Does the existence of the majority owner have impact on dividend policy of the Czech companies?

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Abstract

This paper was focused on two areas. The first aim of this paper is to find out to what extent the Czech dividend policy can be considered stable, or if it is somehow possible to identify it nearer by any means. Due to a relatively short existence of public limited companies in the Czech Republic and the economic changes, through which the economy went from 1990, it is somewhat difficult to obtain a sample of companies, which would continuously pay dividends continuously for several succeeding years. Here, data from 81 companies has been used for the analysis, which always paid out dividends for five succeeding years. For presenting conclusions, data has been used in this part, which has been acquired by applying simple statistical quantities. The second aim of this paper is then to find out whether the analyzed sample of 81 companies, which paid out regularly dividends, is a feature of the existence of the majority owner. The following data has been compared afterward with data of 52 public limited companies, which did not pay out regularly dividends this way. The second sample is made up by companies, whose shares are traded at the RM-System.

Key words: dividend policy, information asymmetry, representative conflict, signal effect, majority owner, Czech companies.

JEL codes: G01, G32

1. Introduction

Dividend policy has developed since its formation, and its development has been connected with the development of public limited companies. The foundations of dividend policy were laid as early as the 16th century, when the captains of seagoing ships in Great Britain and Holland sold receipts to investors, which confirmed their claim to yields of navigation. After the successful reaching of the destination harbor, the cargo was sold and after settling debts, the rest was proportionally divided among the owners of receipts. This payment was something what definitely wound up a company (risky maritime navigation), and presented someway liquidating dividend. At the end of the 16th century, the above mentioned receipts began to be traded at public markets.

In the course of the 17th century, public limited companies started to arise in other spheres of business, too and not only as representatives for doing overseas trade. For instance, in the year 1686 a maritime insurance company was established in France, and in 1694, Bank of England. In first place, it was Europe, particularly Great Britain, Holland and France and lastly other countries joined, for example The Philadelphia Contributionship for the Insuring of Houses from Loss by Fire, which was obviously established as the first public limited company in the territory of the USA in the year 1768.

The first mandatory regulation appeared in the year 1807 in Napoleon's Code de commerce.

Dividend policy was considered first as a marginal matter and it was mainly oriented on settling a balance from a trading activity, primarily then on the payment, which we call today liquidating dividend. Profits were reinvested into new investments in an absolute majority of cases. It was only in the course of time, when dividend policy grew to be a full-bodied part of the financial policy of the public limited company and became a subject of not only academic discussions and disputes.

At the beginning of the 50's of the 20th century, an opinion predominated unequivocally among theorists and financial managers referring to the fact that investors prefer dividend to capital gains and that companies can increase the price of the share by opting for a generous dividend policy. At that time, the theory called "the Bird in the Hand Theory" arose. According to this theory, the prices of shares are very variable, and so dividends represent rather a much more reliable form of proceeds than capital gains. A higher security connected with dividends led investors to attach greater importance to dividends than the equivalent sum of the insecure capital gain.

The representatives of the theory are, for instance, (Benjamin Graham a David Dodd, 1951). In their work, they came to a conclusion that "a verdict of the capital market when assessing shares is based on a generous dividend". An ordinary share investor bases his/her investment decision on evaluating the current share value, which he/she intends to buy, simultaneously, applying one multiplier and a different lower multiplier for the future retained profit for calculating the current value of the future profit paid out in the form of dividends.

Economist of dividend irrelevance school, whose most prominent representatives are M. H. Miller and F. Modigliani (1961), argued (and still argue) on the contrary that the market value of the share is a function (ceteris paribus) of the profit made by the company regardless of its further use, in other words, it is independent upon the fact, if the profit is retained and reinvested or paid out to shareholders (or its certain part) in the form of dividends. This theory is based by Miller and Modigliani on the prerequisite of the existence of the perfect capital market though, which is characteristic of circumstances, which are practically unattainable in the real economy. Economists, when formulating it, abstracted absolutely away from market imperfections. They presuppose, for instance, the existence of absolute security when making decisions by economic subjects too, rational behavior of all participants of the financial market, and having the same quota of information or the nonexistence of transaction costs available. Companies and individuals can borrow and lend at the financial market at the market interest rate. The risk-free feature of the economy causes then that returns of entire investments are equal to the risk-free interest rate.

Consequently, based on the above stated prerequisites, the company has no need to explore preferences of shareholders, who are indifferent in the given existence of circumstances as for financing new investments from the retained profit and borrowed funds. The existing shareholders and potential investors into shares of the company behave always rationally when bidding and demanding shares based on the full knowledge of the future intentions of the company and possible alternative investments and the result is then the real evaluation of shares (market value) in the evident dependence on the really economic results of the company achieved. There is a reason for searching for optimal dividend policy, since dividend policy does not influence in essence the market value of the company.

One of the key prerequisites of the given theory is the independence of corporate investment policy on its dividend policy. Companies can express costs capital and alternative costs (which equal to the market interest rate) and accept only projects with a clear current value, what means that all discountable cash flows linked with the respective investment are in a total sum higher than input investments. By accepting such projects, the maximization of the shareholder' wealth takes place. In essence, the company can in its financing (from the theoretical point of view) make use of the debt without limits, and its use, given the circumstances stated by MM, has no impact on capital costs and the price of shares. In the case of the set investment policy, dividend policy has impact then only on the size of the sum of external financial means, which is necessary to obtain on the financial market, either for paying out dividends alone, or for the set investments. Based on the above mentioned prerequisites, one can state that each Crown of today's dividends means in essence only one Crown less of future dividends, or in other words, it represents future capital gains by one Crown less. Investment possibilities and abilities of the given company are the only essential determinant of the market value of the company.

In circumstances of a perfect capital market, shareholders are fully familiar with possible investment possibilities and necessary expenditures. If for any reason they want to obtain immediate cash, for instance for paying consumers expenditures or investing into shares of another company (diversification in the circumstances of perfect market is not necessary), they can transform the value of shares in a more simple manner into cash, and they do not have to rely on corporate dividend policy. In the real economy, this fact is not always possible, not even if one abstracts away from transaction costs, since at the time of the shareholder's decision making about selling shares, the price can be low, so the shareholder takes low or no capital gain, or possibly loss.

Part of dividend irrelevance school is residual profit theory, which is based on the prerequisite that profit has to be distributed to shareholders only after using all investment alternatives with a positive net current value. Dividends are paid out only then, if all investments have been carried out, yet, the company has residual funds available. This theory is, in essence, definitely anti-dividend.

At the end of the 70's of the 20th, a diversion of financial theorists took place from dividend irrelevance and modeling in the circumstance of a perfect capital market and particular models once again tried more or less to capture the real economic situation. For example, (Ross, 1977), implies in his article that in MM theory of dividend irrelevance, the implicit prerequisite is absolute knowledge of the amount of future cash flows, i.e. proceeds and profit, on which basis, it is possible to determine the value of the observed company. However, the market does not evaluate known and certain quantities in the real circumstances, but it assesses the anticipated (perceptible) flow of contemporary and future proceeds of the company. It means that changes in the capital structure (or in dividend payouts) can change the prerequisites of the market. In other words, by changing the capital structure or dividend policy, a change in the perception of the level of future presumed risk linked with the company may take place, despite the fact that the current risk perceived will stay unchanged.

Managers, who have "monopolistic" approach to information on corporate anticipated cash flows, will always send unchallenged signals about the future development of the company, provided that they have a motive to do so. The company, which distributes dividends, signals that it is anticipating future cash flows, which are high enough to cover all costs connected with dividend payments, along with paying all liabilities, so that an increased probability of bankruptcy would not take place. Furthermore, Ross argues that announcing the payout of dividends is a very crucial message for shareholders and potential investors, since it cannot be applied by a company, which does not presume profits in the future and, moreover, the announcement of dividends makes managers tell the truth about the company's financial situation.

However, Ross was not the first economist, who dealt with information effect of dividends. The first study, which mentioned this topic, was a study, whose authors were (Fama, Fisher, Jensen and Roll, 1969), dealing mainly with stock split. The authors found out in their research that if stock split is connected with the announcement of dividends, then a decrease of market prices in shares takes place, for which a lowering of dividend payouts takes place against the previous period, and on the contrary, an increase in the price when dividend is growing.

A similar stance was taken by (Bhattacharya, 1979) too, who claimed that if inventors believe that a company, which pays higher dividends for a share, has a higher value, and then an unexpected increase in dividends will be seen as a positive signal. Probably, dividends represent information, which cannot be fully shared in any other manner; it is not contained in annual reports, profit forecasts, or financial analyses. For a less successful company it is very expensive to simulate this signal, for it has to spend additional costs connected with obtaining external financial sources, in order to be able to pay out dividends. Thus, dividends are a positive signal, which is a replacement for tax losses connected with its payout. Bhattacharya, in his article, came to a conclusion that given the above stated circumstances, one can refer to heading for an optimal dividend policy, if proceeds, which were caused by a positive signal, would be higher than tax costs.

(Hakansson, 1982) dealt with dividends as an information signal for investors too, who assumed that if dividends could be perceived as a positive information signal, it is necessary to fulfill one of the following terms at least:

- Investors have to differ in probable estimates of dividend payouts,
- Investors have to have various requirements in the area of allocating consumers expenditures in time,
- The financial market has to be imperfect.

All three prerequisites can exist at the same time, and all of them can be marked as rational.

Theories, which dealt within the flow of dividend relevance with representative costs and external financing, tried very often to clarify sometimes very distinct differences in dividend policies applied by companies in practice and not only on the market as a whole, but within particular spheres too. For instance, (Rozeff, 1981), presumed in his work that differences in amounts of paid out dividends towards the attained net profit of companies could be explained by a compromise between costs connected with the growth of external capital and benefit from the reduction of representatives costs.

Dividend payments can serve as a tool for monitoring the activity of management. Although higher dividends can lead to the increase in costs connected with the need of additional external sources, an advantage of making management provide a greater amount of the detailed information about the company can be manifested here. This is usually required from the side of the bank as a potential creditor or stock exchange bodies in placing a new issue of shares on the public tradable markets.

It is apparent from the given theories of particular economists dealing with dividend policy and its impact on the prices of shares that here does not exist a single opinion of the fact whether dividend policy influences the market value of shares at all, and if it so, if it is a positive or negative impact. Unlike Miller and Modigliani, whose work was eminently theoretical, most of other theorists tried to support their opinion by means of empirical examinations too. A number of problems were connected with empirical evidence, though.

One of the most essential problems of dividend empiricism is the separability of the impact of dividend policy on the price of shares from effects, which are caused by other facts. Many economists argue, for instance, that riskier shares and shares of small companies are generally connected with higher proceeds. If it was not like that, investors would have interest in investing into them. It is not then an unambiguous consequence of appropriately selected dividend policy. However, the problem is a fact too that dividends are paid out only maximally four times a year1. Some scientists dealt with an issue, whether this cycle of payments has a more significant impact on the price of shares.

A very frequent argument used for supporting dividend relevance is an assumption that total proceeds of shares (that is also the price) increased simply then, when dividend proceeds were higher in the given period than estimated ones, and on the contrary, total proceeds fell, if real dividends decreased in relation to the estimated ones. The following argument is problematic too, since the primary problem is to determine, what dividend proceeds were really anticipated by investors. It possible only then to assess, what impact the change had against estimates of total proceeds of shares.

Another significant characteristic, which does not make dividend research transparent, are taxes. In various countries, there are more or less different tax systems, which classify capital and divided proceeds into much differing tax groups, in which different high rates of the tax applied occur in dependence on, for instance, the income of the investor. In tax systems, a great number of asymmetries exist.

Based on the above stated facts, it is evident that a good reason exists as far as the reciprocal differentiation of empirical research of particular economists is concerned. The following fact is depicted in Table 1, too, which contains a selection of some significant studies, which were carried out in the 70's and 80's in the last century, along with briefly given results too, to which economists came.

Table 1 Selected empirical studies published in the 70's and 80's of the 20th century

Author/authors	Period observed	Observation interval	Estimated tax rate (TR)	Standard deviation of TR
Brennan (1970)	1946-65	Monthly	34 %	12
Black Scholes (1974)	1936-66	Monthly	22 %	24
Litzenberger Ramaswamy (1979)	1936-77	Monthly	24 %	3
Litzenberger Ramaswamy (1982)	1940-80	Monthly	14-23 %	2-3
Rosenberg Marathe (1979)	1931-66	Monthly	40 %	21
Bradford Gordon (1980)	1926-78	Monthly	18 %	2
Blume (1980)	1936-76	Quarterly	52 %	25
Miller Scholes (1981)	1940-78	Monthly	4 %	3
Stone Bartter (1979)	1947-70	Monthly	56 %	28
Morgan (1982)	1946-77	Monthly	21 %	2

Source: Brealey, R. A.: Does dividend policy matter? The revolution of corporate finance. Blackwell, Oxford 1999, pp. 439-444.

[1] The frequency of paying out dividends is different in particular countries. In the Czech Republic, dividends are usually paid out only once a year, unlike in the USA, where they are usually paid out four times a year.

2. Research Methodology

The essence of dividend policy is a decision, whether to pay out profit or its part or to retain or reinvest it. Therefore, it contains the following issues in addition:

- A high or low payout?
- Stable or irregular dividends?
- With what frequency?
- Is it good to notify a type of dividend policy?

Most dividend theories imply that changes in dividends have information content about future earnings of the firm. Some theories explain that dividend variations are explicit signals about future earnings sent intentionally, at some costs, by the management. A rise in dividend is generally taken as a signal of increased future earnings of the firm. It carries greater conviction than a mere announcement of better prospects by the management. A reduction of dividends reflects negatively on the future earnings prospects of the firm. The markets normally react favorably to dividend initiations and increases and negatively to announcements of dividend decreases or emissions.

The aim of the paper was to analyze dividend policy of selected companies in the Czech Republic. For the analysis, two groups of companies were selected, that is, companies, which paid out dividends for five succeeding years 2004 - 2008 (hereafter S1) and then those, which paid out in the years 2005-2009 (hereafter S2). The first group comprises 38 public limited companies, and the second one 43. Based on the selected statistical variables, the development of dividend policy of these companies was observed in time.

First, in both sets with all companies, it was examined, what standard deviation of dividend payments for five respective years was. Subsequently, the results were divided into four intervals in a way, as Table 2 states. Within the survey, it was found out that only in the case of one company in both groups; dividend policy was constant. We are dealing here with the same public limited company in both cases. One could refer to stable dividend policy in the company too, where σ ranges in the interval of <0,10>, if however, dividends would be slightly increasing. In S1 and S2, there can be found only 8 and 10 such companies. (Stability does not mean that the dividends do not vary over a period of time. It only indicates that dividends should not decrease and the standard deviation should be low because of little fluctuation of dividends). The other firms, which fall into this interval, have fluctuating dividends, sometimes rising, at another time decreasing.

If the random variable X takes on the values x1,...,xN (which are real numbers) with equal probability, then its standard deviation can be computed as follows. First, the mean of X is defined as:

$$\overline{x} = \frac{1}{N}\sum_{i=1}^{N} x_i = \frac{x_1 + x_2 + \cdots + x_N}{N}$$

Next, the standard deviation simplifies to:

$$\sigma = \sqrt{\frac{1}{N}\sum_{i=1}^{N}(x_i - \overline{x})^2}$$

Given only a sample of values x1,...,xN from some larger population, many authors define the sample (or estimated) standard deviation by:

$$s = \sqrt{\frac{1}{N}\sum_{i=1}^{N}(x_i - \overline{x})^2}$$

Subsequently, the results were divided into four intervals in a way, as Table 2 states. Within the survey, it was found out that only in the case of one company in both groups; dividend policy was constant, i.e. stable. We are dealing here with the same public limited company in both cases. One could refer to stable dividend policy in the company too, where σ ranges in the interval of <0,10>, if however, dividends would be slightly increasing. In S1 and S2, there can be found only such companies. The others, which fall into this interval, have fluctuating dividends, sometimes rising, at another time decreasing.

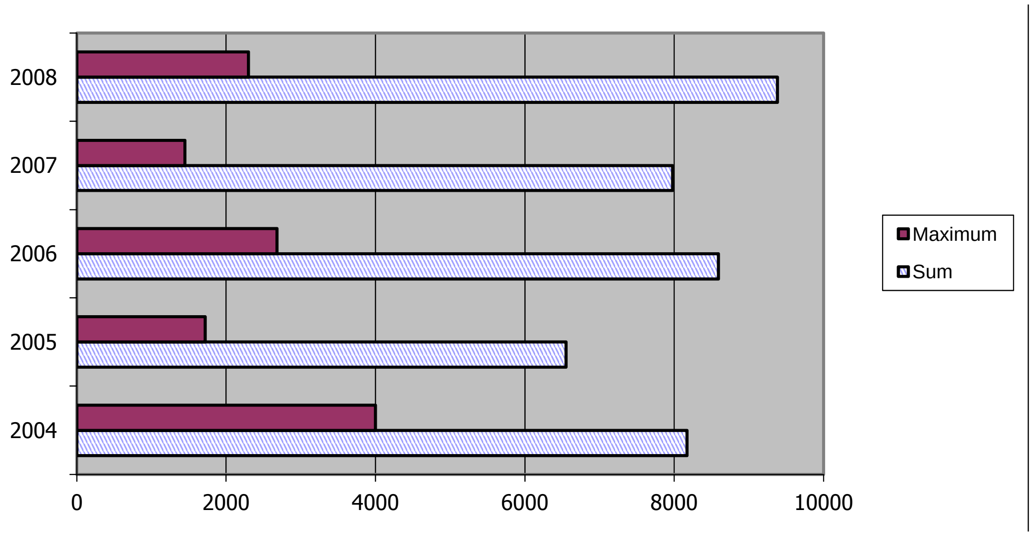
Table 2 Intervals of standard deviations

Interval σ	Number in S1 (2004-2008)	Number in S2 (2005-2009)
<0,10>	8	10
(10,50>	15	10
(50,100>	5	9
<100,∞)	10	14

Source: one's own calculations

Graph 1 depicts subsequently the development of the sum of the paid out dividend of a share in all companies S1 in the particular years. It is apparent that between years 2004 and 2008, an increase took place; however, the trend is not definitely rising. The maximal value, on the other hand, dropped up to 42,5 %.

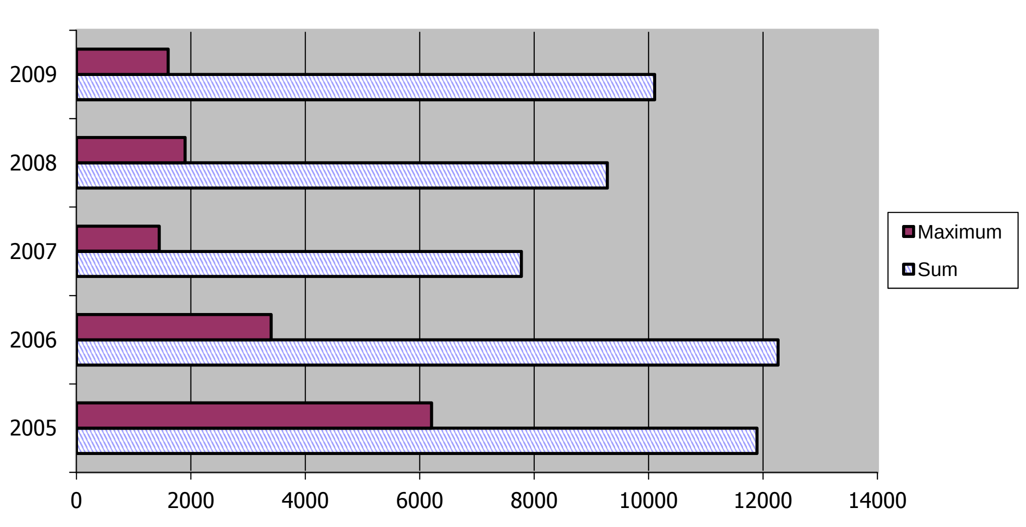
Graph 1. Development of S1 in the years 2004-2008 (in CZK)



Source: one's own calculations

Graph 2 describes the same what the previous Graph 1 now, however, for the group S2. Here, one can refer to the rising trend with the sums in the past three years, i.e. 2005-2009. The maximal paid out dividends for one share dropped again, here, even by 74,1 %.

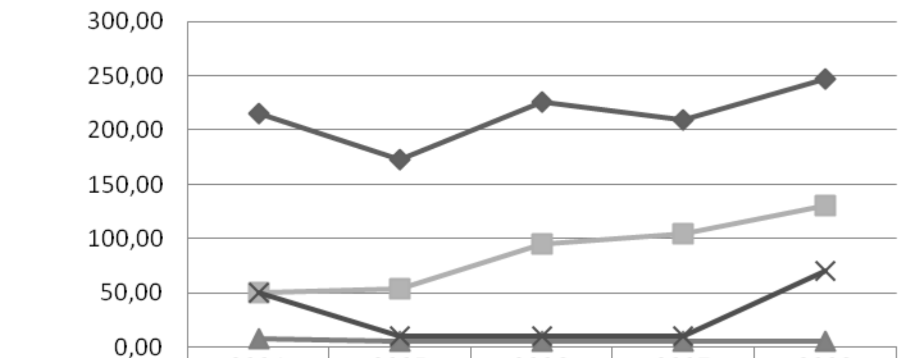
Graf 2. Development of S2 in the years 2005-2009 (in CZK)



Source: one’s own calculations

Graph 3 and a table, which is its part, shows the development of statistical values of: arithmetic average, median and mode. Arithmetic average expresses a typical value describing the set; however, it does not mean that it has here some expressiveness. Arithmetic average is relatively high, however if we compare the values reached with median, then, we will come to a conclusion that arithmetic average is considerably affected by extreme values, or by high paid out dividends in exceptional cases. Mode describes typical (most occurring) values from the set.

Graph 3. The development of selected indicators S1 in the years 2004 - 2008 (in CZK)

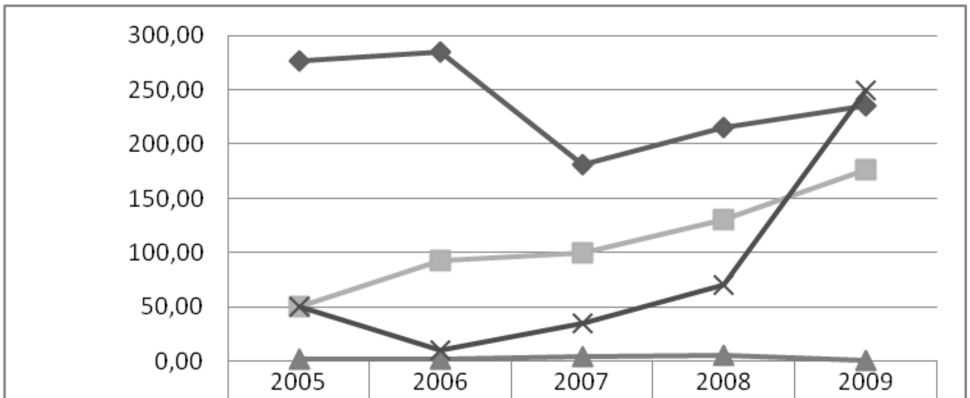


	2004	2005	2006	2007	2008
Average	215,00	172,37	226,01	209,93	246,82
Median	50,00	54,00	94,60	104,90	130,95
Minimum	7,50	5,00	5,00	5,50	6,00
Mode	50,00	10,00	10,00	10,00	70,00

Source: one’s own calculations

The same, what applies to Graph 3, applies to the following Graph 4 too. The difference is that in 2004, surprisingly, the most frequent occurring dividend value for one share was 250,- CZK.

Graph 4. The development of the selected indicators S2 in the years 2005-2009 (in CZK)



	2005	2006	2007	2008	2009
Average	276,57	285,21	180,83	215,74	235,03
Median	50,00	93,00	100,00	130,00	176,00
Minimum	2,00	2,50	4,50	6,00	1,00
Mode	50,00	10,00	35,00	70,00	250,00

Source: one's own calculations

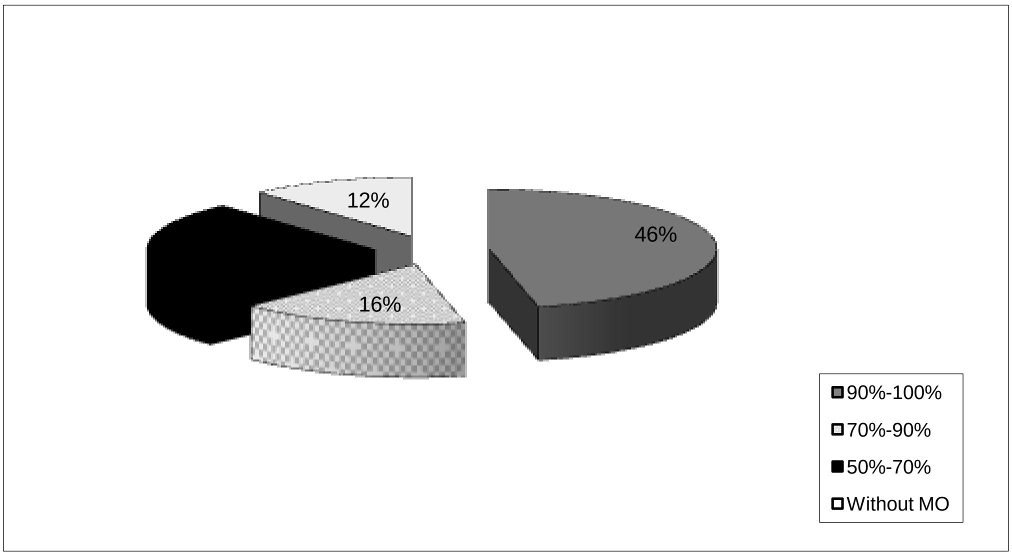
3. Does the existence of the majority owner have impact on dividend policy of the Czech companies?

Does the existence of the majority owner have impact on dividend policy of the Czech companies? In the subsequent part of the paper two groups of companies will be analyzed; companies from the group S2 (43 companies analyzed above, which paid out dividends regularly in the years 2005-09) and companies which will be named S3 (they are 81 of them in the sample). S3 comprises companies, whose shares are traded within the RM-System (RMS). The RMS represents an organizer of off-exchange securities market, which allows smaller investors, unlike the stock exchange, trading, either at the branches or via the Internet. At the RMS, some shares of companies of the group S2 are traded too, these, logically, were not classified as the group S3. S3 stands for companies, which did not pay regularly dividends in the past years (here, the analysis of their dividend policy is not carried out, since the author considers it as irrelevant for this analysis). The conclusions in the sphere of property structure achieved for both groups were compared.

Four intervals were set for the analysis. The interval from 100% of share in registered capital up to 90 %, such property can be considered as a very distinct control of the company2. Further 90 – 70 % and 70 – 50 %. These two intervals still represent a majority of the subject, if there was another strong investor in the company or people acting in mutual agreement, it could weaken the decision position of the majority owner. Reciprocal relations of further persons were not part of this analysis though. Only the mutual accords were incorporated, which can influence the existence or impact of the majority owner (i.e. its share in registered capital). The last group is the interval below 50 %, into which companies are incorporated without the majority owner (without MO).

[2] I considered the percentage in owner's capital instead of common majority of right to vote but there is not difference under the chosen Czech firms' conditions.

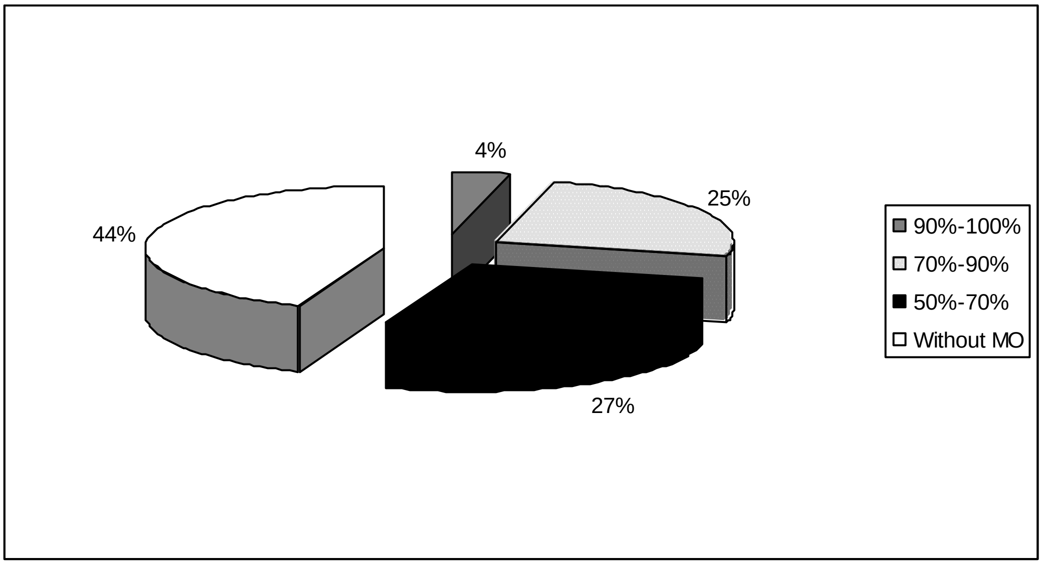
Graph 5 The existence of majority owners in companies S2



Source: one's calculations

It is apparent from Graph 5 that almost the half of companies of the group S2 has only one owner, or an owner who has a very noticeable majority; i.e. his/her share in registered capital of the company in the amount higher than 90%. By means of the sum of percentage shares it is visible that an investor exists in 88% of companies, whose share in registered capital represents minimally 50 %. It means that only 12 % of companies are without the obvious majority owner. Subjects are incorporated into the following data too, who act in mutual agreement, since it is presumed that this agreement will show in approving of the amount of paid out dividends.

Graph 6 The existence of majority owners in companies S3

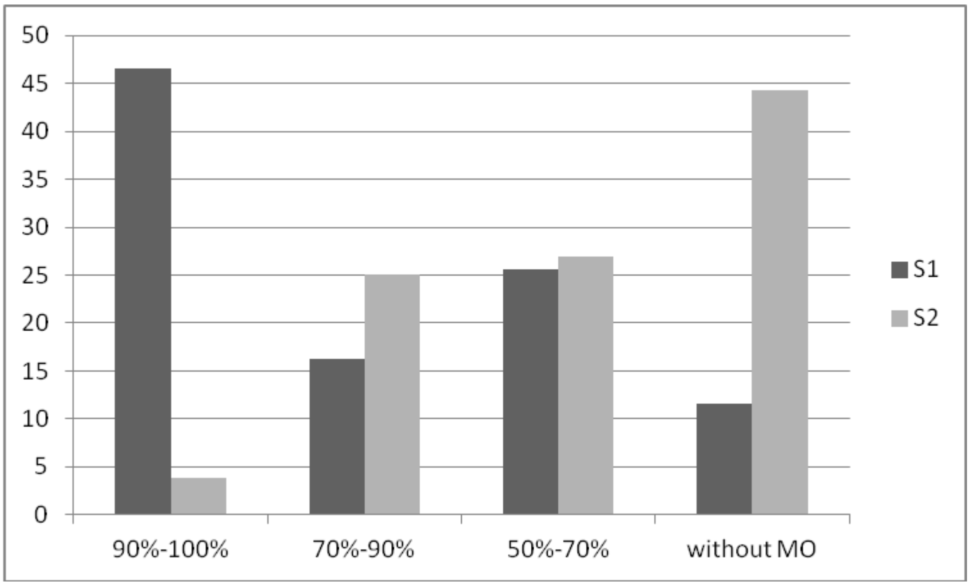


Source: one's won calculations

On the other hand, it is obvious from Graph 6 that the situation in the group S3 is very different. The interval, which had the greatest weight in S2 (90 - 100 %), represents only 4 % of companies. Yet, 44% of companies are without the majority owner. As a result, a subject exists in 66% of companies, who has absolute share in registered capital available. This figure is noticeably higher than in the case of S2.

The given data is much more apparent from Graph 7, which includes a comparison of both groups in the given intervals of share in registered capital of the analyzed companies.

Graph 7 The comparison of data for S2 and S3



Source: one's own calculations

4. Conclusion

It follows from the above stated part of research that public limited companies in the Czech Republic, with the exception of some, do not apply stable dividend policy. Their dividend policy is very hard to define and from data obtained, it is evident that companies in their decision making about financial policy take obviously into account other aspects rather than signal effect. These aspects can be, for instance, interests of the majority owner, or future investment intentions of the company. What generally applies is that at present in the developed countries of the world, the most of mature companies, which generate profit, pay out dividends. Nevertheless, it holds true that if the company does not pay out dividends, automatically it is not profit making. If the management is convinced that it has advantageous investment possibilities for created financial means, it can suggest retaining and reinvesting profit in the general meeting.

If we consider apart from other factors, it can be stated based on the given analysis that in specific Czech circumstances, the existence of the foreign majority owner has a substantial impact on dividend policy of public limited companies. The reason can be the effort of the owner (in particular a foreign investor) to maximize the return of invested funds in the possible shortest time horizon. This is substantiated by the fact that some companies paid out higher DPS in 2007 than the created profit was for one share in the year.

Privatization process in the Czech Republic took place gradually and still, the state controls thoroughly some strategic companies or to a certain extent and not only by means of regulatory tool but also by physical sharing ownership. A great wave of privatization processes took place for example in the year 2007 and it could be the reason for a noticeable increase in DPS in some companies. Anyway, following the privatization, fundamental changes in corporate governance took place along with changes of financial policy of the company.

It will be interesting to follow, how dividend policy will develop in the years to come. If it tends to follow an out-of-balance development or if the stabilization of the payout of dividends takes place. The subject of further research will be the analyses of further owners in companies, too. The impact of other aspects will be examined as well, such as, for instance, the development of the economic result or affiliation with the economic sphere. The following analysis is considered only as partial.

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