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EVIDENCE ON IRISH COMPANY MANAGERS' VIEWS ABOUT DIVIDEND POLICY

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ABSTRACT

This study investigates the views of Irish corporate managers regarding dividend policy. It seeks to explain (i) how firms determine dividend levels, (ii) perceptions of the relationship between dividend policy and firm value, and (iii) the role of earnings, risk preferences and tax clienteles in determining payout ratios. Data were obtained from a mail survey sent to the top 1,000 Irish companies. The empirical results highlight several clear patterns in the general attitudes of Irish firms to dividend policy as well as a number of areas where specific differences in perceptions exist across the respondent groups.

INTRODUCTION

The question of why companies pay dividends and how any such dividend payments are determined has puzzled academics for several decades. Since the seminal work of Miller and Modigliani (1961) which concluded that dividends are irrelevant in a world of perfect capital markets with no taxation or information asymmetries, academics have sought to explain why a high proportion of firms choose to pay out cash to investors at regular intervals rather than retain funds within the company and let the capital value of the shares appreciate.

This puzzle deepens when Lintner's (1956) pioneering findings published in the *Journal of Finance* are considered. In Lintner's study, the 28 US managers interviewed were found to spend significant amounts of time deliberating before deciding on the level of dividend payments that their firms should make. The primary concern of managers appeared to be the attainment of smooth growth in dividend payout ratios based on current earnings and prior dividend levels. Lintner also reported that managers sought to avoid making changes in the payout rate that might have to be reversed within a year or so, and appeared instead to favour partial adjustment towards a long-term payout ratio.

One argument advanced to explain why managers attach importance to payout ratios in practice is that in a world characterised by information asymmetry (i.e. where insider managers know more about the future prospects of the firm than external shareholders) the dividend can act as a tangible signal of future earnings (Pettit, 1972; Healy and Palepu, 1988; Ghosh and Woolridge, 1991; Marsh, 1993; Abeyratna, Power and Lonie, 1996). Proponents of this view argue that dividend increases convey good news about future prospects while dividend cuts tend to signal poor performance and a reduced ability to generate free cash flow[1]. Indeed, a number of theoretical models have been developed to show how dividends can act as a signal of future investment opportunities because it is costly for companies with poorer prospects to mimic the high payout process (Bhattacharya, 1979; Miller and Rock, 1985).

A second explanation for the attention paid to dividends in practice centres on differences in the tax treatment of income and capital gains. According to this view, if the tax treatment of capital gains is more (less) favourable than that of income from dividends, investors will require relatively large (small) pre-tax returns on shares in high dividend-paying companies, implying a negative relationship between share price changes and payout ratios. Empirical analyses in this area suggest that high dividend-paying shares typically offer a premium in the range of 10 per cent to 30 per cent to compensate for the tax differential (Litzenberger and Ramaswamy, 1979; Bradford and Gordon 1980; Litzenberger and Ramaswamy, 1982). This premium is thought to vary with changes in the taxation of dividends relative to capital gains (Poterba and Summers, 1984; Lasfer, 1996)[2]. In such a setting, investor demand for dividends is even more surprising.

To date, most research into dividend behaviour has focused on large developed markets such as in the US. These investigations have attempted to quantify how share prices respond to the publication of information about dividends in order to determine if the news from the signal is favourable, unfavourable or non-existent; they also seek to examine whether firms' payout policies are influenced by the profile of their investor clientele. Such studies encounter significant problems when the dividend news is not disclosed in isolation, but is published at the same time as other data such as earnings or capital expenditure plans; disentangling the importance of the dividend component of the joint signal can be difficult (Kane, Lee and Marcus, 1984; Abeyratna et al., 1996). Also, examining share price reactions may not be appropriate for smaller markets where equities are thinly traded.

This paper overcomes the difficulties outlined above by surveying managers of Irish companies and thereby directly gauging their perceptions of the factors that determine dividend levels. To date, very little is known about the dividend payout policies of Irish firms. The few studies that have been undertaken are either based on small samples or were conducted more than 10 years ago[3]. The attitude of Irish managers is of particular interest given the significant growth in inward investment over the past decade and the changing pattern of foreign investor participation in the Irish stock market[4]. Moreover, Irish institutional investors have significantly reduced their exposure to Irish equities from an estimated weighting of 50 per cent in the early 1990s to 17 per cent in 2001 (Kellaher, 2002). Irish managers' attitudes to dividend policy may have changed since the previous studies were undertaken, given the change to a more globalised shareholder base in recent years. Finally, recent changes in the Irish system of company taxation (including the introduction of withholding tax and the new 12.5 per cent rate of Corporation Tax) may have a profound impact on the way in which Irish firms determine dividend policy and so this issue is also explored in the present study.

The central objective of the study is to ascertain whether Irish corporate managers believe that dividends are relevant to share valuation. The study examines how firms determine the amount of dividends to pay and whether managers perceive that there is a relationship between dividend payment policy and share value. Respondents' views about the importance of earnings, liquidity, risk and tax preferences for the dividend decision are also sought.

The study differs from previous investigations of the Irish market in three main respects. First, the sample of firms employed in the present study is larger than that used in previous analyses and should provide better grounds for comparison with previous large-scale US studies. Second, the data are drawn from both quoted and unquoted companies to facilitate a comparative analysis of the views of managers in both types of firm. Finally, the study provides a direct comparison of the views of managers in (i) dividend-paying and non dividend-paying companies and (ii) firms which have recently changed their dividend payout policy and those which have not. No such analysis was performed in previous Irish investigations.

The remainder of the paper is divided into four main sections[5]. A review of some particularly relevant dividend surveys previously undertaken in the US, the UK, Australia and Ireland is followed by an outline of the survey design. The third section presents the research findings and compares them with other empirical evidence, while the final section summarises the study's main conclusions.

PRIOR SURVEYS OF MANAGERIAL VIEWS ABOUT DIVIDEND BEHAVIOUR

A small number of surveys have been conducted during the last three decades in an effort to explain dividend behaviour and the main features of these studies are displayed in **Table 1**. A number of points emerge from an analysis of this table.

First, the surveys that have been conducted vary in terms of sample size and geographic location. Two have been undertaken in the US, two in the UK and one in each of Australia, Germany and Ireland. The samples employed have ranged in size from 35 in Green, Pogue and Watson (1993) to 420 in Frankfurter, Kosedag, Schmidt and Topalov (2002), the most recent paper in the area.

Second, despite these differences, the findings of the various surveys have been remarkably consistent; most indicate that managers perceive the dividend decision as being important primarily because they believe that shareholders view it as a

TABLE 1: STUDIES OF MANAGERIAL ATTITUDES TOWARDS DIVIDEND POLICY

Study	Sample Size	Year of Study	Country	Main Conclusions
Baker et al. (1985)	318	1983	USA	Explanatory power of Lintner's model remains high; respondents concerned with dividend continuity; dividend payments affect share values; respondents aware of signalling and clientele effects.
Partington (1985)	93	1983	Australia	Dividend policy supports share prices; dividend policy is not residually determined; Australian company directors attach considerable importance to meeting shareholders' requirements for income and maintaining shareholder loyalty; dividend payments provide an important signal about management's views regarding future profitability.
Allen (1992)	67	1988	UK	Results indicate that the majority of respondent companies use target payout ratios, and dividend payments provide an important signalling mechanism.
Green et al. (1993)	35	1989	Ireland	Dividend decisions by listed Irish companies appear to be taken by 'reference to the exogenous factor of dividend stability, but consideration is also given to investment and/or financing decisions' (p. 74).
Baker and Powell (1999)	198	1997	USA	Explanatory power of Lintner's model high; respondents displayed highest level of agreement with statements about signalling; respondents uncertain about tax preferences and bird-in-the-hand explanations of dividend behaviour.
Dhanani and Edgley (2002)	164	2001	UK	Managers believe that firms should design their corporate dividend policies to maximise shareholder value; shareholder requirements are rated as the most important factor in determining dividend policy, followed by signalling implications.
Frankfurter et al. (2002)	420	2001	Germany	Investors are thought to be interested in increases in dividends which can be maintained in the future.

signal about the future. In this respect, the findings of virtually all of the surveys confirm Lintner's early conclusion that managers will only raise the dividend if they can maintain the payment at the new level, not least because they fear the consequences of having to make a subsequent cut. For example, Baker, Farrelly and Edelman (1985) compared the determinants of company dividend policy in the early 1980s with Lintner's behavioural model of the mid-1950s and concluded that the major determinants of dividend payments in the early 1980s were similar to those pertaining 30 years earlier. In a more recent US study, Baker and Powell (1999) confirmed the existence of managerial beliefs about the relationship between dividend policy and firm value. They concluded that managers' views on setting dividend payments in the late 1990s were fundamentally the same as those reported by Lintner in the 1950s; irrespective of time period, managers were extremely reluctant to make major alterations to dividend levels because of the danger that they might have to be reversed at a later date[6].

Third, the Baker et al. (1985) study also provides evidence that managers were aware of the signalling and clientele effects of dividend policy, a finding supported for UK data by Dhanani and Edgley (2002) and for Australian data by Partington (1985). The former study analysed the responses from 164 senior executives in UK-listed companies and reported that shareholder requirements are rated as the most important determinant of payout ratio, followed by concerns about the signalling impact of any changes. Partington (1985) surveyed senior executives in 93 large Australian companies and found that managers perceived dividends to be important in signalling their views on future company profitability. The study also reported that senior managers of Australian companies considered dividend increases to be associated with share price rises; the author's overall conclusion was, therefore, that managers had clear motives for seeing dividend payouts as something other than mere residuals.

Fourth, several investigations have highlighted that dividend decisions are often related to other important areas of company policy. For example, Green et al. (1993) provided evidence from a survey of financial directors in 1989 that Irish companies appear to subscribe to the view that dividend policy is not established in isolation, but rather that a degree of interdependency exists between dividend, investment and financing decisions. However, the empirical evidence contained in the Green et al. study relates to only 35 useable responses from a questionnaire survey of companies listed on the Irish Stock Market in 1989.

SURVEY DESIGN

A questionnaire was used to seek the views of managers of the largest 1,000 companies operating in Ireland about various aspects of the dividend decision. Extensive consultation took place on the content of the statements to be included on the questionnaire and on the overall layout of the document. A pilot study was undertaken whereby an early version of the questionnaire was posted to 40 major Irish fund managers and stockbrokers licensed by the Central Bank of Ireland, and to 10 full-time academic staff at Dublin City University Business School. Some 32 responses to the pilot were received. The pilot respondents confirmed that the average time taken to complete the questionnaire was 11 minutes. Where respondents indicated that some questions lacked clarity the questions were rephrased to eliminate any ambiguities.

It was decided that individuals might be more inclined to reply if the survey was conducted in conjunction with a well-known finance house and/or the Irish Stock Exchange. Both a leading firm of stockbrokers in Dublin, Davy Stockbrokers, and the Irish Stock Exchange agreed to support the survey. Davy Stockbrokers permitted the use of their logo in correspondence associated with the questionnaire while the Irish Stock Exchange allowed the inclusion of a paragraph in the covering letter referring to the Exchange's support for the survey. In addition, the head of research at Davy's signed the covering letter. Finally, as Jobber and O'Reilly (1995) note that response rates in surveys can be considerably improved by offering an incentive to all recipients who complete the questionnaire form, it was decided to include all respondents in a free draw for a case of champagne if the completed questionnaire was returned by a fixed date.

The final version of the questionnaire was divided into four main sections. Section One comprised 10 closed-end questions and one open-ended question and sought the views of respondents about the factors that a firm should consider when setting its dividend payment policy. Section Two asked respondents about whether dividends act as a signal and how the market responds to dividend announcements. This section included 13 closed-end questions and two open-ended questions. Section Three, which comprised nine closed-end questions and one open-ended question, sought views of respondents on taxation issues. Section Four obtained background information on respondents and their firms (e.g. the respondent's role within the firm, whether the firm was quoted or unquoted and the firm's main activity). Section Four also sought details on whether the firm currently paid a dividend, whether the level of dividends had changed since the previous year, whether respondents believed that the reasons for dividend payments should be explained to investors and how such information could best be conveyed to the market. The main reason for asking the questions in this final section was to facilitate a categorisation of respondents into several sub-groups and an examination of whether identifiable differences existed, based on answers to earlier questions for the various groupings.

EMPIRICAL FINDINGS

The questionnaires were sent to the chief executive officer of each of the top 1,000 Irish companies along with an explanatory covering letter. The survey yielded a total of 285 replies of which 269 were usable (a 26.9 per cent response rate). The respondents were drawn from companies with a range of different characteristics and operating across a large variety of industrial sectors. As **Table 2** shows, a similar number of quoted and unquoted firms responded: 131 and 137 respectively (one of the respondents failed to provide this information). As expected, a majority

TABLE 2: DESCRIPTIVE STATISTICS

SECTOR	Total	Quoted	Unquoted	Dividend paid	Dividend unpaid	Dividend changed	Dividend unchanged
Building/Construction	24	7	17	15	8	15	8
Energy	9	2	7	5	4	5	3
Banking/Financial Services	33	21	12	24	9	21	9
Communications/IT	30	12	18	13	17	13	13
Manufacturing/Packaging	52	33	19	39	13	37	14
Storage/Transport	10	4	6	6	4	1	9
Healthcare/Medical	21	16	5	14	7	14	6
Retail/Distribution	43	13	30	28	15	26	14
Food/Drink/Agribusiness	35	20	15	27	8	19	15
Tourism/Leisure	10	3	7	5	5	3	6
Other	2	1	1	1	1	1	1
Total	**269**	**132**	**137**	**177**	**91**	**155**	**98**

Notes: The table provides details about the 269 usable responses to the questionnaire survey. The disaggregated totals do not always add up to 269 because the required information was omitted by some respondents. The quoted/unquoted characteristic was determined by responses to the question 'Is your company quoted on a stock exchange?'; the dividend paid/dividend unpaid characteristic was based on responses to the question 'Does your company pay an annual dividend?', while the dividend changed/dividend unchanged characteristic was determined by responses to the question 'Has the level of the dividend changed recently?'

(66 per cent) of these firms pay dividends and most of these had changed their dividend level in the financial year prior to the survey.

One feature of the results presented in **Table 2** is the high number of companies that do not pay dividends; 91 (or 34 per cent) of the respondents had a payout ratio of zero. This figure is, however, considerably lower than the 79.2 per cent of US firms reported not to pay a dividend in 1999 by Fama and French (2000)[7]. The finding in **Table 2** is not surprising given that this study surveyed unquoted as well as quoted firms; in addition, the unprecedented high growth levels achieved by Irish industry throughout the period may have encouraged firms to retain cash for investment rather than to pay out funds to investors.

Finally, **Table 2** supplies a breakdown of the sample by sector. An analysis of the table reveals that firms from most key industrial sectors are represented in the sample. The "Manufacturing and Packaging" sector provided the highest number of respondents (52 replies) while the "Wholesale, Retail and Distribution" and "Banking and Financial Services" sectors were next with 43 and 33 respondents respectively. The sector that provided the lowest number of usable responses was "Energy" with nine. Overall, the range of sectors represented in the sample suggests that the results of this study are based on responses from a wide cross-section of Irish industries.

Examination of the respondent numbers reveals several trends across and between the various sectors. For example, other than the "Banking and Financial Services", "Manufacturing and Packaging", "Healthcare and Medical" and "Food, Drink and Agribusiness" industries, a majority of respondents from every sector work in unquoted firms. In addition, with the exception of the "Communications and IT" and "Tourism" sectors, a majority of firms in every sector paid a dividend. Finally, in seven out of the 11 sectors a majority of firms reported changing their dividend in the past.

Determinants of dividend payments

Table 3 shows the results from Section One of the questionnaire where respondents were asked about the factors that influenced their dividend decision. For **Tables 3**, **4** and **5** the mean response and the standard deviation of the response from a five-point Likert scale are shown. The five possible responses to each statement were "strongly agree" (assigned a value of 1 for the analysis of the results), "agree" (2), "uncertain" (3), "disagree" (4) and "strongly disagree" (5). The assigned values indicate that the lower the mean score, the stronger the level of agreement with the statement in question. This information is supplied for the whole sample and for the different groupings of quoted and unquoted firms, dividend-paying and non dividend-paying companies as well as dividend-changing and dividend-unchanging firms. For the different pairs of groupings a p-value is shown which tests the null hypothesis that the mean responses are equal.

TABLE 3: ANALYSIS OF THE FACTORS WHICH INFLUENCE DIVIDEND DECISIONS

	Total		Quoted		Unquoted		*Quoted v. unquoted*	Dividend Paid		Dividend Unpaid		*Paid v. unpaid*	Dividend Changed		Dividend Unchanged		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
A firm should base the current dividend on the amount of dividend paid by its competitors	3.69	0.90	3.68	0.84	3.69	0.96	0.99	3.77	0.87	3.53	0.96	0.05*	3.80	0.88	3.41	0.87	0.00*
A firm should determine the current dividend based on last year's dividend	3.13	1.08	3.02	1.06	3.23	1.09	0.10	3.12	1.05	3.13	1.14	0.96	3.11	1.07	3.05	1.07	0.68
A firm should base the current dividend on the firm's expected earnings	3.02	1.06	2.96	1.06	3.07	1.07	0.39	3.04	1.09	2.98	1.01	0.65	3.07	1.11	2.82	0.94	0.06
A firm should allow dividend to fluctuate in accordance with its current investment and financing needs	2.44	1.20	2.52	1.18	2.37	1.22	0.32	2.42	1.16	2.48	1.28	0.72	2.32	1.16	2.76	1.24	0.01*
A firm should be responsive to shareholders' preferences regarding dividends	2.23	0.84	2.18	0.75	2.28	0.92	0.29	2.23	0.84	2.23	0.84	0.99	2.23	0.87	2.15	0.66	0.38

	Total		**Quoted**		**Unquoted**		*Quoted v. unquoted*	**Dividend Paid**		**Dividend Unpaid**		*Paid v. unpaid*	**Dividend Changed**		**Dividend Unchanged**		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
A firm should have a target payout ratio	2.23	0.87	2.29	0.92	2.16	0.82	0.21	2.23	0.89	2.21	0.84	0.82	2.26	0.90	2.18	0.81	0.46
A firm should avoid changes in its dividend rates that may have to be reversed in a year or so	2.22	0.99	2.15	0.98	2.28	0.99	0.27	2.22	0.99	2.22	0.99	1.00	2.30	1.03	2.05	0.84	0.41
A firm should strive to maintain an uninterrupted record of dividend payments	2.15	0.98	2.02	0.87	2.27	1.06	0.03*	2.10	0.95	2.24	1.03	0.25	2.16	0.98	2.08	0.90	0.53
A firm should base the current dividend on the firm's current earnings	2.12	0.82	2.23	0.88	2.02	0.74	0.04*	2.11	0.80	2.14	0.86	0.78	2.12	0.79	2.13	0.81	0.98
A firm should determine the current dividend based on cash flow / liquidity considerations	2.02	0.74	2.18	0.80	1.87	0.65	0.00*	2.09	0.75	1.88	0.70	0.03*	2.05	0.71	2.01	0.77	0.66

*Note: The table shows the responses to ten statements relating to influences on dividend policy. A five-point Likert scale was used where 1= 'strongly agree' 2 = 'agree' 3 = 'uncertain' 4 = 'disagree' and 5 = 'strongly disagree'. SD is the standard deviation and the p-value tests the null hypothesis that the mean response to a statement for two subgroups is equal using a two-tailed t-test. An * indicates that the p-value is significant at the 5 per cent level.*

A number of points emerge from a visual inspection of **Table 3**. First, when the responses are analysed for the whole group, those replying displayed the highest level of agreement with the statement that firms should base current dividends on cash flow considerations. This statement had the lowest mean score of 2.02 and the lowest standard deviation of 0.74. Such a result is consistent with the findings in a 1989 survey of Irish quoted companies (Green et al., 1993) where respondents considered cash resources to be an important factor in the dividend setting decision. However, a significant difference emerges when the responses are separated into those from quoted and unquoted firms. Quoted companies' directors were significantly less inclined to believe that firms should base current dividends on their cash flow situation (mean score of 2.18 and standard deviation of 0.80) than were unquoted companies' directors. This finding is not unexpected given that quoted companies' directors should have easier access to external funds, other things being equal. Moreover, quoted firms' desire to maintain dividends, which was originally identified by Lintner (1956), may imply the borrowing of funds for the purpose rather than disappointing investors with a dividend cut.

Second, there was support amongst respondents as a whole for the suggestion that firms should base current dividends on existing earnings levels (with a mean score of 2.12). As with the statement on cash flow/liquidity considerations, a significant difference emerges when the responses are assessed separately for quoted and unquoted firms. Unquoted companies' directors believed strongly that firms should base dividends on their current earnings (mean score of 2.02) whereas quoted companies' directors appeared to be less certain on this issue, with a significantly higher mean of 2.23 emerging. This result is again consistent with the survey findings reported by Green et al. (1993), where respondents indicated that profitability (both current and expected) was the most important factor in the dividend decision. However, unlike those replying in the earlier study, respondents in the present survey were not unequivocal about the view that a firm should base its dividend on expected future earnings (mean score of 3.02 and standard deviation 1.06).

Third, the survey responses as a whole were generally consistent with Lintner's model. For example, there was strong support for the views that firms should maintain an uninterrupted dividend and avoid making changes in dividend rates that might have to be reversed in a year or so, and that a target payout ratio should exist (mean scores of 2.15, 2.22 and 2.23 respectively). All three statements had relatively low standard deviations, indicating some degree of consensus among firms[8]. A significant difference emerges when comparing responses from quoted and unquoted firms. Quoted companies' directors provided significantly higher support for the view that firms should maintain an uninterrupted dividend than did those working for unquoted companies. This finding is not surprising, given that quoted companies may face greater pressure from current and potential investors to provide a tangible signal of their financial strength. Such companies may wish to avoid the adverse reaction to a dividend cut which has been identified in several studies of the share price response to a reduction in the dividend payment (Aharony and Swary, 1980; Gunasekarage and Power, 2002). The finding is consistent with the results reported by Baker et al. (1985) who recorded an average mean score of 2.26 for a similar question in their 1983 survey of quoted firms. Predictably, support for a stable dividend policy was weaker among firms that reported having changed their payout levels in the past, significantly so when views about reversing changes were sought.

Fourth, there was support for the notion that a firm should be responsive to shareholders' preferences regarding dividends, with a mean score of 2.23 being recorded. One implication of this finding is that respondents were sympathetic to the notion that clienteles of investors were attracted by particular dividend policies because of their need for a stable income stream (Keane, 1985). The management of such firms therefore needed to consider the views of their investor group when making a change to this policy. This evidence regarding the influence of shareholder views on Irish companies' dividend decision-making is similar to that reported for the US by Baker et al. (1985) and for Australia by Partington (1985).

Fifth, two statements had a mean score of appreciably more than 3.00 for the whole group. Specifically, respondents disagreed with the view that a firm should base its current dividend decision on last year's dividend or the amount of dividend paid by its competitors (mean scores of 3.13 and 3.69 respectively). This result is surprising when compared with respondents' views about investors' expectations. Responses to the questions in Section Two strongly indicated a perception that investors base their expectations about this year's dividend on last year's payment and on payout trends within their sector. It appears that, despite believing investors to base expectations about this year's dividend on both last year's figure and sectoral trends, respondents did not regard those expectations as being very important in setting dividend policy.

Market signals

Table 4 contains the responses to statements about whether dividends convey indications of future earnings to capital market participants. The whole sample analysis shows that responses to the various statements averaged 2.46, suggesting that the respondents were generally supportive of the arguments raised in the dividend signalling literature. However, when specific statements are studied, the views of respondents appear less supportive of the dividend signalling literature than might have been expected. For example, the respondents disagreed with the view that the market considered dividend announcements separately from earnings news (mean score of 3.40 and standard deviation 0.96) but instead viewed the two as joint signals (Abeyratna et al., 1996; Kane et al., 1984). In addition, respondents appear unsure that dividend payments provide a signal of future prospects (mean score of 2.56 and standard deviation 0.94) which is the central theme dominating the current dividend signalling literature. While this finding is not as clear cut as that contained in Baker and Farrelly (1989), where only 3.3 per cent of institutional investors were reported as believing past and current dividends to be a useful signal of future profitability, the result appears not to support the evidence in Baker et al. (1985) and Baker and Powell (1999).

TABLE 4: RESPONDENTS' VIEWS ABOUT THE SIGNALLING CAPABILITIES OF DIVIDENDS

	Total		Quoted		Unquoted		*Quoted v. unquoted*	Dividend Paid		Dividend Unpaid		*Paid v. unpaid*	Dividend Changed		Dividend Unchanged		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
The market views dividend announcements entirely independently of concurrent earnings announcements	3.40	0.96	3.41	0.97	3.39	0.95	0.82	3.41	0.92	3.38	1.02	0.86	3.36	0.96	3.51	0.93	0.22
An increase in dividends will usually lead to a rise in share price	2.78	0.97	3.02	0.92	2.55	0.96	0.00*	2.90	0.91	2.54	1.03	0.00*	2.95	0.90	2.46	0.99	0.00*
A change in the existing dividend payout is more important than the actual amount of dividends paid	2.64	1.00	2.60	0.92	2.68	1.07	0.55	2.70	0.95	2.53	1.08	0.18	2.75	0.94	2.39	0.99	0.00*
Dividend payments provide a signal of future earnings prospects	2.56	0.94	2.60	0.93	2.52	0.96	0.48	2.63	0.92	2.44	0.97	0.13	2.64	0.91	2.43	0.95	0.08
A decrease in dividends will usually lead to a fall in share price	2.56	0.98	2.69	0.99	2.44	0.96	0.44	2.66	0.98	2.38	0.96	0.03	2.65	0.94	2.41	1.05	0.06
Investors perceive dividends to be less risky than capital gains	2.38	0.87	2.38	0.80	2.39	0.93	0.97	2.40	0.83	2.35	0.94	0.67	2.44	0.82	2.27	0.93	0.12
Investors base their expectations about this year's dividend on last year's earnings announcement	2.38	0.78	2.40	0.86	2.35	0.70	0.60	2.36	0.78	2.40	0.78	0.71	2.39	0.79	2.38	0.73	0.92

	Total		Quoted		Unquoted		*Quoted v. unquoted*	Dividend Paid		Dividend Unpaid		*Paid v. unpaid*	Dividend Changed		Dividend Unchanged		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
Investors base their expectations about this year's dividend on trends within the sector	2.32	0.70	2.33	0.80	2.31	0.59	0.87	2.35	0.76	2.27	0.58	0.36	2.30	0.74	2.38	0.67	0.43
Investors base their expectations about this year's dividend on current economic conditions	2.32	0.71	2.35	0.77	2.28	0.66	0.43	2.37	0.74	2.22	0.65	0.13	2.32	0.74	2.37	0.64	0.60
Investors base their expectations about this year's dividend on forecast earnings	2.27	0.68	2.27	0.72	2.26	0.65	0.92	2.27	0.69	2.26	0.66	0.84	2.29	0.71	2.26	0.64	0.74
The market reaction to a decrease in dividend will depend on how the new figure compares to investors' expectations	2.17	0.69	2.31	0.71	2.04	0.65	0.00*	2.26	0.70	1.99	0.64	0.00*	2.27	0.66	2.03	0.76	0.01*
The market reaction to an increase in dividend will depend on how the new figure compares to investors' expectations	2.08	0.62	2.12	0.60	2.04	0.65	0.31	2.15	0.65	1.96	0.56	0.02*	2.17	0.65	1.96	0.60	0.01*
Investors base their expectations about this year's dividend on the previous year's dividend	2.06	0.61	2.08	0.70	2.04	0.52	0.68	2.05	0.60	2.09	0.63	0.59	2.07	0.62	2.06	0.61	0.97

*Note: The table shows the responses to thirteen statements regarding the signalling effect of dividend announcements. A five-point Likert scale was used where 1= 'strongly agree', 2 = 'agree', 3 = 'uncertain', 4 = 'disagree' and 5 = 'strongly disagree'. SD is the standard deviation and the p-value tests the null hypothesis that the mean response to a statement for two subgroups is equal using a two-tailed t-test. An * indicates that the p-value is significant at the 5 per cent level.*

Indeed, Irish managers appear less certain about this issue now than in 1989 when Green et al. (1993) reported strong support for the view that dividends are a very important mechanism for signalling management's expectations about future profitability. There were no significant differences in the responses to these two statements from the various groupings examined. This finding is particularly surprising for the quoted/unquoted dimension, because the former group of companies might have been expected to be more interested in signalling information to capital market participants to maintain and improve market value. The latter category, because of the small equity base and the preponderance of closely held shares, might have been expected to place less emphasis on the need for market signals.

Although respondents agreed with the conclusions of previous empirical studies that dividend changes convey some unanticipated information to the market, the level of concurrence is considerably lower than that reported in Baker and Powell (1999). In particular, respondents did not provide any consensus about the view that a rise (fall) in dividend is typically associated with a share price increase (decrease); mean scores of 2.78 and 2.56 respectively were obtained, and the standard deviations of almost 1.00 in each case indicated that views on these issues varied considerably. These figures reflect significant differences in the responses from various sub-groups of firms. For example, the responses from the quoted companies to the statement that a rise in dividend was typically associated with a share price increase was neutral at 3.02, whereas the mean unquoted response was more in agreement at 2.55; this difference was significant at the 5 per cent level. One possible explanation for this finding is that quoted firms tend to be more sanguine about the need to convey news to the capital market, whereas unquoted firms are less aware of the realities of the modern corporate communication process.

When the responses in **Table 4** are analysed for the whole group, those replying displayed the highest level of agreement with the statements concerning investors' expectations. In the opinions of firms, these expectations are based on several variables, most notably last year's dividend and forecast earnings (mean scores of 2.06 and 2.27 respectively). Respondents believed that investors also base their expectations about this year's dividend, albeit to a lesser extent, on payment trends within their sector, on current economic conditions and on last year's earnings.

There were a number of differences in the responses to the statements about investor expectations from the various groupings examined. Although the mean scores for quoted firms were higher than for unquoted companies, the p-values which result from a test of the null hypothesis that the mean responses are equal were generally greater than 0.05. Again, the average responses from firms which pay dividends were higher than those from non dividend-paying companies, with the only exceptions occurring for investors' use of the prior year's dividend and current earnings as the basis for their expectations of current year dividends. The four cases where the p-value was less than 0.05 related to the views that dividend rises (falls) usually lead to a rise (fall) in share price and that the reaction to an increase or decrease in dividends depends on investor expectations. In each case, perhaps surprisingly, the greatest degree of support was expressed by non-paying firms, and the overall results based on this disaggregation suggest that conventional signalling notions are supported most strongly by firms without recent experience of paying a dividend. This result has potential implications regarding a gap between theory and practice in the transmission of signals throughout the Irish stock market.

Finally, there were mixed views about whether (i) investors perceive dividends to be less risky than capital gains and (ii) a change in the existing dividend payout is more important than the actual amount of dividends. Responses to the statements produced mean scores (standard deviations) of 2.38 (0.87) and 2.64 (0.99) respectively. Conventional finance theory (Gordon, 1959; Fama and Miller, 1971) would appear to predict strong support for both these statements and yet the results here are consistent with earlier findings in Baker et al. (1985) and Baker and Powell (1999), where responses to similar questions produced equally indeterminate results.

The influence of taxation on dividend policy

Table 5 summarises the responses to nine statements regarding the influence of the Irish tax system on dividend policies and perceptions. Ireland potentially provides an interesting setting for examining this question, as taxation policy has changed in recent years, thereby possibly influencing investors' desire for receiving their returns in the form of a dividend or capital gain (Brealey and Myers, 2003). Those answering the questionnaire disagreed with the notion that the tax status of the company's shareholders should affect dividends (a mean score of 3.63). This result does not support the US-based research findings in Baker et al. (1985) and Baker and Powell (1999). In the current study, however, a significant difference emerged when the responses were separated into those from quoted and unquoted firms. Quoted companies' directors were significantly less inclined to believe that firms should determine dividends on the basis of the tax status of the company's shareholders (mean score of 3.78 versus 3.49 for unquoted firms). Considering that it would be nearly impossible for quoted companies' directors to know the tax status of its shareholders this result is to be expected.

Consistent with prior research, respondents appeared uncertain about whether investors in high (low) tax brackets are attracted to low (high) dividend shares (mean scores of 2.80 and 2.74 respectively). The associated standard deviations of 0.99 and 0.96 respectively are the highest recorded in the table, indicating the diverse nature of views on the matter. An analysis of the responses to both statements for quoted and unquoted firms revealed that the mean for the former group was higher than for the latter, suggesting that taxation issues were more of a concern for unquoted companies. Support for these notions of a dividend clientele was also significantly stronger among firms that had not paid dividends or changed their dividend, again suggesting that recent experience of the dividend-paying process in Ireland alters corporate perceptions of the likely impact of the payment.

TABLE 5: RESPONDENTS' VIEWS ABOUT THE EFFECT OF TAXATION ON DIVIDEND DECISIONS

	Total		Quoted		Unquoted		*Quoted v. unquoted*	Dividend Paid		Dividend Unpaid		*Paid v. unpaid*	Dividend Changed		Dividend Unchanged		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
Management should determine the annual dividend based on their perception of the tax status of the shareholders	3.63	0.92	3.78	0.72	3.49	1.06	0.01*	3.63	0.92	3.64	0.93	0.94	3.62	0.94	3.66	0.88	0.77
The introduction of capital gains tax treatment for employee share options will lead to higher dividend pay-out ratios	3.25	0.83	3.32	0.83	3.18	0.82	0.16	3.22	0.79	3.30	0.89	0.48	3.21	0.80	3.30	0.86	0.41
The introduction of the new 12.5% rate of Corporation Tax will lead to higher dividend payouts	2.85	0.95	2.93	0.90	2.77	0.98	0.17	2.85	0.94	2.85	0.97	0.97	2.80	0.91	2.96	1.01	0.19
Investors in high tax brackets are attracted to low dividend shares	2.80	0.99	2.90	0.95	2.69	1.02	0.09	2.90	0.98	2.60	0.99	0.02*	2.94	0.94	2.51	1.04	0.00*
Investors in low tax brackets are attracted to high dividend shares	2.74	0.96	2.87	0.91	2.61	1.00	0.03*	2.84	0.94	2.55	0.99	0.02*	2.89	0.91	2.45	1.00	0.00*

	Total		Quoted		Unquoted		*Quoted v. unquoted*	Dividend Paid		Dividend Unpaid		*Paid v. unpaid*	Dividend Changed		Dividend Unchanged		*Changed v. unchanged*
	Mean	**SD**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**	**Mean**	**SD**	**Mean**	**SD**	**p-value**
The taxation of scrip dividends as income rather than deferred capital gains has made cash dividends more attractive to shareholders	2.47	0.74	2.52	0.73	2.43	0.76	0.37	2.50	0.74	2.43	0.76	0.48	2.54	0.70	2.33	0.78	0.03*
The introduction of the dividend withholding tax has made dividend payments less attractive to shareholders	2.47	0.78	2.53	0.81	2.41	0.75	0.29	2.53	0.80	2.36	0.74	0.11	2.53	0.80	2.35	0.74	0.07
The abolition of tax credits on dividends has made dividend payments less attractive to shareholders	2.44	0.83	2.55	0.85	2.32	0.79	0.02*	2.48	0.87	2.35	0.74	0.21	2.47	0.84	2.36	0.82	0.33
Investors prefer returns from capital gains rather than dividends because of the reduction in the capital gains tax rate to 20%	2.09	0.78	2.08	0.76	2.09	0.80	0.95	2.09	0.82	2.08	0.70	0.88	2.12	0.82	2.04	0.71	0.45

*Note: The table shows the responses to nine statements concerning the effect of taxation on dividend decisions. A five-point Likert scale was used where 1= 'strongly agree', 2 = 'agree'; 3 = 'uncertain', 4 = 'disagree' and 5 = 'strongly disagree'. SD is the standard deviation and the p-value tests the null hypothesis that the mean response to a statement for two subgroups is equal using a two-tailed t-test. An * indicates that the p-value is significant at the 5 per cent level.*

Respondents disagreed with the view that the recent introduction of a new capital gains tax treatment for employee share option schemes would lead to higher payout ratios, despite dividends now apparently becoming more valuable (Poterba and Summers, 1984); quoted firms' views were slightly stronger on this issue. One possible explanation for this finding is that unquoted firms may have doubts about introducing or expanding share option schemes without the prior approval of non-employee stakeholders. Typically, such approvals may be conditional on some reward for other company participants, such as a re-designation of existing shareholdings, a change in the firm's profit sharing arrangements, or, indeed, an alteration to the firm's dividend policy.

In contrast, respondents agreed that recent changes in the taxation regime in the Irish Republic, such as the introduction of the new 12.5 per cent rate of Corporation Tax, the introduction of a dividend withholding tax and the treatment of scrip dividends as income, made dividend payments less attractive to shareholders. Intuitively, the effect of these innovations on the tax differential between capital gains and dividends might have been expected to favour a high retention policy, thereby saving investors tax and leading to an appreciation in share values (Litzenberger and Ramaswamy, 1979)[9]. This may explain why such a high number of the sample firms do not pay dividends[10].

An analysis of the responses for quoted and unquoted firms revealed that the mean responses of the former group were generally higher than the latter, suggesting that taxation issues were more of a concern for unquoted companies. The one exception to this general comment related to the statement about the effect of the reduced capital gains tax rate, but even here, the average response from the quoted firms of 2.09 was virtually identical to that from unquoted companies (2.08).

CONCLUSIONS

The findings of this survey suggest that several conclusions can be drawn about contemporary Irish dividend policy. First, taken as a whole, the survey responses were consistent with Lintner's early fieldwork. For example, three statements which achieved high levels of agreement suggested that firms should maintain an uninterrupted dividend, avoid making changes in dividend rates that might have to be reversed in a year or so, and adopt a target payout ratio.

Second, most respondents appeared unsure about the suggestion that dividend policy affects share value. In particular, they did not agree with the view that a rise (fall) in dividend is typically associated with a share price increase (decrease). Accordingly, the current study provides little support for theoretical models which indicate how dividends might act as signalling mechanisms to outside investors. The findings in this paper therefore also contradict the Irish results reported by Green et al. (1993) more than a decade ago.

Third, in contrast with the findings of Baker and Powell (1999), the Irish respondents to this survey hold relatively strong views about the impact of tax on dividend decisions. For example, respondents agreed that recent changes in the taxation regime in the Irish Republic make dividend payments less attractive to shareholders. These findings may explain why such a high number of the sample firms do not pay dividends.

Finally, while there was some evidence of unanimity among respondents, the results also point to a divergence between: (i) firms that pay and vary their dividends and (ii) those that do not; in particular, the former group provided stronger support for conventional theoretical notions of dividend signalling and the tax clientele effect. This finding has potential implications for those charged with regulating the flow of information on the Dublin stock exchange in terms of establishing why adherence to textbook norms appears to dissipate when confronted with practical experience.

The study has some obvious limitations, notably (i) that the number of prior questionnaire-based surveys of dividend policies against which to compare the results is limited and (ii) that, despite recent impressive growth, the Irish economy remains small by global standards. Also, there are a number of instances where the findings indicate inconsistencies in the responses to the questions posed. Nonetheless, the results appear to represent an extension to prior investigations of why Irish companies select particular dividend policies. To the extent that the study disaggregates the results according to the listed status of the company, industrial sector and the historical pattern of respondents' dividend behaviour, the findings are novel. In addition, the large sample size and the seniority of those responding makes the views expressed worthy of consideration. Finally, the transformation of the Irish economy since early work was conducted in this area suggested that further research on this topic was necessary. The current findings therefore appear to represent an enhancement of knowledge about the perception of dividends in a modern, high-growth, European context.

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NOTES

1 A separate strand of this literature argues that dividend cuts may, in fact, signal good news, since they indicate that a firm is retaining funds to finance profitable investments rather than disbursing cash and subsequently having to incur transaction costs when issuing new shares (Woolridge and Ghosh, 1985; Soter, Brigham and Evanson, 1996). Alternatively, several authors have suggested that the response to a dividend cut should be positive, since it usually signals a turnaround in the future performance of the firm (Johnson and Jensen, 1997).

2 Of course, a number of researchers have suggested that high dividend yield shares command no premium in the stock market (Black and Scholes, 1974; Miller and Scholes, 1982; Kalay and Michaely, 2000) and interpret this evidence as a rejection of the hypothesis that taxation influences the valuation of dividend-paying shares.

3 The empirical evidence documented is consistent with Irish companies having a policy of dividend stability. Stewart (1987), Barrett and Cotter (1990) and Green and McIlkenny (1991) provide empirical evidence from an analysis of published financial data, both at the aggregate and individual firm level, which supports the contention that the Lintner (1956) model is descriptive of the dividend policies pursued by Irish companies. Green and McIlkenny (1991) found the constant term in the model to be statistically insignificant, whilst Barrett and Cotter (1990) suggested that there appeared to be a strong tendency for Irish companies to maintain dividends at constant levels.

4 In addition, Ireland's entry into the Euro in 1999 eliminated currency risk for Irish investors investing in Euro zone equities. At the beginning of 2001, Irish equities represented 2 per cent of all Euro-denominated stocks (Kellaher, 2002).

5 In the interest of brevity – and because the literature on dividend policy is already well documented – a separate section on the details of the dividend literature is not provided. For a summary of the dividend policy literature, see, for example, Ang (1987), Abeyratna et al. (1996) or Baker and Powell (1999).

6 Several quantitative studies have undertaken examinations of the dividend-paying characteristics of companies. Jose and Stevens (1989) find that investors value steady growth in dividends per share rather than stable payout ratios. Pruitt and Gitman (1991) also detect continued support for Lintner's model while Benartzi, Michaely and Thaler (1997) conclude that 'Lintner's model of dividends remains the best description of the dividend setting process available.' Chowdhury and Miles' (1987) extensive analysis of 653 companies between 1969 and 1984 reveals that smoothing of dividend payments was a common phenomenon in the UK in the 1970s and early 1980s. Comparing the dividend payout ratio with a measure of rate of return, they noted that in years when profits had been high the payout ratio had fallen, and in years when profits had been low the payout ratio had risen. They suggest that this is consistent with Lintner's notion that shareholders prefer a smooth path of dividend payments. The qualitative results of the present study are largely consistent with the findings from such prior quantitative research.

7 Chowdhury and Miles (1987) report that only 0.9 per cent of UK firms failed to pay a dividend in 1978, whereas six years later the figure had risen to almost 10 per cent. They suggested that such a rise might have resulted from the UK Government's decision to abolish dividend controls in 1979. The rise may also have been associated with the severe economic recession in the UK during the early 1980s.

8 While agreeing that dividends should be maintained, respondents also supported the arguably contradictory view that the dividend should be allowed to fluctuate in accordance with current investment and financing needs. Baker and Powell (1999) reported that although nearly 90 per cent of respondents in their 1997 survey believed that a firm's investment, financing and dividend decisions were related, the respondents held widely different views about whether a firm should consider the dividend as a residual after financing desired investments from earnings. Partington (1985) concluded that on occasions when Australian firms did not have sufficient external funds available for investment they adopted a simultaneous policy for dividends and investment (i.e. the dividends were allowed to fluctuate in accordance with current investment and financing needs).

9 This result appears at odds with the views expressed about the first statement in **Table 5**. One possible explanation for these findings lies in the tax clientele argument; it may be the case that Irish management do not explicitly factor tax considerations into their dividend decision making, but recognise that investors tend to cluster around firms whose policies suit their particular tax circumstances (Elton and Gruber, 1970).

10 Respondents also agreed that both the new lower capital gains tax rate of 20 per cent for investors and the abolition of tax credits for dividends had improved the relative attractiveness of capital gains over dividend income. These statements had the lowest mean scores of 2.09 and 2.44 respectively, and the second and fourth smallest standard deviations.

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