J. Int. Financ. Markets Inst. Money xxx (2017) xxx–xxx

Contents lists available at ScienceDirect

Journal of International Financial Markets, Institutions & Money

journal homepage: www.elsevier.com/locate/intfin

How do creditors respond to disclosure quality? Evidence from corporate dividend payouts

Julie Byrne [a], Thomas O'Connor [b,*]

[a] UCD Smurfit Graduate Business School, University College Dublin, Carysfort Avenue, Blackrock, Co. Dublin, Ireland
[b] Department of Economics, Finance and Accounting, Maynooth University, National University of Ireland Maynooth, Maynooth, Co. Kildare, Ireland

ARTICLE INFO

Article history:
Received 11 August 2016
Accepted 11 April 2017
Available online xxxx

JEL classification:
G30
G35

Keywords:
Dividend payout
Creditor rights
Disclosure standards
Agency outcome and substitution model of dividends

ABSTRACT

Using a sample of 17,544 firms from 28 countries we explore how creditors influence dividend payouts in various disclosure regimes. Poorly-protected creditors do not restrict the practice by firms in opaque regimes of using large dividend payouts to build reputation capital, and place few restrictions on dividend payouts in transparent regimes. In intermediate disclosure regimes creditors place large restrictions on dividend payouts. Dividend payouts are always largest in transparent regimes. Our findings say that the disclosure standards versions of the outcome and substitution agency models of dividends are not mutually-exclusive, and are as effective under weak as they are under strong creditor rights.

© 2017 Elsevier B.V. All rights reserved.

1. Introduction

Shleifer and Vishny (1997, pp. 737) define corporate governance as "the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment". Investors can attempt to safeguard their investment by monitoring the firms they invest in. However, effective monitoring is part influenced by the accounting standards which determine the amount and accuracy of corporate disclosures. Where corporations provide abundant, accurate and timely disclosures, agency costs of debt and equity are low (see Botosan, 1997; Sengupta, 1998). In contrast, where disclosure environments are opaque, agency costs arise between corporate insiders and outsiders (see Atanasov et al., 2007).

Creditors modify loan contracts to account for poor enforceability of contracts, weak creditor rights, and information asymmetry. Bae and Goyal (2009) show that banks reduce the loan amount, decrease loan maturity, and increase the cost of debt capital where loan contract violations are poorly enforced. In this paper we examine whether creditors take steps beyond modifying the loan contract and examine if and to what extent they shape corporate dividend payout policies in various disclosure regimes. Brockman and Unlu (2009) explore the relationship between dividend payout and creditor rights. Creditors permit large dividend payouts where their legal rights are strong, yet poorly-protected creditors restrict dividend payouts (the substitution hypothesis). Brockman and Unlu (2011) show that the dividend-disclosure relationship is neither positive (the agency "outcome" model says the dividend-disclosure relationship is positive) nor negative (the agency

* Corresponding author.
E-mail address: Thomas.g.oconnor@nuim.ie (T. O'Connor).

http://dx.doi.org/10.1016/j.intfin.2017.04.002
1042-4431/© 2017 Elsevier B.V. All rights reserved.

Please cite this article in press as: Byrne, J., O'Connor, T. How do creditors respond to disclosure quality? Evidence from corporate dividend payouts. J. Int. Financ. Markets Inst. Money (2017), http://dx.doi.org/10.1016/j.intfin.2017.04.002

"substitution" model says the dividend-disclosure is negative), but "u-shaped". In opaque regimes, growth firms substitute poor country-level disclosure standards with "reputation capital", which is achieved by establishing a history of paying large dividends over time to "convince shareholders that it will invest properly and for their benefit" (see Claessens and Yurtoglu, 2013, pp. 21; Gan et al., 2014). In transparent regimes where outsiders can better observe managerial actions and corporate profitability, dividend payouts are an outcome of strong disclosure standards. Where disclosure standards are neither strong nor weak, dividend payouts are much lower, a result which Brockman and Unlu (2011) do not try to explain.[1]

In this paper we seek to provide the answers to three questions which arise in light of the collective findings of Brockman and Unlu (2009, 2011). First, if growth firms in opaque disclosure regimes use large dividend payouts to build trust with outside investors; will they still be able to do so given weak creditor rights? In other words, does the disclosure standards version of the agency substitution model of dividends hold under weak creditor rights?[2] To the best of our knowledge, no study to-date has conclusively tested either version (legal rights or accounting standards) of the agency substitution models of dividends inclusive of the agency costs of debt. Studies which do find a negative dividend–shareholder rights relationship are very often single-country dividend-corporate governance studies (see Jiraporn and Ning, 2006; Chae et al., 2009). These studies make it impossible to test the creditor rights inclusive agency substitution model of dividends, as creditor rights are constant within countries.[3] In an international multi-country setting where creditor rights vary across countries, Brockman and Unlu (2011) present strong evidence in favour of the disclosure standards version of the substitution model, which makes tests of this model inclusive of the agency costs of debt possible.

Second, we examine if the disclosure standards version of the outcome model of dividends holds under weak creditor rights? Byrne and O'Connor (2012) and Shao et al. (2013) show that the shareholder rights version of the outcome model of dividends is most effective under strong shareholder and strong creditor rights; dividend payouts are reduced where shareholder rights are strong (the shareholder rights outcome model of dividends), yet creditor rights weak (the creditor rights substitution model of dividends). Tests of the disclosure standards version of the outcome model of dividends inclusive of the agency costs of debt have yet to be performed.

Finally, we test the dividend-creditor rights relationship in intermediate disclosure regimes to test whether the low dividend payouts which we observe in intermediate regimes are caused by the inclusion of firms from Canada and the U.S., where dividend payouts are low, but crucially, creditor rights weak.

We argue that the answer to the first question is not obvious since there are valid reasons why creditors may not restrict dividend payouts in opaque disclosure regimes. The bonding costs borne by reputation-building firms may be sufficiently large to offset the agency costs of debt associated with poor creditor rights and/or weak disclosure standards and build trust with creditors. Large stable dividend payouts paid over time can built trust with creditors and reduce the agency costs of debt if they; first, reduce the agency costs of free cash flow and the risk of overinvestment which can reduce creditors' claims on firm assets (see Jensen, 1986); second, the issue of new shares expose firms to the additional scrutiny of capital markets (see Easterbrook, 1984); and third, if reputation building increases the market value of the firm and in turn the market value of the firm's debt holdings (see Handjinicolaou and Kalay, 1984). Therefore in opaque regimes creditors may view large dividend payouts as beneficial to their own needs and may not restrict dividends payouts given weak creditor rights.

In relation to the second question, we hypothesize that poorly-protected creditors may not place large restrictions on dividend payouts in transparent regimes as they do in strong shareholder rights regimes. This is because they may view strong disclosure laws as a viable substitute for weak creditor rights. Strong shareholder rights likely benefit shareholders alone, yet strong disclosure laws reduce the agency costs of debt and equity.[4] Therefore, even given weak legal rights, creditors may not restrict dividend payouts to reduce agency costs of debt since abundant disclosures may already serve to do so. In this regard, strong disclosure laws may moderate the dividend–creditor rights relationship and reduce the need for creditors to use dividend payouts to substitute for weak creditor rights.

Finally, the agency models of dividends say that dividend payouts should either increase (the outcome model) or decrease (the substitution model) as disclosure quality improves, resulting in dividend payouts that are lowest in either weak (outcome model) or strong (substitution model) disclosure regimes, respectively. These models, which have yet to consider the strength of creditor rights, offer no reason for why dividend payouts are actually lowest in intermediate disclosure regimes. The asymmetric dividend payout models can offer no explanation either. The theoretical work of Miller and Rock (1985) and others say that dividend payouts have information content under the assumption of an information asymmetry between insiders and outsiders. These models predict that dividend payouts should be lowest in transparent regimes because the information content of dividend payouts is at its lowest here because of the abundant disclosures which enrich the information environment (see Howe and Lin, 1992; Li and Zhao, 2008). Therefore, neither the asymmetric or agency models of dividends can explain why dividend payouts are lowest in intermediate disclosure regimes. In this paper we consider an

[1] Studies prior to Brockman and Unlu (2011), and beginning with La Porta et al. (2000), test the outcome and substitution agency models of dividends by exploring the relationship between dividend payouts and the strength of shareholder rights (legal rights).

[2] The idea that firms can build capital market reputation using dividend payout is not new. Campbell and Turner (2011) find evidence to support the agency substitution model of dividends in Victorian Britain. Agarwal (2013) finds support in favour of the outcome model in early 1900s United States.

[3] Another problem with these single country studies is that their findings appear to be influenced by the corporate governance measured used. Jiraporn and Ning (2006) and Chae et al. (2009) find support in favour of the substitution model. Also using U.S. firms, but different corporate governance measures, Jiraporn et al. (2011) find support in favour of the outcome model of dividends.

[4] Klock et al. (2005) and Cremers et al. (2007) present for evidence from the U.S. which suggests that bondholders frown upon strong shareholder rights. Botosan (1997) and Sengupta (1998) show that the cost of debt and equity capital is inversely related to disclosure standards.

Please cite this article in press as: Byrne, J., O'Connor, T. How do creditors respond to disclosure quality? Evidence from corporate dividend payouts. J. Int. Financ. Markets Inst. Money (2017), http://dx.doi.org/10.1016/j.intfin.2017.04.002

Download English Version:

https://daneshyari.com/en/article/5100989

Download Persian Version:

https://daneshyari.com/article/5100989

Daneshyari.com