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CORPORATE DIVIDEND POLICIES IN BANK-BASED AND MARKET-BASED SYSTEMS: SURVEY EVIDENCE FROM UK AND PORTUGAL*

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Abstract

This paper reports the empirical results of a questionnaire survey about corporate dividend policy addressed to finance directors of UK and Portuguese listed firms. Similar to other studies (for example, Brav *et al.*, 2005 in the US and Dhanani, 2005 in the UK), we survey 313 finance directors in the UK and 48 in Portugal to examine their views of and understanding about the dividend decision in order to compare practice with theoretical propositions to be found in the literature and to examine cross-country determinants of dividend policy. Our survey results demonstrate similarities in the responses from the UK and Portugal, but also substantive differences, particularly in respect of the interaction between dividend and investment decisions and views about the signalling consequences of dividends.

Key Words: *Cash Dividends, Dividend Policy, Agency Hypothesis, Signalling Hypothesis, Clientele Hypothesis*

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1. INTRODUCTION

This paper reports the empirical results of a questionnaire survey about corporate dividend policy addressed to finance directors of UK and Portuguese listed firms. Similar to other studies, (for example, Brav *et al.*, 2005 in the US and Dhanani, 2005 in the UK), we survey 313 finance directors in the UK and 48 in Portugal to examine their views of and understanding about the dividend decision in order to compare practice with theoretical propositions to be found in the literature. In addition, we use this cross-country study to investigate whether corporate views about the dividend decision are country dependent.

We know of a limited number of studies that compare dividend policy in two or more countries. For example, Baker *et al.,* (2006) compare Norway and the US, Baker *et al.*, (2007) compare Canada and the US, Bancel, Mitto and Bhatacharyya (2005) survey managers from 16 European countries, and Frankfurter *et al.,* (2004), examine firms from five countries on three continents, covering three different types of economies.

The comparison between the UK and Portugal is of interest because there are substantial institutional differences between the two countries, which might well give rise to differences in payout policies. First, the two countries are different in terms of size and economic development. Second, they differ in terms of the scale and sophistication of their respective capital markets. Portugal is still largely a bank-based system, whereas the UK is a market-based system. Other things equal, we expect that dividend policy should be more important for firms operating in a financial environment dominated by capital markets (Aivazian, Booth and Cleary, 2003). Third, dividend policy is likely to be heavily influenced by the legal protection afforded to shareholders. La Porta *et al.,* (2000) document that common law countries, (such as the UK), where investor protection is better, have higher dividend payouts that in civil law countries (such as Portugal). Finally, ownership structure may be another important factor in the decision about dividend policy: Portuguese firms have a more concentrated ownership than UK firms and so, for example, signalling might be less important in Portugal. As a result of these differences we consider it likely that dividend policy might well be different in Portugal and the UK.

The corporate finance literature contains a conundrum known to its readers as the 'dividend puzzle' (Black, 1976). Summarising what finance academics understood about corporate dividend policy at the time, Fisher Black posed the well-known question and answer: *"What should corporations do about dividend policy? We don't know!"* (Black, 1976: 5). Despite three decades of theorising and empirical research since then, Black's observation seems as germane today as it was in 1976. For example, Brealey, Myers and Allen (2008) in their widely used corporate finance textbook observe that, despite the abundance of academic

research, we still face a 'dividend controversy' which they identify as one of the ten 'unsolved problems in finance'. That controversy or puzzle stems from the seminal contribution of Miller and Modigliani (1961) and their demonstration that in a world of perfect markets, the pattern of dividend payments should not matter. The fact that they seem to, even in a world where tax regimes discriminate against dividends, clearly warrants further empirical investigation.

The main contribution of the paper rests in the identification of similarities and differences in the perceptions of finance directors operating in bank-based and market-based settings. There is little difference with respect to agency and clientele issues, but UK respondents are much more convinced about the signalling impact of dividend policy and consider stability in dividends streams is much more important than their Portuguese counterparts. Overall, we find no evidence for the agency hypothesis.

The rest of this paper is organised as follows. The next section presents a brief summary of the major theoretical positions and explanations of dividend policy that have been advanced in the literature, as well as a brief review of relevant strands of the empirical literature. Section three explains the research methods adopted and presents the data sample. Section four presents the results and the final section summarises and concludes.

2. LITERATURE REVIEW

As is well known, the dividend puzzle consists of two elements. First, the apparent necessity perceived by (some) corporate executives to pay dividends and their occasional willingness to do so, even in the face of financial fragility. The second aspect of the puzzle is the apparent eagerness of (some) investors to receive dividend payments, even when such payments give rise to an additional tax liability.

The corporate finance literature offers a variety of explanations for dividends and the puzzle that they present. In essence, three fundamental positions can be found in the literature with respect to dividends. The first of these, the so-called 'bird-in-the-hand' hypothesis (Gordon and Shapiro, 1956)[1] posits that dividends can increase firm value by reducing the risk perceived by investors in corporate cash flows. It holds that, other things equal, if two firms, A and B, are identical in all respects save that firm A pays a dividend with expectations of future dividend growth, then A will have a higher share price.

[1] Frankfurter *et al.*, (2002) recount correspondence with Gordon wherein he denies ever having used the term bird-in-the-hand, even though he is the person most associated with its use. Nevertheless, Gordon acknowledges that the term provides a reasonably accurate representation of his views.

At the other end of the spectrum, we have a position that suggests that in the face of market imperfections such as transaction costs and taxes, dividends can have negative consequences for shareholder wealth. Advocates of this position argue that if the tax rate on income is greater than that on capital gains, then dividend payments are economically irrational (Elton and Gruber, 1970). Similarly, if a firm pays a dividend, but then raises equity finance to fund investment, the consequent issue costs represent an unnecessary reduction in shareholder wealth. Inconsistency in the results generated by the empirical studies with quantitative archival data was found in relation to the tax and clientele explanations of dividends. Elton and Gruber (1970), Bajaj and Vijh (1990) and Graham and Kumar (2006) offer evidence in support of such clientele effects, whereas Kalay and Michaely (2000) do not.

This second position builds on a third, which is the famous dividend irrelevance proposition presented by Miller and Modigliani (1961). Given conditions for a perfect capital market, dividends become a residual cash flow to shareholders after investment decisions have been taken. If a firm decides to reinvest all its net cash flows and forego a dividend, then shareholders who need income for consumption purposes can use the capital market to manufacture 'home-made' dividends in the short term. In the longer term they will benefit from the increased net present value created by the firm's capital investment.

Despite the impeccable logic of the Miller and Modigliani position on the irrelevance of patterns of dividend distributions, dividend policy does seem to matter, to both investors and managers. Survey evidence from Lintner (1956) to Brav *et al.*, (2005) and Dhanani (2005) demonstrates that managers in the US and UK pursue active dividend policies. US surveys of dividend policy (for example, Baker, Farrelly and Edelman, 1985; Baker and Powell, 1999 and Baker, Veit and Powell, 2001) report consistently that managers have more regard to the change in dividend payouts, than levels, and that they tend to smooth the pattern of dividend growth. These surveys also report that managers generally attempt to increase dividends only when they think that increases in earnings are sustainable. Furthermore, managers believe that decreases in the payout will cause an adverse price reaction. These results are broadly confirmed for the UK by the survey conducted by Dhanani (2005).

In contrast, Frankfurter *et al.,* (2004) report a comparative analysis of the perceptions of financial managers in five countries, across three continents, covering three types of economies (Hong Kong, Turkey, UK, USA, and Germany). Whilst they find uniform perceptions for some aspects of dividends across the five countries, they also report many more differences. As a result they conclude that they cannot conceive of theories and explanations of why firms pay dividends that would apply consistently to all countries. Indeed they go further and deny the possibility of the universal applicability of current theories even in one country.

The difference in responses across countries is also reported by Bancel *et al.,* (2005) in their survey of financial managers in 16 European countries. However, in their exploration of cross-country determinants of dividend policy, they report similarities in survey responses that are broadly in line with the findings of Lintner (1956), particularly in respect of dividend smoothing and the reluctance to cut or to reduce dividend payouts. They also conclude that dividend policy is strongly influenced by ownership structure, but, unlike La Porta *et al.,* (2000), find little evidence that it is influenced by the nature of legal systems.

In their survey of US and Canadian finance managers Baker *et al.,* (2007) find considerable similarity in the responses of the two groups. According to Canadian managers, the most important determinants of dividend policy are the level of expected future earnings, stability of earnings, pattern of past dividends, and the level of current earnings. They found little support for ownership structure influencing the dividend payout.

Despite the dearth of systematic evidence on investors' attitudes to dividends, it seems reasonable to assume that if managers are pursuing an active, but misinformed dividend policy aimed at pleasing shareholders, then the latter would be likely to communicate the lack of necessity to do so fairly readily (particularly institutional shareholders, perhaps). Certainly reports in the financial press of shareholder reaction to dividend cuts would seem to suggest strongly that investors regard dividends as an important 'ritual'.

In addition to these three fundamental positions, the literature has provided two further mainstream developments, the application of principal-agent theory and the signalling hypothesis. The agency explanation suggests that the role of dividends is to ensure that managers 'disgorge' free cash flow (defined as cash flow in excess of that required for all positive NPV projects) rather than waste it on unprofitable investment and managerial slack, (Easterbrook, 1984; Jensen, 1986). Whilst agency theory might help to explain how the presence of dividends might alleviate potential agency problems, it does not offer an explanation for the remarkably stable pattern of dividends that many firms pursue. In certain circumstances an agency perspective could be consistent with any of the three fundamental positions outlined above. Therefore agency theory might well make a valuable contribution to our understanding of the dividend phenomenon, but it does not provide a complete explanation, although in fairness none of its advocates make such a claim.

The signalling explanation for dividends is based on the idea that financial reports and press releases are easier to manipulate than cash flows. Although financial reports might show good historical and current earnings performance and managers might claim that future prospects are good, investors place more weight on management actions. If managers are truly confident about future performance, then they can best signal this by maintaining or indeed increasing

the dividend payout. The signalling hypothesis, therefore, focuses on changes in dividends, rather than levels. There is a substantial amount of empirical support for the signalling effect. For example, empirical studies show that firms tend to increase dividends only after sustained increases in earnings (Benartzi, Michaely and Thaler, 1997) and that the initiation of dividend payments is read as a positive signal of future prospects by investors (Healy and Palepu, 1988).

The evidence from statistical studies of secondary data in large samples is rather less consistent than the survey evidence. For example, Redding (1997) found a positive link between firm size (which might be a proxy for maturity and stability of cash flows) and dividend payouts, and further that informational factors, signalling, had a strong influence on dividend policy – which is in line with the reported survey results. In contrast, the US work of Benartzi, Michaely and Thaler (1997), Grullon, Michaely and Swaminathan (2002) and Benartzi *et al.*, (2005) suggest that dividend increases do not provide reliable signals of future performance, but rather map onto past earnings performance. If the signalling hypothesis is framed in terms of the dividend signal providing indications of future increases in earnings, rather than simply the sustainability of the current earnings level, then this evidence might be regarded as a negative finding.

The negative findings in respect of the signalling hypothesis are also reported in the US study by DeAngelo, DeAngelo and Skinner (1996), although other statistical studies report in favour of the signalling role of dividends (Healy and Palepu, 1988; Aharony and Swary, 1980; Nissim and Ziv, 2001; Arnott and Asness, 2003a, 2003b and Dhillon, Raman and Ramírez, 2003). Baker *et al.*, (2007) results provide greater support for the signalling explanation, than for the bird-in-the-hand fallacy, tax preferences and dividend clienteles.

However, the mixed findings about the power of dividends to signal future performance, contrasts with the evidence about dividend cuts, which shows that dividend cuts lead to statistically significant negative stock price reactions (Healy and Palepu, 1988 and Aharony and Swary, 1980). This result from regression studies is consistent with survey evidence (for example, Lintner, 1956; Baker and Powell, 1999; Baker, Veit and Powell, 2001 and Brav *et al.*, 2005) and in the financial press (for example, Jenkins, 2002). A statistical empirical result that is also consistent with the survey evidence is the UK study by Ap Gwilym, Morgan and Thomas (2000), who find that dividend stability has a positive influence on stock returns.

In addition to these mainstream positions, other explanations have been proffered in alternative fields of inquiry such as behavioural finance. Shefrin and Statman (1984) suggest that investors have a preference for dividends over capital gains, because they avoid decisions about consumption level and about selling part of their stock, claiming that this benefit is enough to compensate contradictory effects, such as the dividend tax effect. In a similar vein, Baker and

Wurgler (2004) propose a catering theory of dividends, whereby firms respond to (time-varying) investor dividend preferences. Focussing on dividend initiations and omissions, they claim evidence that supports a view in which "... the propensity to pay dividends depends on a dividend premium (or sometimes discount) in stock prices." (Baker and Wurgler, 2004: pp. 1125-26).

In their review of payout policy (both dividends and share re-purchases) Allen and Michaely (2003) point to some empirical regularities that have been reported in the literature. Nevertheless, they also point out that, "It is possible to tell a story, [about payout policy], but it is by no means clear that it is anything more than a story." (Allen and Michaely, 2003: p.117). Furthermore, Frankfurter *et al.*, (2002), taking account of behavioural factors consider dividends as a necessary *ritual*, although in some ways this account is aligned with signalling and agency perspectives:

> "... the dividend payment is a ritual meant to strengthen the bond between the owners and the stewards of the firm, a reinforcement necessary because of the separation of ownership from management." (Frankfurter *et al.*, 2002: 203).

There could, of course, be a number of reasons for the rather mixed set of results from the empirical literature based on statistical studies of the dividend puzzle. For example, changes in the regulatory climate, taxes regimes, behavioural reasons and macroeconomic environment might well affect the inclination of managers to pay dividends and the desire of investors to receive them. Therefore, it is possible that the reports of contradictory results based on samples in different calendar time simply reflect the impact of changes in the economic environment. If so, such studies would do little to corroborate or reject the mainstream hypotheses about dividends. Given that mainstream theoretical explanations typically do not allow for (say) variations due to the business cycle, it is not surprising that some empirical studies do not even attempt to take account of such factors. However, if these factors do influence dividend decisions then their omission from models to be tested empirically would lead to variations in the results published over time.

Furthermore statistical empirical studies typically use stock returns as a measure of the impact of dividend policy and assume one-way causation from dividends to returns – from the productive realm to the financial. However, during the bull market of the 1990s there was plenty of evidence that the performance of financial markets had an impact on the so-called real economy. The omission of dividends by many firms during this period and the (apparently) concomitant rise in the use of share re-purchases, particularly in the US (Fama and French, 2001), but also in other countries (Osobov, 2004), might be evidence of two-way causation.

Of course, such ideas are only speculative at this stage. Nevertheless, the evidence of shifts in distribution patterns from both the US and UK (Fama and French, 2001; Benito and Young, 2001 and Ap Gwilym, Seaton and Thomas, 2004) suggest that this might be an appropriate time to survey firms in order to assess management attitudes to the distribution decision. Furthermore, (and unlike the substantial number of US surveys), survey research in European countries[2] is limited and cross-country studies typically rely on very small samples in each country surveyed. We suggest, therefore, that additional work in Europe will make a further contribution to our understanding of the dividend puzzle, particularly as our study has a much larger number of in-country responses than most previous cross-country surveys.

3. RESEARCH METHODS AND DATA SAMPLE

Our survey was based on a methodology similar to that adopted in the US by Baker, Veit and Powell (2001) and Brav *et al.,* (2005). We based the majority of our questionnaire on the survey by Brav *et al.,* (2005), which also incorporated share repurchase, as well as dividends. We amended their questionnaire to fit the European context and then re-worked the questions to focus on dividend policy. The questionnaire was piloted with academic colleagues at Kingston University. Their feedback was noted and the questionnaire revised in the light of their comments. In an effort to encourage companies to respond, anonymity was guaranteed and a summary of the findings was offered to the respondents. The final version of the survey contained 24 questions and was 6 pages long.

The survey questionnaire was sent to the finance directors of 313 UK larger companies listed on the London Stock Exchange in 2003. Subsequently it was translated and sent in 2006 to the finance directors of the 48 Portuguese companies listed on the Euronext Exchange in Lisbon (the difference in timing arose because the Portuguese survey arose as a result of interest in the presentation of the UK results at the *European Accounting Association Annual Congress*, 2004.) We focussed on the larger firms, because they are the ones that, typically, have a greater propensity to pay dividends, and we were keen to examine the views of dividend payers, rather than non-payers.

Clearly evidence from questionnaire surveys presents a number of difficulties. First, the respondents might not understand the questions and so the questionnaire might not elicit the responses sought by researchers. Considerable care was taken, via the pilot with academic colleagues, to ensure that the question was posed in

[2] For example, to the writers' knowledge, the only published surveys in the UK were undertaken by the investment fund 3*i* in 1993 and Dhanani (2005).

as simple a form as possible; to avoid misunderstanding, but the possibility clearly still exists. Second, respondents might not answer truthfully or lack appropriate incentives to search for information that is not readily to hand, thereby inducing the potential for a form of measurement error. Brav *et al.*, (2005) summarise this problem in the following way: [surveys] "measure beliefs and not necessarily actions" (2005:3)[3]. We hope that the guarantee of anonymity might have helped to alleviate this problem. Third, like all researchers, we had to deal with the trade off between survey length and the likelihood of participants responding. In an ideal world we would have liked to ask more questions, but in the event we erred on the side of brevity in the expectation of a higher response rate.

Baker *et al.*, (1985) identified a fourth problem with questionnaires about dividend policy, which is the restrictive nature of only obtaining views from one person, (in this case finance directors), when it is likely that more than one person will decide on distribution policy. As they point out, chief financial officers are "not the only individuals involved in dividend policy decisions" Baker *et al.*, (1985: 83). We accept that others, notably the CEO, is likely to be involved in the dividend decision, but we believe that the views of finance directors are likely to be prominent, if not definitive.

Yet another problem associated with questionnaire surveys is the issue of response bias. In an attempt to counter this problem we followed conventional practice and undertook follow-up mailings to non-respondents in order to "increase the response rate and reduce potential non-response bias" (Baker and Powell, 1999:23). The response rate for the UK for the study was 32.9 per cent and 60.4 per cent in Portugal, making an overall response rate of 36.6 per cent. This compares well with earlier studies as can be seen from Table 1. The standard tests for bias between first time and second respondents did not find any statistically significant differences in responses in either UK or Portuguese samples.

TABLE 1

Comparison of Dividend Survey Response Rates

Authors	Response Rate %
Baker, Farrelly and Edelman (1985)	56.6
Farrelly and Baker (1989)	25.8
Baker and Powell (1999)	32.9
Baker, Veit and Powell (2001)	29.8
Frankfurther *et al.* (2004)	27.8
Brav, Graham, Harvey and Michaely (2005)	16.0
Dhanani (2005)	16.4
The Current study	36.6[1]

[1] UK response rate = 32.9% (103 answers); Portuguese Response Rate = 60.4% (29 answers)

[3] In order to avoid these problems, we test first the questionnaire with some academics first.

The UK sample was drawn from the population of all listed, non-financial sector companies in the UK. Of all theses companies, we identify the names of the finance directors for 313 of them. Thus, for these 313 firms, they were sent an introductory letter and the questionnaire in the summer of 2003 and 40 responses were received. Follow-up letters and the questionnaire were then sent to non-respondents and a further 63 responses were elicited in two tranches of 52 and 11. In total 103 usable replies were received.

In the case of Portugal a letter and questionnaire were sent to the finance directors of all 48 firms listed on the Euronext Lisbon stock exchange. Nine responses were received from the initial mailing and a further 20 were received after the mailing of a follow-up letter and the questionnaire instrument. A total of twenty-nine usable responses were received.

The payout characteristics and alternative uses of cash for the UK and Portuguese samples are shown in Table 2. Panel A shows that over 90 per cent of UK firms have paid dividends in the past 3 years (including 31 per cent that have also repurchased shares. This compares with 62 per cent in the Portuguese sample (with 14 per cent also having repurchased shares). Only 7 per cent of UK firms did not make a distribution within the 3 year period prior to the survey, compared with 35 per cent in Portugal.

As well as substantial differences in respect of dividends and distributions, there are also notable differences between the two samples in respect of alternative uses of the cash distributed as shown in Panel B. In the UK, only 18 per cent would retain cash, whereas 48 per cent of the Portuguese sample indicates this as an alternative to dividends. There also appear to be substantial differences in terms of investment as an alternative use of funds, but when mergers and acquisitions are included in potential investment, there is little difference between the two groups (81.5%) in the UK and (79.3%) in Portugal. In the UK sample 27 firms (26.2%) indicate share repurchases as an alternative use of funds, but only one firm (3.4%) does so in Portugal. Similar proportions of firms in each country indicate debt repurchase as an alternative to dividends, 48.5 per cent in the UK and a slightly higher proportion, 58.6 per cent, in Portugal.

4. SURVEY RESULTS

In this section we report and compare the questionnaire responses from UK and Portuguese firms and present results for parametric and non-parametric tests of similarities and differences between the two samples. We begin with dividend policy and the decision making process, then consider clientele issues, and the relationship between investment and dividend decisions, and finally we examine responses to questions about agency and signalling considerations.

TABLE 2

Sample characteristics

Panel A: Sample Characteristics – Payout Policies

	UK Sample		Portuguese Sample	
Payout Characteristic	n	%	n	%
During the past three years, the company has:				
Both paid dividends and repurchased shares	32	(31.1)	4	(13.8)
Only repurchased shares	2	(1.9)	1	(3.4)
Only paid dividends	61	(59.2)	14	(48.3)
Neither paid dividends nor repurchased shares	7	(6.8)	10	(34.5)
No answer	1	(1.0)	–	

Panel B: Sample Characteristics – Payout Policies

	UK Sample		Portuguese Sample	
Payout Characteristic	n	%	n	%
Of funds that could be used for dividends, the most likely alternative use would be to:[1]				
Retain as cash	18	(17.5)	14	(48.3)
Invest more	47	(45.6)	16	(55.2)
Mergers/acquisitions	37	(35.9)	7	(24.1)
Repurchase shares	27	(26.2)	1	(3.4)
Repay debt	50	(48.5)	17	(58.6)
Other	2	(1.9)	3	(10.3)

[1] Multiple responses possible

4.1 Dividend Policy and Dividend Setting Process

We asked a variety of questions about dividend policy and the nature of the dividend setting process. This allows comparison with the results from Lintner's (1956) survey in the US, where he found that firms set dividends on a conservative basis, used a target payout ratio, with dividend payouts determined by sustainable future earnings. Lintner's sample of 28 US firms also indicated an extreme reluctance to cut dividend payouts. These early US survey results have been broadly confirmed by most subsequent US surveys. Panel A of Table 3 presents the results for the UK and Portuguese samples.

The conservative nature of the dividend decision can be seen throughout. For the UK, earnings are an important determinant of dividend payouts with around 83% of respondents reporting that the stability of future earnings (Question 3.3) and sustainable changes in earnings (Q3.2) are important or very important considerations. This is reflected in the response to the statement about the influence of temporary changes (Q3.1) where 70% of respondents report that

TABLE 3

Survey Responses Related to Dividend Policy and Dividend Setting, Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel A: UK and Portuguese Responses		UK								Portugal							
Survey Question: *How important are the following factors to your company's dividend decisions?*		N	%+	%-	Mean	*t*-value	*p*-value	K-S 'z'	*p*-value	N	%+	%-	Mean	*t*-value	*p*-value	K-S 'z'	*p*-value
3.1	A temporary change in earnings	101	7.9	70.3	-0.83	-9.45	0.000	2.799	0.000	29	10.3	75.9	-0.97	-5.51	0.000	2.290	0.000
3.2	A sustainable change in earnings	103	83.5	3.9	1.12	12.90	0.000	2.864	0.000	29	68.9	10.3	0.76	3.75	0.001	2.368	0.000
3.3	Stability of future earnings	103	82.5	3.9	1.10	13.73	0.000	2.817	0.000	29	82.7	3.4	1.10	7.70	0.000	2.662	0.000
3.4	Having extra cash relative to our desired cash holding	101	25.8	43.6	-0.32	-2.83	0.005	1.764	0.004	29	34.4	34.5	-0.17	-0.78	0.445	1.161	0.135
3.12	Maintaining consistency with historic dividend policy	102	72.5	4.9	0.84	10.74	0.000	3.069	0.000	29	65.5	20.7	0.76	3.14	0.004	2.182	0.000
3.17	Market price of our stock	101	28.7	29.7	-0.05	-0.54	0.586	2.258	0.000	29	34.5	20.7	0.07	0.42	0.677	2.476	0.000
4.6	Dividends are as important for stock valuation as 15-20 years ago	100	41.0	22.0	0.24	2.70	0.008	2.137	0.000	29	10.3	44.8	-0.59	-3.21	0.003	1.300	0.022
4.7	Dividend policy is used as a tool to influence credit rating	102	6.9	69.6	-0.94	-10.45	0.000	2.241	0.000	29	6.9	65.5	-0.93	-5.22	0.000	1.857	0.002
20.1	The company considers the level of dividends paid in recent years	98	64.2	10.2	0.67	6.86	0.000	2.717	0.000	29	20.7	58.6	-0.62	-2.64	0.013	1.811	0.003
20.2	We consider the change or growth in dividends per share	100	79.0	3.0	1.02	12.31	0.000	2.804	0.000	29	55.2	24.1	0.24	1.10	0.282	1.625	0.010
20.3	We try to maintain a smooth dividend stream from year-to-year	99	73.7	8.1	0.90	10.37	0.000	2.825	0.000	29	41.4	27.6	0.10	0.43	0.669	1.207	0.109
20.4	We try to avoid reducing dividends per share	100	87.0	6.0	1.30	15.35	0.000	2.858	0.000	29	55.1	27.6	0.24	1.05	0.305	1.625	0.010
20.10	We are reluctant to make dividend changes that might be reversed in future	99	61.6	14.1	0.64	6.24	0.000	2.548	0.000	29	24.1	44.8	-0.21	-0.97	0.339	1.393	0.041

Notes: K-S = Kolmogorov-Smirnov test for 2 independent samples

TABLE 3

Survey Responses Related to Dividend Policy and Dividend Setting, Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel B: Differences in responses by UK and Portuguese firms

	Survey Question	Difference	*t*-value	*p*-value	K-S 'z'	*p*-value	M-W 'z'	*p*-value
3.1	A temporary change in earnings	0.113	0.585^{z}	0.559	0.403	0.997	-0.766	0.444
3.2	A sustainable change in earnings	0.358	1.835^{z}	0.069	0.691	0.726	-1.683	0.092
3.3	Stability of future earnings	-0.006	-0.038^{z}	0.970	0.048	1.000	-0.051	0.959
3.4	Having extra cash relative to our desired cash holding	-0.144	-0.602^{z}	0.548	0.431	0.992	-0.704	0.481
3.12	Maintaining consistency with historic dividend policy	0.085	0.433^{z}	0.665	0.964	0.311	-0.424	0.672
3.17	Market price of our stock	-0.118	-0.622^{z}	0.535	0.428	0.993	-0.779	0.436
4.6	Dividends are as important for stock valuation as 15-20 years ago	0.826	4.303^{z}	0.000	1.453	0.029	-3.682	0.000
4.7	Firm uses dividend policy as one tool to influence credit rating	-0.010	-0.052^{z}	0.958	0.1994	1.000	-0.032	0.974
20.1	The company considers the level of dividends paid in recent years	1.294	5.082^{x}	0.000	2.290	0.000	-4.800	0.000
20.2	We consider the change or growth in dividends per share	0.779	3.312^{x}	0.000	1.130	0.156	-3.320	0.001
20.3	We try to maintain a smooth dividend stream from year-to-year	0.796	3.120^{x}	0.000	1.532	0.018	-3.126	0.002
20.4	We try to avoid reducing dividends per share	1.059	4.304^{x}	0.000	1.833	0.002	-4.521	0.000
20.10	We are reluctant to make dividend changes that might be reversed in future	0.843	3.821^{z}	0.000	1.775	0.004	-3.592	0.000

Notes: K-S = Kolmogorov-Smirnov test for 2 independent samples
M-W = Mann-Whitney test
^{x,z} = unequal and equal sample variances determined by Levene's test

such changes are not important or not at all important. Conservative attitudes to dividend policy and dividend setting are also apparent in Portugal (Table 3, Panel A). Sustainable changes in earnings (Q3.2) and the stability of future earnings (Q3.3) are reported as important or very important by 69% and 83% respectively of Portuguese finance directors. The conservative nature of dividend decisions is confirmed with 76% of the Portuguese sample indicating that temporary changes in earnings are not important for dividend decisions, (Q3.1). All these results are statistically significant at the one per cent level for both parametric and non-parametric tests.

The conservative nature of dividend setting is also reflected on the UK respondents. About 73% percent of respondents consider that the historic pattern of dividends (Q3.12) is important or very important. This is consistent with the finding for Portugal, where 66% rate the historic pattern as important or very important. In the UK the desire to maintain a smooth pattern of dividends is also clear, with 74% of respondents reporting (Q20.3) that this is an important or very important consideration, but this is less important for Portuguese firms, with a corresponding figure of 41%.

These results for the UK are broadly in line with the results reported by Bancel, Mittoo and Bhattacharyya (2005), in their survey of 16 European countries, including the UK and Portugal. They are also broadly consistent with the Canadian study by Baker *et al.,* (2007). These results suggest a certain inconsistency in the Portuguese results, whereby historical dividend patterns are important or very important, but smoothing is not. This finding is consistent with the results of Vieira and Raposo (2007).

The reluctance of UK firms to cut dividends is evident from the responses, with 87% indicating that they try to avoid reducing dividends per share (Q20.4) and 62% reporting (Q20.10) that they are reluctant to make dividend changes that might have to be reduced in future. In the case of Portugal 55% of respondents agree or strongly agree that they try to avoid reducing dividends per share (Q20.4), but this finding is not statistically significant. Furthermore only 24 per cent agree or strongly agree with the statement that they would be reluctant to make dividend changes that might have to be reversed in future (Q20.10) as opposed to 45% who indicate that they would not be reluctant to do so. These results suggest certain ambivalence on the part of at least some Portuguese firms about some aspects of the dividend setting decision.

The current market price of a firm's stock (Q3.17) does not appear to be an important consideration. Indeed, only 41% of the UK firms declare that dividends are as important for stock valuation as they were 15-20 years ago and only 10 per cent of the Portuguese firms consider that dividends are important or very important for stock valuation (Q4.6), with 45 per cent indicating that it is less important now than 15-20 years ago, statistically significant at the one per cent level.

For the UK market, the impact of cash reserves beyond a desired level (Q3.4) is not important or not at all important for 44% of firms, although the mean response to this question, -0.32, is statistically significant at the one per cent level. A large proportion of firms, 70%, do not use dividend policy to influence their credit rating (Q4.7). However, a sizeable majority (66% significant at the one per cent level) of Portuguese respondents indicate that dividends are not used to influence credit rating (Q4.7), although this is not surprising given the undeveloped corporate bond market in Portugal. Cash balances above the desired holding also seem to have now obvious influence on dividend setting (Q3.4).

Changes or growth in dividend per share is regarded as important or very important (Q20.2) by 79% and 55% of UK and Portuguese firms, respectively. For the UK this is consistent with the responses to Q18 about targeting, with 74.8% indicating that they target growth in dividend per share, (reported in Table 4), which by far is the most important target, when compared to the dividend yield and the payout ratio. But this is not the case in Portugal, with only 34.5% target growth in dividends per share.

TABLE 4

Survey Responses about Targetting[1]

	UK Sample		Portuguese Sample	
Survey question	Yes	%	Yes	%
When you make you dividend decisions, do you target?[1]				
Level of dividends per share	37	(35.9)	13	(13.8)
Growth in dividends per share	77	(74.8)	10	(34.5)
Dividend yield	28	(27.2)	12	(41.4)
Dividends as a percentage of earnings	44	(42.7)	16	(55.2)
Do not target at all	3	(2.9)	4	(13.8)
Is the target framed as?				
A strict goal	15	(14.6)	1	(3.4)
A partially flexible goal	34	(33.0)	8	(27.6)
A flexible goal	35	(34.0)	15	(51.7)
Not really a goal	8	(6.8)	5	(17.2)
Number of responses	92	(88.3)	29	(100.0)

[1] Multiple responses possible

The decline in the importance of the payout ratio, 42.7% and 55.2% for the UK and Portugal respectively, compared to Lintner (1956) is consistent with the results of Brav *et al.*, (2005) for the US. As far as targeting is concerned

(Table 4), only 15 UK respondents (14.6%) consider their stated target as a strict goal, with 68% indicating that any target set is treated as a partially flexible or fully flexible goal in their decision making process. This is in line with Portuguese firms, which take a flexible approach to targets, with only one response indicating that strict dividend targets are set.

Although the two surveys elicited similar responses to 7 of the questions dealt with in this section, there are important differences between the two sets of results. The results of difference tests for the two sets of responses are presented in Panel B of Table 3.

Questions about the impact of temporary changes in earnings (Q3.1), sustainable changes in earnings (Q3.2), the stability of future earnings (Q3.3), and historic dividend policies produced very similar responses in the UK and Portugal, with no statistical differences in the two sets of responses. Similarly, there were no substantive differences in the responses about the influence of cash balances above desired holdings (Q3.4) or credit rating (Q4.7).

In contrast, the questions about dividend smoothing (Q20.3), reductions in dividends (Q20.4 and 20.10), past levels of the dividend payment (Q20.1), and the perceived importance of dividends on stock valuation (Q4.6) all produced statistically significant differences between the UK and Portuguese respondents, at the one per cent level. From this evidence it appears that UK finance directors are much more concerned about reductions in the dividend than their Portuguese counterparts. The UK responses are consistent with a long line of evidence from the US (from Lintner, 1956 to Brav *et al*., 2005), whereas the Portuguese responses are clearly not. Some possible reasons for these differences might be associated with the fact that Portugal is a bank-based system, whereas the UK is a market-based system. Ownership is also concentrated in Portugal. The perceived consequences of reductions in dividends are dealt with further below, when we consider signalling.

4.2 Clientele Considerations

Overall the questions about clientele considerations do not elicit strong positive responses from either sample of respondents (see Table 5). For example, the tax positions of stockholders do not influence the dividend decisions of the majority of firms in either country (Q3.7 and Q20.8). In the UK 78 per cent of respondents consider the taxes on dividends as unimportant and in Portugal the figure is 59 per cent, both significant at the one per cent level.

Despite the lack of positive responses to this set of questions, there were some statistically significant differences between the two samples (see Panel B of Table 5). The influence of institutional investors (Q3.9) is much more apparent

TABLE 5

Survey Responses Related to Clientele Considerations and the Relationship between Dividend and Investment Decisions Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel A: UK and Portuguese responses		UK								Portugal							
	Survey Question	**N**	**%+**	**%-**	**Mean**	***t*-value**	***p*-value**	**K-S 'z'**	***p*-value**	**N**	**%+**	**%-**	**Mean**	***t*-value**	***p*-value**	**K-S 'z'**	***p*-value**
Clientele Considerations																	
3.7	Personal taxes stockholders pay when receiving dividend	102	3.9	77.5	-1.12	-13.32	0.000	2.357	0.000	29	10.3	58.6	-0.522	-3.27	0.000	1.424	0.035
3.9	The influence of institutional shareholders	103	46.6	11.7	0.41	4.54	0.000	2.141	0.000	29	31.0	34.5	-0.103	-0.49	0.630	1.021	0.248
3.14	Attracting retail investors to purchase our stock	102	18.7	54.9	-0.51	-5.04	0.000	2.356	0.000	29	34.4	24.1	0.069	0.39	0.702	1.393	0.041
3.15	Attracting institutional investors to purchase our stock	102	48.0	23.5	0.25	2.32	0.022	2.433	0.000	29	37.9	24.1	0.138	0.81	0.424	1.393	0.041
20.5	We pay dividends to attract investors subject to 'prudent man' investment restrictions	96	29.1	35.4	-0.08	-0.86	0.391	1.837	0.002	29	3.4	58.6	-0.759	-4.22	0.000	1.609	0.011
20.8	We pay dividends to demonstrate value despite dividend taxes	95	14.8	61.1	-0.69	-6.63	0.000	2.222	0.000	29	3.4	79.3	-1.000	-7.12	0.000	2.476	0.000
Dividend Decisions in Relation to Investment Decisions																	
3.8	The availability of good investment opportunities	102	41.2	22.5	0.24	2.34	0.021	1.877	0.002	29	72.4	0.0	1.000	7.12	0.000	1.486	0.024
3.10	Merger and acquisition strategy	101	34.6	39.6	-0.13	-1.12	0.286	1.833	0.002	29	58.6	24.1	0.310	1.36	0.184	1.811	0.003
3.11	Flotation costs to issuing additional equity	99	4.0	77.8	-1.18	-13.47	0.000	2.687	0.000	29	6.8	58.6	-0.655	-3.77	0.001	2.321	0.000
4.1	Dividend decisions are made after investment plans are determined	102	32.3	30.4	0.09	0.89	0.378	2.135	0.000	29	51.7	13.8	0.448	2.55	0.017	1.950	0.001
4.5	Rather than reducing dividends, the company would raise new funds to undertake investment	102	62.7	16.7	0.56	5.76	0.000	3.040	0.000	29	37.9	31.0	-0.069	-0.32	0.752	1.161	0.135

TABLE 5

Survey Responses Related to Clientele Considerations and the Relationship between Dividend and Investment Decisions Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel B: Comparision of Survey responses by UK and Portuguese firms

	Survey Question	Difference	*t*-value	*p*-value	K-S 'z'	*p*-value	M-W 'z'	*p*-value
Clientele Considerations								
3.7	Personal taxes stockholders pay when receiving dividend	-0.566	-3.121^{z}	0.002	1.325	0.060	-2.966	0.003
3.9	The influence of institutional shareholders	0.511	2.515^{z}	0.013	1.086	0.189	-2.259	0.024
3.14	Attracting retail investors to purchase our stock	-0.579	-2.725^{z}	0.007	1.462	0.028	-2.761	0.006
3.15	Attracting institutional investors to purchase our stock	0.107	0.492^{z}	0.624	0.480	0.975	-0.713	0.476
20.8	We pay dividends to demonstrate value despite dividend taxes	0.305	1.742^{x}	0.086	0.861	0.449	-1.329	0.184
20.5	We pay dividends to attract investors subject to 'prudent man' investment restrictions	0.675	3.455^{z}	0.001	1.214	0.105	-3.193	0.001
Dividend Decisions in Relation to Investment Decisions								
3.8	The availability of good investment opportunities	-0.765	-4.427^{x}	0.000	1.484	0.024	-3.578	0.000
3.10	Merger and acquisition strategy	-0.439	-1.780^{z}	0.078	1.138	0.150	-1.910	0.056
3.11	Flotation costs to issuing additional equity	-0.527	-2.810^{z}	0.006	1.288	0.072	-2.754	0.006
4.1	Dividend decisions are made after investment plans are determined	-0.360	-1.722^{z}	0.088	0.920	0.365	-1.913	0.056
4.5	Rather than reducing dividends, the company would raise new funds to undertake investment	0.628	2.916^{z}	0.004	1.179	0.124	-2.675	0.007

Notes: K-S = Kolmogorov-Smirnov test for 2 independent samples
M-W = Mann-Whitney test
^{x,z} = unequal and equal sample variances determined by Levene's test

in the UK, with 47% of directors indicating that this was an important or very important consideration, whereas only 31% of Portuguese firms thought this important and 35% of them thought it unimportant or not at all important (12% in the UK sample). Indeed, there is mixed evidence on the clientele effect (Elton and Gruber, 1970; Bajaj and Vijh, 1990 and Graham and Kumar, 2006 offer evidence in support of such an effect, whereas Kalay and Michaely, 2000 do not).

Consistent with this finding, 34 per cent of the Portuguese respondents considered the attraction of retail investors important or very important, whereas the figure in the UK is only 19 per cent.

These results are broadly consistent with recent studies, and the lack of a tax impact on corporate decisions about dividends has already been recorded in US and UK studies (Brav *et al.*, 2005 and Dhanani, 2005). However, it is interesting to note that dividend taxes also do not figure in an economy with very different stock market characteristics such as Portugal.

4.3 Relationship between Investment Decisions and Dividend Decisions

Responses to the survey questions about the relationship between investment and dividend decisions are also presented in Panel A of Table 5. The availability of good investment opportunities (Q3.8) has some influence on UK respondents with 41 per cent (significant at the 5 per cent level) rating this factor as important or very important for the dividend decision. The statement in Q4.1 seeks responses about the priority of the investment decision over the dividend decision; 32 per cent of UK respondents agree or strongly agree that investment is the priority, but this does not represent a statistically significant result. Despite the possible influence that investment opportunities might have on the dividend decision, 63 per cent (significant at the one per cent level) agree or strongly agree that their firms would raise new funds to undertake the investment, rather than reduce the dividend (Q4.5).

According to Miller and Modigliani (1961), it would be in shareholders' interest if a firm were to forego or reduce the dividend payment in order to undertake profitable investment projects. In this view, persisting with a dividend payment and raising external capital in order to do so, especially in the light of transaction costs, could be considered economically irrational. This is addressed by Q3.11 and the UK responses make it clear that the existence of flotation costs would not inhibit raising new funds in order to maintain the dividend.

The influence of available investment opportunities on the dividend decision is much stronger in Portugal with 72 per cent (significant at the one per cent level) acknowledging that influence (Q3.8). In a similar vein, 52 per cent of responses to Q4.1 (significant at the 5 per cent level) agree that the investment

decision is prior to the dividend decision, with only 14 per cent rejecting that priority. The greater importance of investment opportunities in Portugal is consistent with the responses to Q4.5, with only 38 per cent agreeing that new funds would be raised to avoid cutting the dividend in order to undertake more investment, although a 59 per cent response to Q3.11 suggests that flotation costs would not inhibit the raising of external funds. The Portuguese results suggest some agreement with a residual dividend theory.

There are clear differences in the UK and Portuguese responses to questions about the influence of investment opportunities on dividend decisions. As reported in Table 5, Panel B, the differences are statistically significant at the one per cent level for Q3.8 and Q4.5 and at the 10 per cent level for Q4.1.

4.4 Signalling and Agency Explanations

The survey results associated with questions about signalling and agency are presented in Table 6. Although many of the questions already dealt with above might be construed to have implicit inferences for the signalling and agency hypotheses, the questions dealt with in this section addressed these issues directly.

First, we examine the extent to which the finance directors surveyed think that dividends convey signals to investors. Then we consider specific issues associated with the signalling literature and agency issues.

It is clear that UK finance directors are more convinced that dividends convey information to investors. In answer to Q4.2, 77 per cent of UK directors indicated strong or very strong agreement with that idea, with only 2 per cent registering disagreement. In contrast, only 24 per cent of Portuguese respondents agree that dividend convey information and 31 per cent actually disagree. Not surprisingly there is a statistically significant difference between these two sets of responses at the one per cent level. Once more, these results are consistent with the findings of Vieira and Raposo (2007) and Baker *et al.,* (2007), among other studies.

This result is echoed even more strongly with the responses to Q4.4, which posed the statement that there are negative consequences to dividend reductions. In the UK sample 87% of respondents (the largest weighting in the entire survey) registered strong or very strong agreement with the statement. In contrast only 45 per cent of Portuguese respondents agreed with the statement. Again there is a highly significant difference between to two sets of responses as reported in Panel B of Table 6.

This result is confirmed by the responses to Q20.6, which presented the proposition that the cost of raising capital is lower than the costs associated with

TABLE 6

Survey Responses Related to Signalling and Agency Theories of Dividend Policy Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel A: UK and Portuguese responses

		UK								Portugal							
	Survey Question	**N**	**%+**	**%-**	**Mean**	***t*-value**	***p*-value**	**K-S 'z'**	***p*-value**	**N**	**%+**	**%-**	**Mean**	***t*-value**	***p*-value**	**K-S 'z'**	***p*-value**
Signalling																	
3.5	Dividend policies of competitors in our industry	102	22.6	43.1	-0.36	-3.55	0.001	2.081	0.000	29	20.7	51.7	-0.586	-2.82	0.009	1.486	0.024
3.13	Dividends might indicate shortage of profitable investments	102	3.9	76.5	-1.00	-12.69	0.000	2.673	0.000	29	13.8	51.7	-0.552	-3.13	0.004	1.052	0.218
4.2	Dividend decisions convey information about the company to investors	102	76.5	2.0	0.85	12.94	0.000	3.556	0.000	29	24.1	31.0	-0.069	-0.42	0.677	1.393	0.041
4.3	Dividends make stock less risky (versus retained earnings)	100	16.0	40.0	-0.30	-3.54	0.001	2.384	0.000	29	20.7	27.6	-0.241	-1.32	0.199	2.105	0.000
4.4	There are negative consequences to dividend reductions	102	87.3	12.7	1.19	15.36	0.000	2.810	0.000	29	44.8	17.2	0.310	1.61	0.119	1.764	0.004
4.8	Dividend policy used make firm look better than competitors	102	7.8	69.6	-0.99	-10.42	0.000	2.285	0.000	29	6.9	69.0	-1.000	-5.59	0.000	2.043	0.000
4.9	Dividend used to show that firm could bear cost of external financing or passing up	100	2.0	80.0	-1.27	-15.36	0.000	3.013	0.000	29	13.8	62.1	-0.879	-4.34	0.000	2.228	0.000
20.6	The cost of raising capital is lower than the cost of cutting dividends	96	32.3	37.5	-0.07	-0.61	0.547	1.556	0.016	29	3.4	62.1	-0.897	-5.36	0.000	1.671	0.007
20.7	We pay dividends to demonstrate strength to raise capital if needed	97	13.4	52.6	-0.58	-5.64	0.000	1.878	0.002	29	6.9	75.9	-1.000	-6.08	0.000	2.290	0.000
20.9	We pay dividends to show that the firm is strong enough can pass up profitable investments	97	9.3	75.3	-1.02	-9.95	0.000	2.407	0.000	29	6.9	69.0	-0.897	-5.36	0.000	1.919	0.001
Agency																	
3.6	To reduce cash thereby encouraging efficient decision making	102	9.8	70.6	-0.90	-9.39	0.000	2.486	0.000	29	6.9	51.7	-0.655	-3.93	0.001	1.424	0.035
3.16	Attracting institutional investors because of monitoring function	100	19.0	44.0	-0.40	-3.90	0.000	2.118	0.000	29	34.5	20.7	0.172	1.00	0.326	1.578	0.014

TABLE 6

Survey Responses Related to Signalling and Agency Theories of Dividend Policy Registering Agreement or Disagreement to the Questions or Statements Measured on a Scale +2 (strongly agree/very important) to -2 (strongly disagree/not at all important)

Panel B: Comparision of Survey responses by UK and Portuguese firms

	Survey Question	Difference	*t*-value	*p*-value	K-S 'z'	*p*-value	M-W 'z'	*p*-value
Signalling								
3.5	Dividend policies of competitors in our industry	0.223	1.010	0.314	0.519	0.951	-0.951	0.342
3.13	Dividends might indicate shortage of profitable investments	-0.448	-2.324	0.025	1.176	0.126	-2.376	0.018
4.2	Dividend decisions convey information about the company to investors	0.922	5.213	0.000	2.487	0.000	-5.282	0.000
4.3	Dividends make stock less risky (versus retained earnings)	-0.059	-0.316	0.753	0.589	0.879	-0.705	0.481
4.4	There are negative consequences to dividend reductions	0.876	4.216	0.000	2.016	0.001	-4.370	0.000
4.8	Dividend policy used make firm look better than competitors	0.010	0.049	0.961	0.045	1.000	-0.035	0.972
4.9	Dividend used to show that firm could bear cost of external financing or passing up investment	-0.373	-1.677	0.102	0.850	0.465	-1.518	0.129
20.6	The cost of raising capital is lower than the cost of cutting dividends	0.824	3.461	0.001	1.361	0.049	-3.266	0.001
20.7	We pay dividends to demonstrate strength to raise capital if needed	0.423	2.180	0.034	1.100	0.178	-2.049	0.040
20.9	We pay dividends to show that the firm is strong enough can pass up profitable investments	-0.124	-0.594	0.553	0.499	0.965	-0.907	0.364
Agency								
3.6	To reduce cash thereby encouraging efficient decision making	-0.247	-1.228	0.222	0.896	0.398	-1.482	0.138
3.16	Attracting institutional investors because of monitoring function	-0.598	-2.766	0.007	1.133	0.154	-2.638	0.008

Notes: K-S = Kolmogorov-Smirnov test for 2 independent samples
M-W = Mann-Whitney test
^{1,2} = unequal and equal sample variances determined by Levene's test

cutting dividends. Around a third of UK directors agreed with this and just over a third (38%) disagreed. In the Portuguese sample only 3% agreed, whilst 62% disagreed. Again the difference between the two groups, reported in Panel B of Table 6, is significant at the one per cent level. While the approximately uniform distribution of UK responses is ambiguous, the responses suggest that Portuguese finance directors are not persuaded that dividend reductions necessarily send negative signals to investors.

In relation to negative signals, Easterbrook (1984) suggests that in some circumstances dividend payments might be construed as an indictor of a shortage of profitable investment projects. This idea was posed directly in Q3.13 of the survey. In the UK 77 per cent of finance directors disagreed or strongly disagreed with this statement, against 52 per cent in the Portuguese sample, a difference that was significant at the five per cent level (Panel B of Table 6).

All this suggests that UK firms regard dividends as much more likely to signal inside information than their Portuguese counterparts. However, respondents were less convinced of the power of dividends to signal in a positive manner in terms of risk reduction. Q4.3 suggests that dividends make a company's stock less risky as against retentions (a sort of bird-in-the-hand hypothesis). In the UK 40% of finance directors indicated that they disagreed or strongly disagreed with this statement, little different from Portuguese firms (28%).

In setting dividends both Portuguese and UK respondents seem to have little regard fpr the dividend policies of competitors' (Q3.5) with 52% of the former and 43% of the latter indicating that competitor policies were unimportant or not at all important. Furthermore neither group uses their own dividend policies as a competitive device (Q4.8).

Bhattacharya (1979) emphasises that, in order to be credible, signals have to be costly, and he suggests that firms might use dividends to signal quality, whereby dividends increase the risk of having to raise external finance, and that poor performance would be more likely for low quality firms. This proposition is tested directly by Q20.7 with 53 per cent of UK and 76 per cent of Portuguese respondents disagreeing or strongly disagreeing with it. The difference between the two groups in their strength of disagreement with the Bhattacharya hypothesis is significant at the five per cent level, but it is difficult to draw an inference other than it is strongly rejected by both sets of respondents. A slightly different approach to the signalling of quality is provided by Miller and Rock (1985) who suggest that only stronger firms will be able to give up profitable investments in order to maintain or increase the dividend. This hypothesis was tested directly with Q4.9 and rejected resoundingly, by 80 per cent of UK and 62 per cent of Portuguese respondents.

The responses to the questions and statements about signalling show clearly that the UK finance directors are more convinced than their Portuguese

counterparts that dividends convey value-relevant information to investors. Furthermore, UK respondents are also more convinced that dividend cuts are likely to be costly. The UK directors have a clear view that negative signals about dividends are important, whereas the Portuguese are simply more sceptical of the power of signalling with dividends. The more sophisticated signalling models such as those proposed by Bhattacharya (1979) and by Miller and Rock (1985), which offer the possibility of firms being able to send positive signals to the market via dividend policy, are rejected by both groups. The finding against the sophisticated academic models of signalling is consistent with the recent findings in the US by Brav *et al.*, (2005).

Turning now to agency theory and dividends, we only asked two direct questions in this regard, (although, as noted above, other responses might be thought to convey inferences about an agency hypothesis of dividends). Q3.16 suggested that dividends were used to attract institutional investors because of their more exacting monitoring function. This was rejected by 44 per cent and accepted by only 19 per cent of the UK sample (Table 6). In contrast and perhaps counter to intuition, the balance of responses was reversed in the Portuguese sample with 35 per cent in agreement or strong agreement and only 21 per cent rejecting this proposition. The difference between the samples is significant at the one per cent level (Table 6, Panel B), suggesting that there is weak support for this agency perspective in Portugal, but none in the UK (weak because less than 50% of Portuguese respondents supported the statement).

Question 3.6 proposes that dividends reduce cash balances and thereby encourage efficient decision making (in line with the Jensen, 1986 free cash flow hypothesis). Approximately 71 per cent of the UK sample and 52 per cent of the Portuguese sample disagreed or strongly disagreed with this proposition, with no statistical difference between the two groups (Table 6).

The evidence from questions 3.6 and 3.16 provide almost no support for the agency hypothesis of dividends. However, the responses to Q3.6 do not necessarily negate agency imperatives to 'disgorge' surplus cash to shareholders, because UK and Portuguese firms might rely on share re-purchases for that purpose. This interpretation would be consistent with Bancel, Mittoo and Bhattacharyya (2005), who conclude that for the majority of European managers, share repurchase is seen as a flexible tool and not a substitute for dividends.

When we pose a hypothetical question about their preferences in an *ab initio* distribution (Q5), in the UK 63.1% of respondents favour dividends only, 0.7% chose the pure share re-purchase option, and 19.4% chose a combination of dividends plus repurchase (Table 7). In the case of Portuguese managers, the percentages are 93.1%, 0% and 3.4%, respectively.

TABLE 7

Survey Responses about Dividend Initiation

	UK Sample		Portuguese Sample	
Survey question	Yes	%	Yes	%
If you were deciding to make a distribution for the very first time, would your first payout be?				
Dividends only	65	(63.1)	27	(93.1)
Share repurchase only	10	(9.7)	0	(0.0)
Only paid dividends	61	(59.2)	14	(48.3)
Number of responses	95	(92.2)	28	(96.6)

5. CONCLUDING REMARKS

This comparative survey study has uncovered a considerable number of similarities in the ways in which UK and Portuguese finance directors consider policy and decision making with respect to dividend distributions. However, the study has also found some interesting differences between the two groups.

The conservative nature of dividend policies that has been reported in studies since Lintner (1956) is broadly confirmed by both the Portuguese and UK respondents to our questionnaire (though more strongly in the UK). Temporary changes in earnings have little impact on the dividend decisions of either group, whereas historic dividend policies, the stability and the sustainability of future earnings are all important factors for the dividend decision – although sustainability of future earnings is marginally more important in the UK.

Although both groups approach dividend policy conservatively, it appears that decision making in respect of dividends in any one year varies considerably. UK firms are keen to maintain a smooth dividend stream and are clearly much more reluctant to reduce or omit dividends, whereas Portuguese firms consider these factors to be of much less important consideration. Vieira and Raposo (2007) find no evidence that Portuguese firms have stable dividend policies, but they find evidence suggesting that dividend policy for the UK firms is highly predictable. This result suggests that dividend smoothing plays a less significant role in Portugal than in the UK. This might be because Portugal has a greater reliance on bank debt and its firms are more likely to be closely held, and both these characteristics are likely to reduce information asymmetries between insiders and outsiders.

When we take into account clientele issues, there appear to be more similarities than differences between the two groups of respondents. Both seem largely to ignore the taxes on dividends paid by their shareholders. However, it does appear

that UK respondents pay more attention to institutional investors whilst the Portuguese are more aware of retail investors, though the differences are not great.

With regard to the signalling hypothesis of dividends, then UK respondents strongly indicate that dividends convey information to investors, as opposed to a minority of Portuguese respondents. This difference on signalling between the groups is reinforced with the statement on the negative consequences of dividend reductions. Vieira and Raposo (2007) analyse the dividend signalling hypothesis for three European markets: France, Portugal and the UK, and they found that Portuguese and French firms do not use dividend change announcements to convey information to the market, but find some evidence on the dividend signalling hypothesis for the UK market. Goergen, Renneboog and Silva (2005) conclude that firms with concentrated ownership (as in Portugal) do not need to use dividends to signal the market.

Finally, the responses do not offer any real support for the agency hypothesis, a finding consistent with a number of previous studies (Brav *et al.*, 2005; Dhanani, 2005 and Baker *et al.*, 2007).

Although we have recorded a number of similarities in the opinions of UK and Portuguese finance directors in relation to dividend policy and decision making, our surveys have also uncovered some important differences. These differences might, perhaps, be accounted for by the different characteristics of the UK and Portuguese capital markets and economies, such as the ownership structure, the information asymmetry and the bank versus market based system of the two countries. However, what is clear from our results is that it would be difficult to utilise a universal model of dividends to explain the survey evidence that we have generated and reported here.

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Resumo

Este artigo relata os resultados empíricos de um inquérito sobre a política de dividendos das empresas, dirigido aos directores financeiros de empresas do Reino Unido e de Portugal com títulos cotados em Bolsa. À semelhança de outros estudos já realizados (Brav *et al.*, 2005, nos E.U.A. e Dhanani, 2005, no Reino Unido), o inquérito foi respondido por 313 directores financeiros do Reino Unido e 48 de Portugal, no sentido de analisar os seus pontos de vista sobre a decisão de distribuição ou não dividendos, a fim de comparar os factores práticos de influência da política de dividendos e as premissas teóricas sobre esta temática. Os resultados obtidos apontam para algumas semelhanças entre as respostas do Reino Unido e Portugal, mas também foram encontradas diferenças substanciais, particularmente no que diz respeito à interacção entre os dividendos e as decisões de investimento, bem como no que diz respeito à hipótese de sinalização dos dividendos.

Palavras-chave: Dividendos, Hipótese da Sinalização, Efeito de Clientela