DIVIDEND PAYOUT AND CORPORATE GOVERNANCE ACROSS THE GREEK LISTED FIRMS

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ABSTRACT

This paper seeks to test the outcome and substitution agency models of dividends at different stages of the corporate life-cycle. In a sample of Greek listed firms, the empirical analysis shows that the outcome model of dividends, which predicts that dividend payout increases in the strength of shareholder rights, prevails along the corporate life-cycle, but only where creditor rights are strong. Therefore, the agency cost of equity and debt versions of the outcome model of dividends holds. The findings document no evidence in support of the substitution model of dividends. Moreover, the results serve to highlight the profound influence that creditors exert on corporate payout policies. When shareholders enjoy considerable legal rights, but not so creditors, creditors demand, and firms consent to lower dividends.

Keywords: Dividend payout, Corporate governance, Greek listed firms

JEL Classification: G30, G34

Introduction

The fundamental goal of financial management is to maximize the current value per share of the stock market. One substantial financial decision affecting this value maximization goal is the dividend policy. In an early paper, Black (1976) coins the term the 'dividends puzzle' to illustrate the poor understanding of dividend payment policy: "*The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don't fit together.*" Over the years, dozens of theories have attempted to explain the dividends phenomenon with no consensus reached. Many of the theories view agents as rational and dividends either serve as an efficient way to resolve agency problems or as a signaling device to mitigate information asymmetry problems. According to La Porta et al. (2000), and Brockman and Unlu (2009), the strength of the legal rights afforded to the providers of capital to corporations influence the corporate dividend policy. Moreover, the former relate shareholder rights, measure the corporate dividend payout, and test two competing agency models of dividends, such as the outcome and substitution models. Furthermore, the creditor rights influence dividend policies around the world by establishing the balance of power between debt and equity claimants. Creditors demand and managers consent to a more restrictive payout policy as a substitute for weak creditor rights in an effort to minimize the firm's agency costs of debt.

Literature on Dividend Policies and Corporate Covernance

According to Linter (1956), Linter (1962), Bhattacharya (1979), Miller and Rock (1985), the corporate dividend policy is designed to reveal profit-earning prospects of a firm to their investors. Many empirical studies provide evidence in favor of this model. Fama and Babiak (1968) argue that the firms set their target dividend level and attempt to stick to it. Furthermore, based on the signaling approach, there may be interrelations between dividend payout policy and agency costs of the firm (Jensen and Meckling, 1976; Easterbrook, 1984). Dividend payout policy is an effect of the conflict between the insiders and the outsiders. Jensen and Meckling (1976), Rozeff (1982), and Easterbrook (1984) favour agency cost explanations for changes in dividends payout, while decomposing whether dividends can act as a method to align manager's interests with those of investors. Accordingly, the firm pays dividends in order to reduce agency costs, as payment of dividends reduce the discretionary funds available to managers. Jensen (1986) documents that in the presence of free cash flows, the firm pays dividends or retires its debts to restrict the agency cost of free cash flow. Kalay (1982) explores a large sample of bond indentures focusing on collision between shareholders and bondholders on the dividend decision.

The empirical observation by Lintner's (1956) shows that firms gradually adjust dividends in response to changes in earnings, that have acquired the status of a stylized fact on corporate dividend policy. Initially, his work suggests that managers change dividends in response to unanticipated and non-transitory changes in their firm's earnings, and they have reasonably defined policies in terms of the speed with which they adjust dividends towards a long-run target payout ratio. Empirical studies, such as Lintner's (1956), have confirmed Fama and Babiak (1968) original findings.

Another strand in the literature compares dividend payout to firms' life cycle. Especially, a great number of papers observe that the firms that pay dividends, tend to be more mature and unpredictable. Grullon et al. (2002) argue that firms increase or decrease dividends experience a future decline or increase in their profitability. The authors argue that firms exhaust their investment opportunities, increase their dividends, and hence dividends display firm maturity rather than signalling future profitability.

Several papers highlight the link between dividends and idiosyncratic risk. In particular, Venkatesh (1989) shows that idiosyncratic risk and the informational content of earnings fall, following dividends initiation. Moreover, Fink et al. (2006) document that dividend-paying firms have lower idiosyncratic volatility. Furthermore, Bradley et al. (1998) and Chay and Suh (2008) explain the association between dividends and volatility. Only firms with low cash-flow uncertainty feel comfortable in committing to paying dividends, an attitude consistent with the conservative managerial views by Lintner (1956) and Brav et al. (2005). According to Hoberg and Prabhala (2009), the disappearance of dividends (Fama and French, 2001) is associated with an increase in the idiosyncratic risk.

Data

In this study we examine the relationship between the strength of corporate governance and corporate dividend policy for manufacturing listed firms in Greece along their corporate life-cycle. To measure the strength of corporate governance, we follow Mitton (2004) and use the corporate governance scores analysis, developed by Credit Lyonnais Securities Asia (CLSA, 2001). The CLSA governance ratings range from 0 to 100 with higher values suggesting better corporate governance. We also employ the dividend payout yield, as dividends per earning measured as cash dividends paid to common and preferred shareholders. The firm size is measured as their total assets and the profitability is measured as earnings per share. Moreover, the firms' growth is measured through the capitalization metric of the listed firms, firms' cash is their cash flows, and total equity is measured as total shareholders' equity, scaled by book assets. Size and

profitability are expected to impact positively on dividend policy. By contrast, high growth firms typically pay smaller dividends. Finally, the expected relationship between cash and dividend pay-out is ambiguous. All data are on a daily basis and are sourced from DataStream, spanning the time range from 2004 to 2014, with the total sample consisting of 15 listed firms from the Athens Stock Exchange.

Empirical Analysis

The empirical model is well described by the following equation:

$$DIVY_{it} = \alpha_{it} + \beta_1 SCORE_{it} + \beta_2 ASSET_{it} + \beta_3 MARV_{it} + \beta_4 ERS_{it} + \beta_5 CFPS_{it} + \beta_6 EQ_{It} + \varepsilon_{it} \quad (1)$$

where: $DIVY_{it}$ is dividends to yield, $SCORE_{it}$ is the corporate governance score for each firm i, $ASSET_{it}$ is total assets, $MARV_{it\ is}$ displays the capitalization of the firm, ERS_{it} is earnings per share, $CFPS_{it}$ is cash flows per share, and EQ_{it} is equity. α_{it} denotes the presence of fixed effects.

We resort to the following first generation unit root tests: the MW test (Maddala and Wu, 1999), the Choi test (Choi, 2001), the LLC test (Levin et al., 2002) and the IPS test (Im et al., 2003), that are all based on the assumption of independent cross-section units. The results for the panel unit root tests are provided in Table 1. They recommend that for all variables except for the score variable, we can reject the null hypothesis of unit root at the 1% significance level.

Table 1. Panel unit root tests

Variable	MW test	Choi test	LLC test	IPS test
DIVY	4.85	1.19	3.48	-1.39
ΔDIVY	-9.81	-10.73	-11.52	-7.64
SCORE	-8.39	-9.08	-10.22	-8.52
ASSET	3.18	1.15	3.16	-1.57
ΔASSET	-9.04	-11.77	-13.27	-9.24
MARV	3.16	1.27	4.11	-1.58
ΔMARV	-9.63	-11.37	-12.19	-8.75
EPS	2.99	1.16	3.53	-1.29
ΔEPS	-8.75	-10.62	-13.22	-8.04
CFPS	3.17	1.19	3.25	-1.48
ΔCFPS	-9.68	-12.31	-13.46	-9.55
EQ	2.75	1.14	3.48	-1.36
ΔEQ	-8.79	-10.62	-12.35	-8.17

Critical values at the 1%, 5% and 10% significance levels are respectively: MW [7.57, 6.41, 5.41], Choi [2.33, 1.64, 1.28], LLC [-2.33, -1.64, -1.28], IPS [-2.33, -1.64, -1.28].

Given the panel unit root results in Table 1, the empirical analysis proceeds by estimating equation (1) through a fixed effect OLS regression. The presence of specific factors in each listed firm can be tested by the hypothesis that there exist significant individual effects in the estimated regression through a joint restrictions F test. If the value of the F statistic exceeds the critical value, there is evidence that specific corporate effects are present in the estimated model. The F test (H_0: fixed effects = 0) results suggest that using the panel data methodology provides relevant information gains, and in this case, the OLS estimation may generate biased results. As the panel data methodology is the most appropriate, the issue now is to choose the estimation method for fixed effects (FE) or random effects (RE). In the case, in which the used data are not random extractions from a larger sample, the fixed effects model is the most appropriate estimation methodology. Furthermore, in the fixed effects model, the estimator is robust to the omission of relevant explanatory variables that do not vary over time, and even when the random effects' approach is valid, the estimator of fixed effects is consistent, only less efficient. Therefore, the estimation by fixed effects appears to be the most appropriate for our empirical purposes. Table 2 reported the fixed effects findings.

Table 2. Fixed effects estimates

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Variable	Coefficient	p-value
Intercept	0.219	[0.38]
SCORE	0.928***	[0.00]
ΔASSET	0.672*	[0.07]
ΔMARV	-2.85**	[0.04]
ΔEPS	0.455**	[0.05]
ΔCFPS	1.247***	[0.01]
ΔEQ	2.108**	[0.02]
Diagnostics		
R^2-adjusted	0.64	
Hausman test	[0.00]	
No. of firms	15	

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Figures in parentheses denote p-values. *, ** and *** denote statistical significance at the 10%, 5% and 1% level, respectively.

The findings presented in Table 2 are in line with Mitton (2004) and provide support in favor of the outcome model of dividends. The coefficient estimate on the corporate governance variable (SCORE) is positive and statistically different to zero. Its value turns to be 0.328 (p<.01). This coefficient estimate implies that a one percent change in corporate governance, changes dividend payout by 0.93 percentage points.

The firm-level control variables are of the correct sign. Large (ΔASSET) and profitable (ΔCFPS) firms pay higher dividends. Growth (ΔMARV) firms tend to pay lower dividends. Furthermore, and consistent with the life-cycle model of dividends, dividend payout increases with corporate maturity i.e. when earnings per share (ΔEPS) increases.

Overall, the findings are consistent with Mitton (2004) and provide support for the outcome model of dividends. Shareholders use their legal rights, in this instance measured at the firm-level, to extract large dividends from firms. All else equal, dividend payouts are greater in better governed firms.

The reported Hausman specification test has been used to determine which one of the alternative panel analysis methods (fixed effects model and random effects model). With respect to the test, the null H_0 hypothesis claims that "random effects exist", while the alternative H_1 hypothesis claims that "random effects do not exist". The results in Table 2 illustrate that the H_0 hypothesis is rejected at the 1% significance level, thus, not all of the individual effects in the dividend yield model are random, but are fixed. In other words, the H_1 hypothesis

is valid according to which the fixed effects model is more effective than its random effects counterpart.

Conclusion

This paper tested the outcome and substitution model of dividends, recommended by La Porta et al. (2000) along the corporate life-cycle. In particular, it tested the hypothesis that the outcome model of dividends can explains the ability of firms to pay higher dividends, either as an outcome of strong governance, or a substitute for weak governance, is contingent on strong creditor rights.

Using a sample of 15 firms from the Greek stock market, the analysis provide supportive evidence on that the outcome model holds along the corporate life-cycle. In other words, at all stages along the corporate life-cycle, better-governed firms pay larger dividends than their poorly-governed counterparts. It also showed that they can only do so where creditor rights are strong. These findings are in line with those of Brockman and Unlu (2009), Shao et al. (2009) and Byrne and O'Connor (2012) which show that the agency cost of equity and debt version of the outcome model of dividends holds, i.e. dividend payouts are largest where shareholder and creditor rights are strong.

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