta 1*	0,456	0,915	0,365	0,088	0,210	0,835
from earnings.	*Beta 2*	0,333	0,754	0,455	-0,269	-0,501	0,619
	Beta 3	-0,410	-0,663	0,510	0,174	0,265	0,792
8. A firm's investment, financing, and	*Beta 0*	0,889	2,525	0,015	0,923	3,143	0,003
dividends decisions are interrelated	*Beta 1*	0,511	1,053	0,297	0,363	0,889	0,378
	Beta 2	0,444	1,031	0,308	0,744	1,423	0,161
	Beta 3	-1,021	-1,695	0,096	-1,077	-1,689	0,097
9. A firm's dividend policy affects its cost	*Beta 0*	0,778	2,140	0,037	0,769	2,492	0,016
of capital.	*Beta 1*	0,472	0,891	0,377	-0,198	-0,461	0,647
	Beta 2	0,167	0,374	0,710	0,981	1,541	0,130
	Beta 3	-1,181	-1,830	0,073	-0,933	-1,256	0,215
10. Investors use dividend announcements as	*Beta 0*	0,750	2,793	0,008	0,417	1,821	0,075
information to assess a firm's stock value.	*Beta 1*	-0,750	-1,975	0,055	0,298	0,955	0,345
	Beta 2	0,063	0,190	0,850	-0,167	-0,364	0,717
	Beta 3	0,625	1,344	0,186	0,230	0,428	0,671

		Coeff.	t Stat	P-value	Coeff.	t Stat	P-value
11. Dividend increases are ambiguous because they can suggest future growth or a lack of investment opportunities.	*Beta 0*	0,333	0,930	0,357	0,231	0,789	0,434
	Beta 1	0,367	0,742	0,462	0,555	1,366	0,178
	Beta 2	0,078	0,177	0,860	0,936	1,798	0,078
	Beta 3	0,045	0,073	0,942	-1,222	-1,917	0,061
12. A firm should adequately disclose to investors its reasons for changing dividend policy.	*Beta 0*	1,667	6,726	0,000	1,538	7,382	0,000
	Beta 1	-0,067	-0,195	0,846	-0,038	-0,133	0,895
	Beta 2	0,111	0,366	0,716	0,295	0,795	0,430
	Beta 3	-0,299	-0,706	0,484	-0,128	-0,283	0,778
13. A firm should have a target dividend payout ratio and periodically adjust the payout toward the target.	*Beta 0*	1,556	4,957	0,000	1,308	5,394	0,000
	Beta 1	-0,256	-0,591	0,557	-1,022	-3,036	0,004
	Beta 2	-0,889	-2,313	0,025	0,359	0,832	0,409
	Beta 3	0,589	1,096	0,278	0,546	1,037	0,305
14. A firm should avoid changing its regular dividend if that change might have to be reversed in a year or so.	*Beta 0*	-0,667	-1,430	0,159	-0,308	-0,782	0,438
	Beta 1	1,167	1,815	0,076	0,951	1,739	0,088
	Beta 2	0,889	1,556	0,126	0,808	1,153	0,254
	Beta 3	-0,859	-1,077	0,287	-1,260	-1,474	0,147
15. A firm should strive to maintain an uninterrupted record of dividend payments.	*Beta 0*	0,556	1,413	0,164	0,769	2,280	0,027
	Beta 1	0,844	1,558	0,126	-0,698	-1,489	0,143
	Beta 2	-0,500	-1,038	0,304	0,731	1,217	0,229
	Beta 3	0,100	0,149	0,882	0,007	0,010	0,992
16. A firm should strive to maintain steady or modestly growing dividends.	*Beta 0*	0,222	0,566	0,574	0,077	0,241	0,811
	Beta 1	0,111	0,200	0,842	-0,615	-1,364	0,179
	Beta 2	-0,575	-1,185	0,242	0,723	1,194	0,238
	Beta 3	0,007	0,010	0,992	-0,327	-0,449	0,655
17. A firm should be responsive to the dividend preferences of its shareholders	*Beta 0*	0,556	2,062	0,045	0,538	2,399	0,020
	Beta 1	0,044	0,120	0,905	0,319	1,023	0,312
	Beta 2	0,389	1,179	0,244	0,128	0,321	0,750
	Beta 3	-0,176	-0,380	0,705	-0,085	-0,175	0,862
18. A firm cuts dividends in future if taxes on dividends are raised.	*Beta 0*	0,556	1,475	0,147	0,308	0,988	0,328
	Beta 1	-0,111	-0,209	0,836	0,000	0,000	1,000
	Beta 2	-0,614	-1,319	0,193	0,692	1,172	0,247
	Beta 3	0,523	0,794	0,431	-0,952	-1,339	0,187
19. Stocks that pay high dividends attract tax-exempt entities.	*Beta 0*	0,333	1,043	0,302	0,308	1,139	0,261
	Beta 1	0,333	0,738	0,465	0,192	0,493	0,624
	Beta 2	0,792	1,982	0,054	0,692	1,350	0,184
	Beta 3	-1,058	-1,863	0,069	-0,245	-0,391	0,697
20. Investors are attracted to firms that have dividend policies appropriate to the investors' particular tax circumstances.	*Beta 0*	0,444	1,359	0,180	0,385	1,418	0,162
	Beta 1	0,056	0,123	0,902	0,044	0,117	0,908
	Beta 2	0,000	0,000	1,000	0,282	0,585	0,562
	Beta 3	0,000	0,000	1,000	-0,211	-0,357	0,723
21. Investors prefer that a firm retains funds over paying dividends if dividends are taxed heavier than capital gains.	*Beta 0*	0,667	2,026	0,048	0,769	2,749	0,008
	Beta 1	0,667	1,432	0,158	-0,341	-0,877	0,385
	Beta 2	0,000	0,000	1,000	0,831	1,565	0,124
	Beta 3	**-1,216**	**-2,122**	**0,039**	-0,878	-1,383	0,173

		Coeff.	t Stat	P-value	Coeff.	t Stat	P-value
22. Investors prefer certain dividend stream	*Beta 0*	0,333	0,945	0,349	0,231	0,700	0,487
to uncertain price appreciation.	*Beta 1*	-0,033	-0,069	0,946	-0,302	-0,660	0,513
	Beta 2	-1,000	-2,315	0,025	0,269	0,459	0,648
	Beta 3	**1,347**	**2,231**	**0,030**	-0,198	-0,276	0,784
23. Investors prefer certain, current dividends	*Beta 0*	0,222	0,723	0,473	0,308	1,120	0,268
to possibly higher but riskier future dividends.	*Beta 1*	0,378	0,892	0,377	-0,451	-1,181	0,243
	Beta 2	-0,611	-1,624	0,111	0,359	0,734	0,466
	Beta 3	0,541	1,028	0,309	-0,026	-0,043	0,966
24. The payment of dividends forces a firm	*Beta 0*	0,000	0,000	1,000	-0,154	-0,571	0,571
to seek more external financing, which	*Beta 1*	-0,500	-1,064	0,293	-0,346	-0,925	0,360
subjects the firm to scrutiny of investors.	*Beta 2*	-0,667	-1,689	0,098	-0,346	-0,623	0,536
	Beta 3	0,604	1,050	0,299	0,146	0,225	0,823
25. The payment of dividends serves as a	*Beta 0*	0,556	1,629	0,110	0,462	1,619	0,112
bonding mechanism to encourage managers	*Beta 1*	-0,556	-1,152	0,255	0,038	0,097	0,923
to act in the interest of outside shareholders.	*Beta 2*	-0,320	-0,759	0,452	-0,662	-1,223	0,227
	Beta 3	0,883	1,472	0,148	0,477	0,734	0,467
26. A firm's new capital investment requirements	*Beta 0*	-0,111	-0,324	0,747	0,000	0,000	1,000
generally have little effect on modifying	*Beta 1*	-0,444	-0,917	0,364	-0,429	-1,131	0,264
its pattern of dividends.	*Beta 2*	-0,333	-0,794	0,431	-1,200	-2,317	0,025
	Beta 3	0,418	0,701	0,486	1,152	1,861	0,069
27. We would like to see institutional investor	*Beta 0*	0,667	2,266	0,028	0,462	1,909	0,062
to own a large stake of our company.	*Beta 1*	-0,267	-0,658	0,514	-0,319	-0,949	0,347
	Beta 2	-0,373	-1,024	0,311	0,205	0,477	0,636
	Beta 3	0,443	0,876	0,385	0,202	0,384	0,703
28. Dividend preferences vary between	*Beta 0*	1,000	3,490	0,001	0,769	3,038	0,004
shareholders depending on their age.	*Beta 1*	-0,778	-1,919	0,061	0,000	0,000	1,000
	Beta 2	0,062	0,175	0,862	-0,569	-1,185	0,242
	Beta 3	0,186	0,369	0,714	0,550	0,948	0,348
29. A stock repurchase is an alternative	*Beta 0*	0,222	0,723	0,473	1,077	2,715	0,009
method to pay dividends.	*Beta 1*	0,378	0,892	0,377	-0,577	-1,048	0,300
	Beta 2	-0,611	-1,624	0,111	-1,077	-1,526	0,133
	Beta 3	0,541	1,028	0,309	0,815	0,947	0,348

Helsingissä 15.3.1999

Arvoisa rahoitusalan ammattilainen,

Olen rahoituksen pääaineopiskelija Helsingin kauppakorkeakoulusta ja parhaillaan olen tekemässä pro gradu -tutkielmaani suomalaisten pörssiyritysen osinkopolitiikasta. Tarkoituksena on selvittää tekijät, joilla on suurin vaikutus pörssin päälistalla olevien yritysten osingonmaksuun. Lisäksi on tarkoitus tutkia kuinka yritysten johtajat, jotka tekevät ehdotuksen osingonjaosta, näkevät osinkopolitiikan vaikuttavan yritykseensä. Tuloksia Suomesta vertaillaan vastaaviin ulkomaisiin tutkimuksiin mahdollisten erojen selvittämiseksi. Tutkimus on osa kansainvälistä osinkotutkimusta, jonka kuuluisimpia tutkijoita on professori **George Frankfurter** Lousiana State yliopistosta.

Kyselykaavake on lähetetty puhelinkeskustelun perusteella yritykseen henkilölle, joka vaikuttaa aktiivisesti osingonmaksuehdotukseen. Mikäli kyselykaavake ei jostain syystä tavoita kysyseistä henkilöä toivomme teidät toimittavan kaavakkeen vastaavalle henkilölle.

Aikaisempien ulkomaisten tutkimusten perusteella saattaa palautusprosentti jäädä alhaiseksi, joten toivon teidän löytävän aikaa lomakkeen täyttämiseksi, jotta tuloksista voidaan saada tilastollisessa mielessä merkittäviä tuloksia. Luonnollisesti olen valmis lähettämään tutkimukseni tulokset niitä haluaville yrityksille, jotka ovat palauttaneet kyselelomakkeen. Kaikki vastaukset käsitellään luottamuksellisesti.

Kunnioittavasti,

Jussi Korvenoja
kauppatieteiden yo

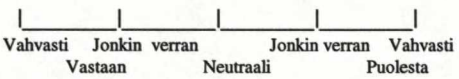
Teppo Martikainen
kauppatieteiden tohtori

SUOMALAISTEN PÖRSSIYRITYSTEN OSINKOTUTKIMUS

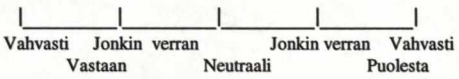
Merkitse "X" seuraavien kysymysten kohdalle sen mukaan miten olet esitetyn kysymyksen puolesta tai sitä vastaan. Vastausvaihtoehtoja tulisi pitää jatkuvana vaihtoehtojen ryhmänä alkaen "*Vahvasti vastaan*" ja päättyen "*Vahvasti puolesta*". Jos kysymykseen ei ole mielipidettä tai se ei vastaa nykyistä tilannetta, jätä kohta vastaamatta. Asettamalla "X" keskelle kohtaan "*Neutraali*" indikoidaan, että mielipide on tasapainossa eli ei olla kysymyksen puolesta eikä sitä vastaan.

****

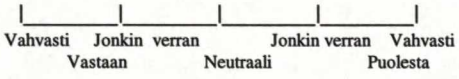
1. Osinkopolitiikan muutos vaikuttaa yrityksen arvoon.



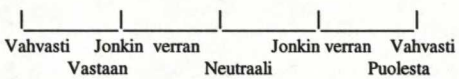
2. Sijoittajat pitävät osinkojen muutoksia signaaleina yrityksen tulevaisuuden näkymistä.



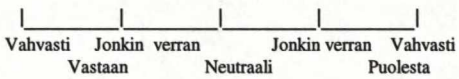
3. Yrityksen osakkeen hinta yleensä nousee, kun yritys odottamatta nostaa osinkojaan tai maksaa osinkoja ensimmäistä kertaa.



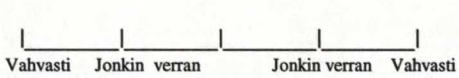
4. Markkinat antavat enemmän arvoa vakaille osingoille kuin vakaille Osinko Per Osake/Voitto Per Osake -suhteille (payout ratio).



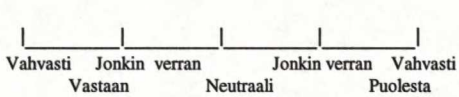
5. Optimaalinen osinkopolitiikka tuo tasapainon nykyisten osinkojen ja tulevaisuuden kasvun välille, mikä maksimoi osakkeen hinnan.



6. Yrityksen tulisi muodostaa osinkopolitiikkansa niin, että se tuottaisi maksimaalisen hyödyn osakkeenomistajilleen.



7. Yrityksen pitäisi nähdä osingot jäänöseränä, jotka maksetaan vasta, kun halutut investoinnit ovat rahoitettu nykyisistä tuotoista.



8. Yrityksen investointi-, rahoitus- ja osinkopäätökset ovat vuorovaikutuksessa keskenään.

9. Yrityksen osinkopolitiikka vaikuttaa pääoman kustannuksiin.

10. Sijoittajat hyödyntävät osinkoilmoitusta yrityksen osakkeen arvonmääritykseen.

11. Osinkojen nostot eivät ole yksiselitteisiä, koska ne voivat tarkoittaa tulevaisuuden kasvua tai investointimahdollisuuksien puutetta.

12. Yrityksen pitäisi riittävän selvästi ilmoittaa sijoittajille syyt osinkopolitiikan muutokselle.

13. Yrityksellä pitäisi olla tavoite Osinko Per Osake/Voitto Per Osake -suhde ja suhdetta pitäisi ajoittain sopeuttaa vastaamaan tavoitetta.

14. Yrityksen tulisi vältää muuttamasta säännöllistä osinkoa, jos muutos täytyisi peruuttaa lähitulevaisuudessa (n. 1 vuosi).

15. Yrityksen tulisi yrittää ylläpitää pitkäjänteistä, keskeytymätöntä historiaa osinkojen maksussa.

16. Yrityksen tulisi yrittää ylläpitää vakaita tai vaatimattomasti kasvavia osinkoja.

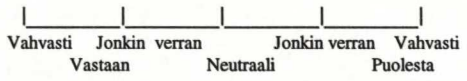
17. Yrityksen pitäisi huomioida osakkeenomistajien osinkopreferenssit.

18. Yritys vähentää tulevaisuudessa osinkojen maksua, jos osinkojen verotusta kiristetään.

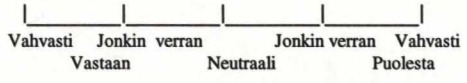
19. Osakkeet, jotka maksavat korkeita osinkoja houkuttelevat verovapaita yhteisöjä.

|_____|_____|_____|_____|
Vahvasti Jonkin verran Jonkin verran Vahvasti
Vastaan Neutraali Puolesta

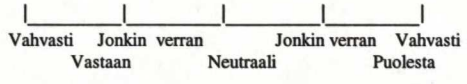
20. Sijoittajat ovat kiinostuneita yrityksistä, joiden osinkopolitiikkat tarjoavat sijoittajille sopivimmat verotusolosuhteet.



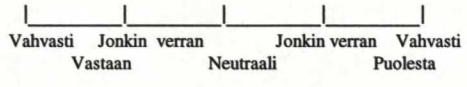
21. Sijoittajat pitävät parempana voittovarojen jättämistä yritykseen osinkojen sijasta, jos osinkoja verotetaan ankarammin kuin myyntivoittoja.



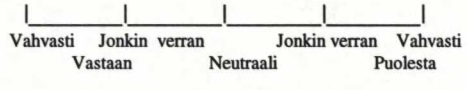
22. Sijoittajat pitävät parempana varmoja osinkovirtoja epävarmojen osakkeen arvonnousujen sijaan.



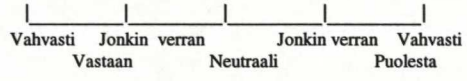
23. Sijoittajat pitävät parempana varmoja nykyisiä osinkoja korkeampien, mutta riskillisempien tulevaisuuden osinkojen sijaan.



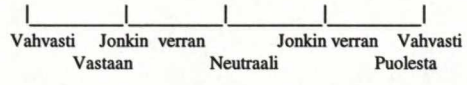
24. Osinkojen maksu pakottaa yrityksen etsimään enemmän ulkoista rahoitusta, mikä johtaa yrityksen lähempään tarkkailuun sijoittajien puolelta.



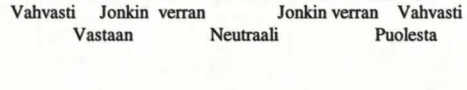
25. Osinkojen maksu palvelee sitouttavana tekijänä ja edistäen johtajien toimia ulkopuolisten osakkeenomistajien intressien mukaisesti.



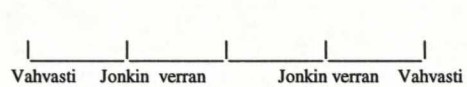
26. Yrityksen uusilla pääomainvestointivaatimuksilla on vähän vaikutusta osinkojen muodostumiseen.



27. Haluamme instutuutionaalisten sijoittajien omistavan suuren osan osakkeistamme.



28. Osinkopreferenssit vaihtelevat eri ikäryhmien välillä.



29. Omien osakkeiden takaisinosto on vaihtoehtoinen menetelmä jakaa osinkoa.

Merkitse "X" seuraavien kysymysten kohdalle sen mukaan miten esitetty tekijä vaikuttaa yrityksenne osingonjakopäätökseen. Vastausvaihotehtoina on annettu neljä eri tärkeystasoa alkaen "*ei vaikutusta*" ja päättyen "*erittäin tärkeä*"

****

1. Nykyiset ja menneisyyden tuotot

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

2. Tulevaisuuden tuotto-odotukset

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

3. Investointinäkökulmat kuten tuottoisien investointikohteiden puute

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

4. Rahoitukselliset näkökulmat kuten kustannukset ulkoisesta rahoituksesta

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

5. Sopimukselliset esteet kuten vieraan pääoman aiheuttamat rajoitteet

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

6. Likviditeettirajoitteet kuten käteisen riittävyys

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

7. Laillisuus säännökset ja rajoitteet, joita osinkojen maksu heikentäisi

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

8. Kontrollinäkökulmat kuten yrityksen omistusrakenne

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

9. Huoli ylläpitää tavoitepääoma

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

10. Huoli osakkeen hinnan säilyttämisestä tai sen nostamisesta

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

11. Huoli, että osinkojen muutos saattaa antaa sijoittajille väärän signaalin

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

12. Osinkojen jatkuvuus

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

13. Rahavirtojen tasaisuus/säännöllisyys

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

14. Preferenssit maksaa mielummin osinkoa kuin toteuttaa riskinen uudelleeninvestointi

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

15. Ennusteet yleisestä taloudentilasta

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

16. Nykyisten osakkeenomistajien halu saada tuloja osinkoina

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

17. Nykyisten osakkeenomistajien tunnuspiirteet kuten heidän veroasemansa

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

18. Oman pääoman tuotto-odotukset

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

19. Halu noudattaa toimialan yleistä osingonmaksutapaa

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

20. Halu maksaa osinkoja pitkällä aikaperiodilla tietyn jakosuhteen verran

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

21. Arvostus, mitä osinkojen maksu tuo yritykselle

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

22. Mahdollisuus ostaa yrityksen omia osakkeita takaisin

|_____|_____|_____|
Ei vaikutusta Erittäin tärkeä
Vähän Jonkin verran

Yrityksen nimi: _____

Vastaajan ammattinimike: _____

Jos yrityksellä on pitkän aikaperiodin tavoite Osinko/Voitto -suhde niin mikä se on? (0%-100%) _____

Osallistun aktiivisesti päätöksiin koskien yrityksen osinkopolitiikkaa kyllä ei

Haluan tutkimustulokset lähetettynä kyllä ei

REFERENCES

Aharony,J., and Swary, I. 1980, Quarterly dividend and earnings announcements and stockholders' returns: an empirical analysis, Journal of Finance 35 (1), 1-12.

Allen, D. E.,1992, Target payout ratios and dividend policy: British evidence, Managerial Finance 18 (1), 9-21.

Allen, D. E. and Izan, H. Y., 1992, Dividend policy: The issues, Managerial Finance 18 (1), 1-8.

Asquith, P., and Mullins, D. 1983, The impact of initiating dividend payments on shareholders' wealth, Journal of Business 56, 77-96.

Bajaj, Mukesh, and Anand Vijh, 1990, Dividend clienteles and the information content of dividend changes, Journal of Financial Economics 26 (2), 193-219.

Baker, H. K., Farelly G. E., and Edelman, 1985, A survey of management views on dividend policy, Financial Management 14, 78-84

Baker, H. K and Powell G. E., 1998, Factors influencing dividend policy decisions, Unpublished working paper.

Baker, H. K and Powell G. E., 1999, How corporate managers view dividend policy, Unpublished working paper.

Barclay, M. J., Smith, C. W., and Watts, R. L., 1996, The determinants of corporate leverage and dividend policy, Journal of Applied Corporate Finance 7 (4), 4-19.

Bernartzi, S., Michaely R., and Thaler, R., 1997, Do changes in dividends signal the future or the past?, Journal of Finance 53 (3), 1007-1034.

Bernstein, P. L., 1996, Dividends: The puzzle, Journal of Applied Corporate Finance 9 (1), 4-15.

Bhattacharya, S. 1979, Imperfect information, dividend policy, and "the bird in the hand" fallacy, Bell Journal of Economics 10 (1), 259-270.

Black, F., and Scholes, M. 1974, The effects of dividend yield and dividend policy on common stock prices and returns, Journal of Financial Economics 1 (1), 1-22.

Blume, M. 1980, Stock returns and dividend yields: some more evidence, Review of Economics and Statistics 62 (4), 567-577.

Bond, M. T. and Mougoué, M., 1991, Corporate dividend policy and the partial adjustment model, Journal of Economics and Business 43, 165-178.

Born, J. A. and Rimbey, J. N., 1993, A test of the Easterbrook hypothesis regarding dividend payments and agency costs, The Journal of Financial Research 16 (3), 251-260.

Brennan, M. J. 1973, Taxes, market valuation and corporate financial policy, National Tax Journal 23 (4), 417-427.

Brown, P. and Walter, T., 1986, Ex-dividend day behaviour of Australian share prices, Australian Journal of Management 2, 139-152

Clarke, A. W., 1992, The ex-dividend day behaviour of Australian share prices pre and post imputation, Managerial Finance 18 (1), 34-48.

Crutchley, C. E., and Hansen, R. S., 1989, A test of the agency theory of managerial ownership, corporate leverage, and corporate dividends, Financial Management (1), 36-46.

Crockett, J. and Friend, I., 1988, Dividend policy in perspective: Can theory explain behaviour?, Review of Economics and Statistics 70, 603-613.

DeAngelo, H., DeAngelo, L. and Skinner, D. J., 1992, Dividends and losses, Journal of Finance 57, 1837-1863.

Easterbrook, F. H., 1984, Two agency cost explanations of dividends, American Economic Review 74, 650-659.

Elton, E. and Gruber, M., 1970, Marginal stockholder tax rates and the clientele, Review of Economics and Statistics 52 (1), 68-74.

Friend, I. and Puckett, M., 1964, Dividends and stock prices, American Economic Review 54, 656-682.

Fama, E. F. and Babiak, H. 1968, Dividend policy: an empirical analysis, Journal of the American Statistical Association 63 (4), 1132-1161.

Feenberg, D., 1981, Does the investment limitation explain the existence of dividends?, Journal of Financial Economics 9, 265-269.

Feldstein, M. and Green, J., 1983, Why do companies pay dividends?, American Economic Review 73, 1-30.

Frankfurter, G. M., 1998, What is the puzzle in "The dividend puzzle"?, The Journal of Investing, Forthcoming.

Frankfurter, G. M. and Lane, W. R., 1992, The rationality of dividends, International Review of Financial Analysis 12, 115-129.

Ghosh, C. and Woolridge J. R., 1988, An analysis of shareholder reaction to dividend cuts and omissions, The Journal of Financial Research 11 (4), 281-294.

Gonedes, N. J. 1978, Corporate signalling, external accounting, and capital market equilibrium: evidence of dividends, income, and extraordinary items, Journal of Accounting Research 16 (1), 26-79.

Gordon, M. J., 1963, Optimal investment and financing policy, Journal of Finance 18, 264-272.

Gordon, M. J. and Bradford, M, 1980, Taxation and the stock market valuation of capital gains and dividends, Journal of Public Economics 14, 109-136.

Gordon, M. J. and Shapiro, E., 1956, Capital equipment analysis: The required rate of profit, Management Science 3, 102-110.

Graham, B. and Dodd, D., 1951, Security analysis, McGraw-Hill, New York.

Healy, P. M. and Palepu K. G., 1988, Earnings information conveyed by dividend initiations and omissions, Journal of Financial Economics 21, 149-176.

Hess, P., 1982, The ex-dividend day behaviour of stock returns: Further evidence of tax effects, Journal of Finance 37, 445-470.

Jensen, M., 1986, Agency costs of free cash flow, corporate finance and takeovers, American Economic Review 76, 323-329.

Jensen, M, and Meckling W., 1976, Theory of the firm: Managerial behaviour agency costs and capital structure, Journal of Financial Economics 3, 305-360.

John, K., and Williams, J., 1985, Dividends, dilution and taxes: A signalling equilibrium, Journal of Finance, 1053-1070.

Jose, M. L. and Stevens, J. L., 1989, Capital market valuation of dividend policy, Journal of Business and Finance & Accounting 16 (5), 651-662.

Kaestner, R., and Liu Feng-ying, 1998, New evidence on the information content of dividend announcements, The Quarterly Review of Economics and Finance, 38 (2), 251-274.

Kalay, A., 1982, The ex-dividend day behaviour of stock prices: A re-examination of the clientele effect, Journal of Finance 37, 1059-1070.

Lamoureux, C. G., 1990, Dividends, taxes, and normative portfolio theory, Journal of Economics and Business 42, 121-131.

Lang, L. H. P., and Litzenberger, R. H., 1989, Dividend announcements cash flow signalling vs. free cash flow hypothesis?, Journal of Financial Economics 24, 181-191.

Lease, R., Lewellen W. and Schlarbaum, G.,1976, Market segmentation: Evidence on the individual investor, Financial Analysts Journal 32, 53-60.

Lintner, J. 1956, Distribution of incomes of corporations among dividends, retained earnings, and taxes, American Economic Review 46 (2), 97-113.

Litzenberger, R. H., and Ramaswamy, K. 1979, The effects of personal taxes and dividends on capital asset prices: theory and empirical evidence, Journal of Financial Economics 7 (2), 163-195.

Litzenberger, R. H., and Ramaswamy, K. 1980, Dividends, short selling restrictions, tax-induced investor clienteles and market equilibrium, Journal of Finance 35 (2), 469-482.

Litzenberger, R. H., and Ramaswamy, K., 1982, The effects of dividends on common stock prices: Tax effect or information effects?, Journal of Finance 37, 429-443.

Long, J. B., 1978, The market valuation of cash dividends: A case to consider, Journal of Financial Economics 6 (3), 235-264.

Miller, M. H., 1986, Behavioural rationality in finance: The case of dividends, Journal of Business 59 (4), s451-s468.

Miller, M. H., and Modigliani, F. 1961, Dividend policy, growth and the valuation of shares Journal of Business 34 (4), 411-433.

Miller, M. H., and Rock, K., 1985, Dividend policy under asymmetric information, Journal of Finance 40, 1031-1051.

Miller, M. H., and Scholes, M. S. 1978, Dividends and taxes, Journal of Financial Economics 6 (4), 333-364.

Miller, M. H., and Scholes, M. S. 1982, Dividends and taxes: some empirical evidence, Journal of Political Economy 90 (6), 1118-1142.

Modigliani, F., 1982, Debt, dividend policy, taxes, inflation and market valuation, Journal of Finance 2, 254-273.

Ofer, A., and Siegel D., 1987, Corporate financial policy, information, and market expectations: An empirical investigation of dividends, Journal of Finance 42, 889-911.

Partington, G. H., 1984, Dividend policy and target payout rates, Accounting and Finance, 63-74.

Pettit, R. R., 1977, Taxes, transaction costs, and the clientele effect of dividends, Journal of Financial Economics 5, 419-436.

Poterba J. M., and Summers L. H., 1984, New evidence that taxes affect the valuation of dividends, Journal of Finance 5, 1397-1415.

Pruitt, S. W., and Gitman L. J., 1991, The interactions between the investment, financing, and dividend decisions of major U.S. firms, Financial Review 26 (3), 409-430.

Rozeff, M. S.1982, Growth, beta, and agency cost as determinants of dividend payout ratios Journal of Financial Research, Fall, 5, 249-259.

Shefrin, H. M., and Statman, M., 1984, Explaining investor preference for cash dividends, Journal of Financial Economics 13, 253-282.

Soter, D., Brigham, E., and Evanson P., 1996, The dividend cut "heard 'round the world": The case of FPL, Journal of Applied Corporate Finance 9 (1), 4-15.

Walter, J., 1963, Dividend policy: Its influence on the value of the enterprise, Journal of Finance 18, 280-291.

Watts, R. 1973, The information content of dividends, Journal of Business 46 (2), 191-211.

Profitability of large companies, The Bank of England Quarterly Bulletin November 1991 527-530.

BOOKS:

Copeland T. E. and Weston J. F., 1992, Financial Theory and Corporate Policy, Addison Wesley, third edition.

Brealey, R. and Myers S, 1996, Principles of Corporate Finance, McGraw-Hill, fifth international edition.

Van Horne, J. C., 1995, Financial Management and Policy, Prentice Hall, tenth international edition.

WEB SITES:

http://www.henderco.com/cgains.html

NEWSPAPERS:

Kauppalehti 12.3.1999, Osinkoja maksetaan viime vuodelta lähes 16 miljardia, page 7.