

How Corporate Managers View Dividend Policy

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This study investigates the views of corporate managers about the relationship between dividend policy and value; explanations of dividend relevance including the bird-in-the-hand, signaling, tax-preference, and agency explanations; and how firms determine the amount of dividends to pay. We also examine whether the responses on these topics differ among three industry groups (manufacturing, wholesale/retail trade, and utilities). We obtain data from a mid-1997 mail survey sent to 603 chief financial officers of U.S. firms listed on the NYSE. Based on 198 usable responses, the empirical results show that most survey respondents believe that dividend policy affects firm value. Of the four explanations for dividend relevance, the respondents generally express the highest level of agreement with statements about signaling. The results also show that managers are concerned about the continuity of dividends when setting dividend payments. Finally, the respondents from the three industry groups surveyed generally hold similar views about dividend policy issues.

Introduction

Dividend policy is one of the most controversial subjects in finance. Finance scholars have engaged in extensive theorizing to explain why companies should pay or not pay dividends. Other researchers have developed and empirically tested various models to explain dividend behavior. Some researchers have surveyed corporate managers and institutional investors to determine their views about dividends. Despite extensive debate and research, the actual motivation for paying dividends remains a puzzle.¹

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¹See Black (1976) and Bernstein (1996) for a discussion of the difficulty of understanding the dividend puzzle from the viewpoint of firms and investors.

In this paper, we investigate the views of corporate managers of major U.S. firms about three topics: (1) the relationship between dividend policy and value, (2) explanations of dividend relevance including the bird-in-the-hand, signaling, tax-preference, and agency explanations, and (3) how firms determine the amount of dividends to pay.² We also examine whether the responses on these topics differ among three industry groups (manufacturing, wholesale/retail trade, and utilities). We examine the level of agreement that corporate managers express about 26 theoretical and empirical issues about dividend policy.

Investigating these issues is important to determine to what extent corporate managers agree with the various messages contained in the academic literature on dividends. Understanding the beliefs of managers who are involved in setting dividend policy may contribute to our understanding of why firms pay cash dividends. This study also contributes to the growing body of survey research on dividend policy. For example, the current study not only expands and updates previous survey research by Baker, Farrelly, and Edelman (1985) among others but also asks different questions especially related to explanations of dividend policy.

The study addresses four research questions. First, do corporate managers believe that dividends are relevant? Second, what explanation of dividends do managers tend to favor? Third, how do firms set the amount of dividends that they pay? Finally, do the views of managers about dividend issues differ among different industry groups?

Some findings probably are predictable, while others are surprising. Overall, the evidence shows that:

- Most respondents believe that dividend policy affects firm value;
- The respondents generally show the highest level of agreement with statements about the signaling explanation of dividend relevance;
- Managers' views on setting dividend payments today are consistent with those reported by managers interviewed by Lintner (1956) and his behavioral model of dividend policy; and
- Few statistically significant differences exist among the responses from the three industries.

Literature Review

The Relationship Between Dividend Policy and Value

The question of whether dividend policy affects the value of the firm has puzzled researchers and corporate managers for many years. Dividend policy is one of the most widely researched topics in finance. Yet, researchers have different views about whether the percentage of earnings that a firm pays out in dividends materially affects

²See, for example, Ang (1987) and Barclay, Smith, and Watts (1995) for a review of corporate dividend theories and evidence.

its long-term share price. Some empirical studies appear to support Miller and Modigliani's (1961) classic dividend irrelevance proposition [e.g., Black and Scholes (1974), Miller and Scholes (1978), Jose and Stevens (1989)]; others do not [e.g., Long (1978), Sterk and Vandenberg (1990)]. In addition, survey research by Farrelly, Baker, and Edelman (1985) shows that corporate managers typically believe that dividend policy affects a firm's value and that an optimal level of dividend payout exists. In practice, most firms pay cash dividends, although paying dividends is costly in various ways. Thus, empirical evidence on whether dividend policy affects a firm's value offers contradictory advice to corporate managers. Today, many academicians and corporate managers still debate whether dividend policy matters.

Explanations of Dividend Relevance

Given that managers typically believe in dividend relevance, the second question is "What explanations of dividends do managers tend to favor?" Researchers have offered four common explanations of dividend relevance: the bird-in-the-hand, signaling, tax preference, and agency explanations.

The Bird-in-the-Hand Explanation

One argument that a relationship exists between firm value and dividend payout is that dividends represent a sure thing relative to share price appreciation. Because dividends are supposedly less risky than capital gains, firms should set a high dividend payout ratio and offer a high dividend yield to maximize stock price. Miller and Modigliani (1961) disagree and call the theory that a high dividend payout ratio will maximize a firm's value *the bird-in-the-hand fallacy*. Bhattacharya (1979) also argues that the reasoning underlying the bird-in-the-hand explanation for dividend relevance is fallacious. The riskiness of a project's cash flows determines a firm's risk. An increase in dividend payout today will result in an equivalent drop in the stock's ex-dividend price. Thus, increasing the dividend today will not increase a firm's value by reducing the riskiness of future cash flows.

The Signaling Explanation

Another possible reason for paying dividends is the use of dividend policy to communicate information about a firm's future prospects to investors.³ Miller and Modigliani (1961) realize that in the real world a change in the market price often follows a change in the dividend rate. According to the information content of dividends or signaling explanation, cash dividends announcements convey valuable

³Ross (1977) first developed the theoretical analysis of dividends as a signaling device. Various dividend-signaling models developed by Bhattacharya (1979, 1980), John and Williams (1985), Miller and Rock (1985), and Ofer and Thakor (1987) posit a positive relationship among dividend policy changes, equity, values, and subsequent performance.

information about management's assessment of a firm's future profitability that other means cannot fully communicate. Information asymmetry suggests that corporate managers have an information advantage over outside investors. If managers have information that investors do not have, managers may use a change in dividends as a way to signal this private information and thus reduce information asymmetry. In turn, investors may use dividend announcements as information to assess a firm's stock price.⁴ On balance, much empirical evidence supports the view of dividends as a signaling device.⁵

Although managers can use dividend actions to convey useful information, dividend changes may not be perfect signals. According to Easterbrook (1994), dividend increases may be ambiguous signals unless the market can distinguish between growing firms and disinvesting firms, i.e., those with a lack of investment opportunities.⁶ For example, Soter, Brigham, and Evanson (1996) note that FPL Group, the parent company of Florida Power & Light Company, announced a 32 percent reduction in its quarterly dividend on May 9, 1994 for strategic reasons, not problems in cash flow. The stock market's initial reaction to FPL's announcement was negative, with an initial drop of about 20 percent in value. After carefully reviewing the reasons for the reduction, analysts concluded that the action was not a signal of financial distress. Instead, the dividend decrease was a strategic decision designed by management to improve the firm's long-term financial flexibility and growth prospects. After the financial community adopted this view, FPL's stock began to recover.

The Tax-Preference Explanation

Another explanation of why dividend policy matters involves the tax effect. According to the tax-preference theory, investors may favor retention of funds over the payment of dividends because of tax-related reasons.⁷ The favorable treatment of capital gains over dividends may lead investors to prefer a low dividend payout to a high payout. This theory suggests that firms should keep dividend payments low if they want to maximize prices.

⁴Although unexpected dividend changes typically result in stock price changes, this does not mean that dividend policy *per se* is relevant. The stock price level may change faster due to the dividend change, but eventually earnings reports would provide the same information as contained in the dividend announcement.

⁵For evidence of signaling effects of dividend announcements, see, for example, Woolridge (1982, 1983), Asquith and Mullins (1983), Benesh, Keown, and Pinkerton (1984), Ghosh and Woolridge (1988), Healy and Palepu (1988), Bajaj and Vijh (1990), Christie (1994), Michaely, Thaler, and Womack (1995), and Impson (1997).

⁶Born and Rimbey (1993) examine the relation between prior financing activity and the market response to initial dividends and find evidence consistent with the Easterbrook (1984) agency cost model.

⁷Brennan (1970) and Stapleton (1972) among others develop an optimal dividend policy based on the tax differential between capital gains and dividends.

Because the tax effect differs among various types of investors, investors may be attracted to firms that have dividend policies appropriate to their particular tax circumstances. Researchers call this notion the *tax clientele effect*. Other things being equal, stocks with low payouts should attract investors in high tax brackets, leaving high payout stocks to investors subject to low or zero tax rates. The empirical evidence on the tax-preference explanation of dividends is inconclusive.⁸

The Agency Explanation

Another popular view of dividend relevance, advanced by Jensen and Meckling (1976), and extended by Rozeff (1982) and Easterbrook (1984), is agency theory. This theory derives from the conflict of interests between corporate managers (agents) and outside shareholders (principals). For example, management can consume excessive perquisites out of undistributed corporate earnings and invest the retained funds suboptimally. This conflict leads to agency costs. Agency theory posits that the dividend mechanism provides an incentive for managers to reduce the costs related to the principal/agent relationship. One way to reduce agency costs is to increase dividends. Paying larger dividends reduces the internal cash flow subject to management discretion and forces the firm to seek more external financing. Raising costly outside capital subjects the firm to the scrutiny of the capital market for new funds and reduces the possibility of suboptimal investment. This monitoring by outside suppliers of capital also helps to ensure that managers act in the best interest of outside shareholders. Thus, dividend payments may serve as a means of monitoring or bonding management performance.

Several empirical studies provide support for the agency explanation for dividends. For example, Rozeff (1982) finds support for the role of dividends in resolving agency costs in minority-manager-controlled firms. His analysis shows a negative relationship between dividend payout and the percentage of insiders. Given a lower percentage of outsiders, less need exists to pay dividends to reduce agency costs. Crutchley and Hansen (1989) and Moh'd, Perry, and Rimbey (1995) conclude that managers make financial policy tradeoffs such as paying dividends to control agency costs.

Setting Dividend Payments

Researchers have developed many different models for explaining dividend behavior. In Lintner's (1956) classic study, managers perceived that shareholders were entitled to a fair share of the firm's earnings through dividends. Although managers advocated a long-range target payout ratio, they believed that shareholders preferred a steady increase of dividends. Managers sought to avoid making changes in their dividend rates that might have to be reversed within a year or so. Therefore, they tended

⁸Ang (1987) provides a summary of the literature on the role of taxes and dividend policy.

to make partial adjustments toward a target payout ratio rather than dramatic changes. Managers smoothed dividends in the short run to avoid frequent changes.

Lintner's behavioral model suggests that the change in dividends is a function of the target dividend payout less the last period's dividend payout multiplied by the speed of an adjustment factor. The target dividend payout is a fraction of the current period's earnings. Lintner tests his propositions and finds that the partial adjustment model predicted dividend payments more accurately than "naive" models.

Other studies have confirmed the dividend policy beliefs of managers, as described by Lintner. For example, Jose and Stevens (1989) find that the market values stable and steady growing dividends per share rather than stable payout ratios. Based on an extensive empirical analysis of changes in dividends, Benartzi, Michaely, and Thaler (1997, p. 1032) conclude that "...Lintner's model of dividends remains the best description of the dividend setting process available." In separate surveys, Baker, Farrelly, and Edelman (1985) and Pruitt and Gitman (1991) find continued support for Lintner's results.

Survey Design

Our sample consists of U.S. corporations listed on the New York Stock Exchange (NYSE) that paid a cash dividend in at least one year during the 1994-1995 period. The primary business of these corporations is manufacturing (SIC 20-39), wholesale/retail trade (SIC 50-58), or utility (SIC 49). We examine three industry groups because research by Michel (1979) and Baker (1988) among others suggests that dividend policies vary across industries.⁹ The total sample is 603 firms: 392 manufacturing, 98 wholesale/retail trade, and 113 utilities. As Table 1 shows, utilities, on average, represent a high dividend-payout industry, whereas firms in manufacturing and wholesale/retail trade have, on average, more moderate dividend payout ratios.

We use a mail survey to obtain information about the respondents' views on various dividend policy issues and a profile of the respondents and their firms. We group these issues into five broad explanations of dividend policy: (1) dividend irrelevance/relevance, (2) bird-in-the-hand, (3) tax preference, (4) signaling, and (5) agency costs. We also ask respondents about how firms set dividend payments. The survey asks the respondents to indicate their general opinion about each of 26 closed-end statements based on a five-point response scale. This scale is as follows: -2 = definitely don't agree, -1 = probably don't agree, 0 = neither agree nor disagree, +1 = probably agree, and +2 definitely agree. We pretested the initial survey among a small group of finance academicians.

⁹Rozeff (1982) concludes that a company's industry does not help to explain its dividend payout ratio. This conclusion may not apply to utilities because he intentionally excludes regulated companies from his analysis because their regulatory status may influence their policies.

We mailed a cover letter requesting participation in this study along with a stamped, self-addressed return envelope and the survey instrument to the chief financial officer (CFO) of the 603 firms in mid-April 1997. The cover letter requested that if the recipients were not actively involved in determining their firm's dividend policy that they give the survey to someone in their company whom was involved. We mailed a second survey to nonrespondents in mid-May, 1997, to increase the response rate and to reduce potential nonresponse bias. The survey contained a code number to identify the respondents and to avoid including duplicate responses in the analysis.

By the end of June 1997 the survey had yielded 198 usable responses (a 32.9 percent response rate). The division of the responses among the three industry groups was: manufacturing 117 of 392 (or 29.8 percent), wholesale/retail trade 28 of 98 (or 28.6 percent), and utility 53 of 113 (or 46.9 percent). Some respondents did not answer every question. The most common position or title of the respondents was CFO (63.2 percent), followed by vice president (16.6 percent), treasurer or assistant treasurer (8.8 percent), director of investor relations (4.7 percent), and other (6.7 percent). About 95 percent of these respondents said that they were actively involved in determining their firm's dividend policy.

Limitations

Before presenting the results, we want to point out several limiting aspects of this research. First, we restrict the sample to three broad industry groups of U.S. firms listed on the NYSE. We also concentrate on firms that paid cash dividends and exclude those firms with other types of dividend policies. Omitting firms that chose not to pay dividends from the survey may bias our findings in several instances. Therefore, readers should be careful in generalizing the findings to other industry groups and to firms whose characteristics differ from those of the current sample.

Second, we obtained the views about dividend policy from one manager within each firm. Because identifying all participants involved in making a firm's dividend decisions is impractical, we use the CFO or other individual familiar with the firm's dividend policy as a proxy for dividend policy makers.

Third, we limit the length and scope of the survey. We did not want to discourage potential respondents by making the survey too lengthy or by asking many open-ended questions. Therefore, the survey instrument involves a tradeoff between the information needed and the response rate. Although our study provides information about *how* dividend policy makers view certain factors in setting dividend policy, it does not provide information about *why* the respondents hold these views.

Fourth, despite efforts to make questions clear, respondents could misinterpret or misunderstand the survey questions. We are most concerned with the two questions in the agency area (S25 and S26). Although these questions were understandable to our pilot test group of academics, they may not have the same meaning to managers. In retrospect, determining if managers generally interpreted the specific questions asked

as we intended would have enhanced our ability to draw valid conclusions from the responses provided. Therefore, we are careful in drawing conclusions based on the responses to these two questions.

Finally, nonresponse bias could affect the findings. To reduce this possibility, we took several precautionary steps to increase the response rate such as having multiple, personalized mailings and assuring anonymity and confidentiality of individual responses. Nonresponse bias is potentially greater between the manufacturing and wholesale/retail trade groups because of their lower response rates compared with the response rate from the utility group. The effect of nonresponse on survey results depends on the percentage not responding and the extent to which those not responding are biased.¹⁰

We conduct t-tests for difference in means to determine whether selected characteristics of the responding firms differ significantly from those of the nonresponding firms. We use COMPUSTAT to compute five characteristics (total assets, total sales, market value of equity, dividend payout ratio, and dividend yield) for all firms in the full sample for which data are available in 1994. To reduce possible scale problems in conducting the t-tests, we convert total assets, sales, and market value of equity to logarithms. As Table 1 shows, no statistically significant differences exist at the 0.05 level for any of the characteristics by the three industry groups.¹¹

Survey Results

Table 2 provides the respondents' opinions about 26 closed-end statements relating to dividend policy. We compute descriptive statistics for each of the 26 closed-end statements and rank each statement by its mean score. We use chi-square tests to test for significant differences in the level of agreement among the three industry groups. To account for inadequate cell sizes in the chi-square tests, we collapse the response scale from five to three categories. These categories are: definitely don't agree and probably don't agree (-2 and -1), neither agree nor disagree (0), and probably agree, and definitely agree (+1 and +2).

The Relationship Between Dividend Policy and Value

Our first research question was "Do corporate managers believe that dividends are relevant?" According to dividend irrelevance theory of Miller and Modigliani (1961), dividend policy does not affect either the price of a firm's stock or its cost of capital.

¹⁰Fowler (1984) states that one way to study nonresponse bias is to compare those who respond immediately with those who respond after taking follow-up steps. We compare the survey results of the first and second mailing and find few significant differences between the two groups of respondents.

¹¹Although not shown, the medians of each variable are generally similar between the responding and nonresponding firms. The only exception is the dividend payout ratio, which is larger for the nonresponding wholesale/retail trade group compared with its responding counterparts.

Table 1—Characteristics of Responding and Nonresponding Firms

This table shows the means of the responding and nonresponding firms on five characteristics for the manufacturing, wholesale/retail trade, and utility groups included in the full sample. COMPUSTAT is used to compute total assets, sales, market value of equity, dividend payout ratio, and dividend yield in 1994. T-tests of difference in means are conducted to determine if the responding and nonresponding firms differ significantly on each characteristic. Because outliers affect the means of the total assets, sales, and market value of equity, each of these variables is converted to logarithms before conducting the t-tests.

Industry	Mean of Firm Characteristic				
	Total Assets (\$ millions)	Sales (\$ millions)	Market Value of Equity (\$ millions)	Dividend Payout	Dividend Yield
Panel A: Manufacturing					
Responding	\$5,000.75	\$4,965.01	\$4,718.71	36.67%	2.27%
Nonresponding	4,021.68	3,599.43	4,009.19	47.37	2.48
t-statistic	-0.03	-0.00	0.02	-0.09	0.03
Number responding	105	105	96	105	102
Number nonresponding	274	274	235	273	271
Panel B: Whole/Retail Trade					
Responding	\$2,750.43	\$5,166.33	\$4,152.81	23.00%	1.97%
Nonresponding	3,805.19	6,040.62	2,672.32	52.61	2.44
t-statistic	0.08	-0.01	0.12	-0.20	-0.32
Number responding	28	28	25	28	28
Number nonresponding	60	60	54	60	58
Panel C: Utility					
Responding	\$5,085.34	\$1,951.64	\$2,777.89	77.24%	6.22%
Nonresponding	4,897.41	1,945.54	2,534.92	70.71	6.21
t-statistic	0.05	0.03	0.00	0.13	0.00
Number responding	52	52	48	52	52
Number nonresponding	58	58	50	58	58

None of the t-values is statistically significant at the 0.05 level

Panel A of Table 2 shows that most respondents agree that a change in dividend policy affects not only firm value (S1) but also its cost of capital (S10). More than 90 percent of the total respondents also agree with two other statements: an optimal dividend policy strikes a balance between current dividends and future growth that maximizes stock price (S5) and a firm should formulate its dividend policy to produce maximum value for shareholders (S6). These findings are clearly contrary to Miller and Modigliani's proposition that in a world without taxes no optimal dividend policy exists. This view suggests that one dividend policy is as good as any other. Such evidence is not surprising because Miller and Modigliani's (1961) restrictive assumptions do not hold in the real world. This finding is also consistent with previous survey research by Baker, Farrelly, and Edelman (1985) involving management views of dividend policy.

Table 2—Statements about Corporate Dividend Policy

The descriptive statistics reflect the respondents' opinions about statements relating to dividend policy in general. To perform the chi-square tests, the cells for the level of agreement are collapsed from five categories to three—definitely don't agree and probably don't agree (-2 and -1), neither agree nor disagree (0), and probably agree and definitely agree (+1 and +2). The chi-square tests are used to determine the significance of the differences in the level of agreement among the three industries: manufacturing, wholesale/retail trade, and utility.

Issue	Disagree					Agree			Std Dev	Rank	Probability	Industry
	-2	-1	0	+1	+2	Mean						
Panel A: The Relationship Between Dividend Policy and Value												
6. A firm should formulate its dividend policy to produce maximum value for shareholders.	1.8%	2.7%	6.2%	20.4%	69.0%	1.53		0.87		1		Mfg
	0.0	0.0	14.3	25.0	60.7	1.46		0.74		2	0.073	WR
	0.0	0.0	1.9	18.9	79.2	1.77		0.47		1		Util
5. An optimal dividend policy strikes a balance between current dividends and future growth that maximizes stock price.	1.8	0.9	7.1	39.8	50.4	1.36		0.80		3.5		Mfg
	0.0	7.1	10.7	39.3	42.9	1.17		0.90		3.5	0.176	WR
	0.0	3.8	0.0	32.1	64.2	1.57		0.69		2.5		Util
9. A firm's investment, financing, and dividends decisions are interrelated.	2.7	1.8	8.0	34.5	53.1	1.34		0.90		5.5		Mfg
	0.0	3.6	3.6	32.1	60.7	1.50		0.74		1	0.905	WR
	0.0	5.7	5.7	30.2	58.5	1.42		0.84		5		Util
10. A firm's dividend policy affects its cost of capital.	6.3	7.1	16.1	38.4	32.1	0.83		1.15		10		Mfg
	3.6	10.7	14.3	42.9	28.6	0.82		1.09		9	0.961	WR
	0.0	13.5	11.5	38.5	36.5	0.98		1.02		10		Util
1. A change in dividend policy affects firm value.	4.4	10.6	8.0	52.2	24.8	0.82		1.06		11		Mfg
	3.6	3.6	28.6	46.4	17.9	0.71		0.94		12	0.034	WR
	3.8	13.2	9.4	35.8	37.7	0.91		1.16		14.5		Util
8. A firm should view cash dividends as a residual after financing desired investments from earnings.	8.8	27.4	16.8	29.2	17.7	0.19		1.27		20		Mfg
	7.1	25.0	17.9	35.7	14.3	0.25		1.21		18.5	0.661	WR
	11.3	35.8	13.2	28.3	11.3	-0.08		1.25		24		Util

Table 2—Statements about Corporate Dividend Policy (continued)

Issue	Disagree					Agree					Mean	Std Dev	Rank	Probability	Industry	
	-2	-1	0	+1	+2											
Panel B: Explanations of Dividend Relevance																
Panel B1: The Bird-in-the-Hand Explanation																
24. Investors prefer certain, current dividends to possibly higher but riskier future dividends.	7.1%	20.4%	33.6%	37.2%	1.8%	0.06	0.97	21.5						Mfg		
	3.6	21.4	42.9	28.6	3.6	0.07	0.90	21					0.038	WR		
	3.8	7.5	28.3	54.7	5.7	0.51	0.87	19						Util		
23. Investors prefer a certain dividend stream to an uncertain price appreciation.	15.9	27.4	38.9	14.2	3.5	-0.38	1.03	25						Mfg		
	14.3	32.1	35.7	14.3	3.6	-0.39	1.03	25					0.186	WR		
	9.4	18.9	39.6	30.2	1.9	-0.04	0.98	22						Util		
Panel B2: The Signaling Explanation																
14. A firm should adequately disclose to investors its reasons for changing dividend policy.	1.8	3.5	7.1	34.5	53.1	1.34	0.89	5.5						Mfg		
	0.0	7.1	25.0	21.4	46.4	1.07	1.02	5.5					0.034	WR		
	0.0	3.8	5.7	26.4	64.2	1.51	0.78	4						Util		
12. Investors regard dividend changes as signals about a firm's future prospects.	4.5	6.3	2.7	50.7	35.9	0.97	0.97	9						Mfg		
	3.6	3.6	3.6	60.7	28.6	1.07	0.90	5.5					0.053	WR		
	0.0	0.0	9.4	43.4	47.2	1.38	0.66	6						Util		
3. A firm's stock price usually falls when a firm unexpectedly cuts or omits its dividend.	13.3	7.1	8.8	36.3	34.5	0.72	1.36	12						Mfg		
	3.6	17.9	10.7	32.1	35.7	0.79	1.22	10					0.869	WR		
	7.5	9.4	5.7	17.0	60.4	1.13	1.32	9						Util		
2. A firm's stock price usually rises when a firm unexpectedly increases its dividend or pays a dividend for the first time.	3.5	9.7	19.5	54.9	12.4	0.63	0.94	14						Mfg		
	0.0	21.4	28.6	35.7	14.3	0.43	1.00	17					0.004	WR		
	0.0	1.9	9.4	60.4	28.3	1.15	0.66	8						Util		
11. Investors use dividend announcements as information to assess a firm's stock value.	6.2	12.4	20.4	51.3	9.7	0.46	1.04	17						Mfg		
	0.0	14.3	17.9	60.7	7.1	0.60	0.83	14					0.090	WR		
	1.9	5.7	9.4	66.0	17.0	0.91	0.81	14.5						Util		
13. Dividend increases are ambiguous because they can suggest future growth or a lack of investment opportunities.	4.4	25.7	22.1	38.1	9.7	0.23	1.08	19						Mfg		
	3.6	32.1	17.9	32.1	14.3	0.21	1.17	20					0.498	WR		
	9.6	34.6	15.4	32.7	7.7	-0.06	1.18	23						Util		

Table 2—Statements about Corporate Dividend Policy (continued)

Issue	Disagree					Agree					Mean	Std Dev	Rank	Probability	Industry
	-2	-1	0	+1	+2										
Panel B3: The Tax-Preference Explanation															
19. A firm should be responsive to the dividend preferences of its shareholders.	3.5%	9.7%	20.4%	47.8%	18.7%	0.68	1.00	13							Mfg
	3.6	14.3	35.7	25.0	21.4	0.46	1.10	16					0.232		WR
	1.9	5.7	24.5	47.2	20.8	0.79	0.91	16							Util
20. Investors are attracted to firms that have dividend policies appropriate to the investors' particular tax circumstances.	4.4	9.7	31.0	44.2	10.6	0.47	0.96	16							Mfg
	0.0	14.3	32.1	35.7	17.9	0.57	0.96	15					0.311		WR
	0.0	5.7	45.3	32.1	17.0	0.60	0.84	18							Util
22. Stocks that pay high (low) dividends attract investors in low (high) tax brackets.	9.7	16.8	46.0	23.9	3.5	-0.05	0.97	24							Mfg
	7.1	25.0	39.3	28.6	0.0	-0.11	0.92	24					0.674		WR
	5.7	26.4	34.0	26.4	7.5	0.04	1.04	21							Util
21. Investors prefer that a firm retains funds over paying dividends because of the way capital gains are taxed as compared with dividends.	4.4	23.0	43.4	23.0	6.3	0.04	0.94	23							Mfg
	0.0	25.0	57.1	10.7	7.1	0.00	0.82	23					0.114		WR
	7.5	35.8	39.6	15.1	1.9	-0.32	0.89	25							Util
Panel B4: The Agency Explanation															
25. The payment of dividends forces a firm to seek more external financing, which subjects the firm to scrutiny of investors.	0.9	0.0	7.2	40.5	51.4	1.41	0.80	3.5							Mfg
	0.0	7.1	10.7	39.3	42.9	1.18	0.90	3.5					0.176		WR
	0.0	3.8	0.0	32.1	64.2	1.57	0.69	2.5							Util
26. The payment of dividends serves as a bonding mechanism to encourage managers to act in the interest of outside shareholders.	33.3	23.4	31.5	10.8	0.9	-0.77	1.06	26							Mfg
	28.6	32.1	32.1	7.1	0.0	-0.82	0.94	26					0.965		WR
	24.5	34.0	30.2	9.4	1.9	-0.70	1.02	26							Util

Table 2.—Statements about Corporate Dividend Policy (continued)

Issue	Disagree					Agree					Mean	Std Dev	Rank	Probability	Industry
	-2	-1	0	+1	+2										
Panel C: Setting Dividend Policy															
16. A firm should avoid changing its regular dividend if that change might have to be reversed in a year or so.	2.7%	5.3%	6.2%	21.2%	64.6%	1.40	1.00	2							Mfg
	3.6	14.3	7.1	39.3	35.7	0.89	1.66	7.5	0.438						WR
	3.8	1.9	7.5	26.4	60.4	1.38	0.99	7							Util
18. A firm should strive to maintain steady or modestly growing dividends.	2.7	0.9	15.9	49.6	31.0	1.05	0.86	8							Mfg
	3.6	3.6	14.3	57.1	21.4	0.89	0.92	7.5	0.813						WR
	0.0	7.5	17.0	50.9	24.5	0.92	0.85	12.5							Util
17. A firm should strive to maintain an uninterrupted record of dividend payments.	2.7	3.5	16.8	37.2	39.8	1.08	0.97	7							Mfg
	3.6	3.6	25.0	50.0	17.9	0.75	0.93	11	0.858						WR
	0.0	7.5	20.8	41.5	30.2	0.94	0.91	11							Util
4. The market places greater value on stable dividends than stable payout ratios.	3.5	9.7	25.7	48.7	12.4	0.57	0.95	15							Mfg
	0.0	14.3	25.0	42.9	17.9	0.64	0.95	13	0.194						WR
	3.8	5.7	11.3	52.8	26.4	0.92	0.98	12.5							Util
15. A firm should have a target dividend payout ratio and periodically adjust the payout toward the target.	9.7	14.2	22.1	34.5	19.5	0.40	1.23	18							Mfg
	7.1	21.4	25.0	32.1	14.3	0.25	1.17	18.5	0.370						WR
	0.0	17.0	15.1	43.4	24.5	0.75	1.02	17							Util
7. A firm's new capital investment requirements generally have little effect on modifying its pattern of dividends.	11.5	26.5	17.7	32.7	11.5	0.06	1.23	21.5							Mfg
	14.3	17.9	25.0	35.7	7.1	0.04	1.20	22	0.856						WR
	7.5	30.2	15.1	32.1	15.1	0.17	1.24	20							Util

Percentages may not add to 100 due to rounding

-2 = definitely don't agree, -1 = probably don't agree, 0 = neither agree nor disagree, +1 = probably agree, and +2 = definitely agree

Underlining indicates that at least 20 percent of the cells have expected counts less than 5. Chi-square may not be a valid test

Mfg = manufacturing where n = 113, except S12 where n = 112 and S26 where n = 111

WR = wholesale/retail where n = 28

Util = utility where n = 53, except S10 where n = 52

The respondents hold views that conflict with a primary tenet of corporation finance theory involving the separation of a firm's investment, financing, and dividend decisions. Originally proposed by Modigliani and Miller (1958), the *separation principle* asserts that, in the presence of perfect capital markets, a firm's value is completely independent of the manner in which the firm finances its productive assets. More than 88 percent of the respondents believe that a firm's investment, financing, and dividend decisions are related (S9).¹² The respondents, however, hold widely divergent views about whether a firm should view cash dividends as a residual after financing desired investments from earnings (S8). An implication of the Miller and Modigliani (1961) argument is that the dividend decision is a residual decision. Taken as a whole, the evidence suggests that most of the respondents are proponents of dividend relevance.

Explanations of Dividend Relevance

The second research question was "What explanations of dividends do managers tend to favor?" Panel B of Table 2 provides the results for four popular explanations of dividend policy: the bird-in-the-hand, signaling, tax preference, and agency explanations.

The Bird-in-the-Hand Explanation

Two statements reflect the explanation of dividend relevance: investors prefer certain, current dividends to possibly higher but riskier future dividends (S24) and investors prefer a certain dividend stream to an uncertain price appreciation (S23). The responses produce mixed results on these statements. About a third of the respondents neither agree nor disagree with either statement.

The Signaling Explanation

Six statements involve information content or signaling effects (S2, S3, S11, S12, S13, and S14). The respondents agree, on average, that investors regard dividend changes as signals about a firm's future prospects (S12) and investors use dividend announcements as information to assess a firm's stock value (S11). The respondents also agree with conclusions of empirical studies that dividend changes convey some unanticipated information to the market (S2 and S3). The respondents show a high level of agreement with the notion that a firm should adequately disclose to investors its reasons for changing dividend policy (S14). The responses vary about whether dividend

¹²The empirical literature on Modigliani and Miller's (1958) investment-financing irrelevance propositions reaches divergent conclusions. Some researchers (Peterson and Benesh, 1983) find a significant linkage between the investment, financing, and dividend decisions of firms while other researchers (Smirlock and Marshall, 1983) do not.

increases are ambiguous. Taken as a whole, however, the responses suggest general agreement that changes in dividends have signaling effects.

The Tax-Preference Explanation

The four statements involving the tax-preference explanation of dividends (S19, S20, S21, and S22) command mixed agreements. Most respondents agree that a firm should be responsive to the dividend preferences of its shareholders (S19) and that investors are attracted to firms that have dividend policies appropriate to the investors' particular tax circumstances (S20). Yet, the most typical response is uncertainty (neither agree nor disagree). Respondents are uncertain about whether stocks that pay high (low) dividends attract investors in low (high) tax brackets (S22). They are also unsure about whether investors prefer that a firm retains funds over paying dividends because of the way capital gains are taxed as compared with dividends (S21).¹³

The Agency Explanation

The survey contains two statements that provide an agency explanation for paying dividends (S25 and S26). More than 90 percent of the total respondents think that the payment of dividends forces a firm to seek more external financing, which subjects the firm to scrutiny of investors (S25). The respondents generally disagree that the payment of dividends serves as a bonding mechanism to encourage managers to act in the interest of outside shareholders (S26). If respondents were unfamiliar with agency theory, then the phrase *bonding mechanism* might connote that bonding has a legal meaning or something stronger than a simple economic incentive. This potential miscommunication might prompt some managers to disagree with the statement. The responses concerning the agency explanation for paying dividends appear mixed. Yet, they should not be discarded or discounted based solely on the survey's results.

Setting Dividend Payments

Our third research question was "How do firms set the amount of dividends that they pay?" Several statements in the survey reflect the dividend policy beliefs of managers, as described by Lintner (1956), and Lintner's behavioral model of dividend policy, namely, S4, S7, S15, S16, S17, and S18. Taken as a whole, the survey responses were generally consistent with Lintner's fieldwork and dividend model.

The results show that several statements commanded a high level of agreement. For example, almost 85 percent of the total respondents believe that a firm should avoid

¹³Omitting firms that chose not to pay dividends from the survey could bias the findings about the tax-preference explanation. For example, a high percentage of respondents, especially among utilities, indicates that the differential tax rates on dividend income and capital gains are not an important consideration for investors (S21). Firms that chose not to pay dividends may view this factor as an important consideration.

changing its regular dividend if that change might have to be reversed in a year or so (S16). About three quarters of the total respondents also agree that a firm should strive to maintain steady or modestly growing dividends (S18) and should strive to maintain an uninterrupted record of dividend payments (S17).

The current findings also confirm managerial perceptions reported by Lintner that the market values stable dividends rather than stable payout ratios (S4).¹⁴ Less than half the respondents, however, agree that a firm's new capital investment requirements generally have little effect on modifying its pattern of dividends (7). This latter finding is inconsistent with Lintner's fieldwork.

Lintner suggests that a partial adjustment model can incorporate dividend behavior. According to his model, a firm should have a target dividend payout ratio and periodically adjust the payout toward the target (S15). The survey results provide some support for Lintner's behavioral model of dividend policy.

Industry Influence on Dividend Policy

The final research question is "Do the views of managers about dividend issues differ among different industry groups?" The results of the chi-square tests show that the responses of the three groups differ significantly at the 0.05 level for only four of the 26 statements (S1, S2, S14, and S24). 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 current findings contrast sharply with the conclusion of Baker, Farrelly, and Edelman (1985) that the opinions of the respondents from utilities differ markedly from those of the manufacturing and wholesale/retail trade industries. These results may be due to the greater competitive environment in which utilities have been thrust during the past decade or more. As Soter, Brigham, and Evanson (1996) note, the economic environment for utilities has been changing over time. Due to regulator actions, the utility industry has become a riskier place in which to operate and invest. Today, utilities find themselves increasingly subject to competition.

The respondents from the utilities show a higher level of agreement on all four of these statements than the respondents from the other two industry groups. Analysis of these statements suggests that the results may be due to industry characteristics rather than regulation. Given that the utilities have higher payouts than the other two industries (manufacturing and wholesale/retail trade), such differences are not surprising. The survey findings show that managers of utilities are sensitive to how an unexpected change in dividend policy (S1 and S2) may affect a firm's stock price and shareholder value. In addition, most utility respondents strongly agree that a firm should adequately disclose to investors its reasons for changing dividend policy (S14). This

¹⁴Jose and Stevens (1989) empirically find support for the notion that the market values stable dividends rather than stable payout ratios.

finding is not surprising considering the market reaction to the dividend cut of Florida Power & Light Company reported by Soter, Brigham, and Evanson (1996). Finally, the high level of agreement among utility managers that investors prefer certain, current dividends to possibly higher but riskier future dividends may reflect the characteristics of utilities including investor clienteles.

Conclusions

The findings of this survey lead to several conclusions about dividend policy. First, most respondents believe that dividend policy affects firm value. Although Baker, Farrelly, and Edelman (1985) reached the same conclusion more than a decade ago, the current study provides additional support for managerial beliefs about the relationship between dividend policy and value.

Second, of the four explanations for dividend relevance examined in this study, the respondents generally had the highest level of agreement with statements involving signaling. The respondents typically are most uncertain (neither agree nor disagree) about statements involving the tax-preference and bird-in-the-hand explanations of dividend relevance. As previously noted, however, omitting firms that chose not to pay dividends from the survey could bias the findings involving the importance of differential tax rates. Although the responses are inconsistent involving the agency explanation of paying dividends, respondents may not have fully understood the meaning of these questions.

Third, the results show that managers' views on setting dividend payments today are consistent with those reported by managers interviewed by Lintner (1956). In particular, the respondents are highly concerned about continuity of dividends. The survey results also provide some support for Lintner's behavioral model of dividend policy.

Finally, the opinions of the respondents from the three industry groups show few statistically significant differences among the 26 statements. This finding contrasts with earlier survey research by Baker, Farrelly, and Edelman (1985). The differences among industries may have diminished over time because of the changing economic and competitive environment for utilities.

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