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Determinants of Dividend Policy —
International Evidence: 1990 to 2010

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Statement of Originality

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Yukun YAO

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Abstract

This thesis investigates the changing nature of dividend policy, by undertaking analyses of the company, country, and time-level determinants that affect companies’ decisions to pay, initiate, and omit dividends, and the amount of dividends that are paid. The research contributes to existing literature by examining the combination of theories of dividend policy, including dividend smoothing theory, agency costs theory, signaling theory, catering theory, and tax clientele theory. The analysis is undertaken using a panel data of 66,831 company-year observations drawn from thirty-one countries, over the period 1990 to 2010. In all stages of model estimation, a baseline model that incorporates central company characteristics, and augmented models that include additional variables that proxy for alternative theories, are specified and tested.

A logit regression model is employed to examine the factors that affect companies’ decisions to pay, initiate, and omit dividends. The large and profitable companies that generate excess free cash flows, and whose shareholders are tax advantaged when receiving cash dividends are more likely to initiate and pay dividends. However, the companies with more growth options and more liquid shares are less likely to initiate and pay dividends. Mixed results are found in terms of the impact of debt on dividend payment and initiation decisions. For the majority of countries, companies’ decisions to omit dividends are only affected by profitability, available investment opportunities, and size. The impact of the Global Financial Crisis on the decision to omit dividends is persistent and robust, indicating that companies are highly likely to omit dividends if they face financial difficulties. The multi-country analysis, which is drawn from twenty-two countries over the period 1991 to 2008, reveals that companies operating under civil law regimes are more likely to initiate and pay dividends. Moreover, companies in developed markets are more likely to initiate and pay dividends compared with those in emerging markets. Of note, the degree of investor protection offered and the maturity of financial markets play a significant role in mitigating the severity of agency problems.
Panel data regression analysis is undertaken to examine the company, country, and time-level determinants on the amount of dividends paid. The majority of dividends are typically paid by large, profitable companies with excess free cash flows. Conversely, companies with more available investment opportunities and more liquid shares tend to pay fewer dividends. Mixed results are found regarding the impact of debt levels on the amount of dividends paid. The results provide evidence that the presence of investor protection and the maturity of financial markets weaken the relationship between managerial ownership and the dividend payout ratio, suggesting that the degree of investor protection offered and the maturity of financial markets are a substitution mechanism for dividend payout in mitigating the severity of agency problems. Further, the joint impacts of the determinants on the amount of dividends paid are significantly different between developed and emerging markets. Specifically, companies in developed markets follow a smoother dividend policy and their payout ratios are less dependent on profitability relative to those in emerging markets. Additionally, for companies in emerging markets, there is a strong negative relationship between corporate debt levels and the dividend payout ratio.

On the whole, the key factors in determining the decisions to pay or not to pay dividends and the amount of dividends paid are homogeneous across countries, namely profitability, investment opportunities, company size, capital structure, liquidity, and free cash flows. Most importantly, strong evidence is found for the dividend smoothing hypothesis, the free cash flow hypothesis of agency costs theory, the tax clientele theory, and the dividend substitution theory in explaining the decisions to pay, initiate, and omit dividends and the amount of dividends paid. However, the evidence casts doubt on dividend signaling theory and agency costs theory to the extent that they are proxied by the managerial ownership variable.
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