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Can we predict dividend cuts?

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HIGHLIGHTS

- I examine the predictability of dividend cuts using a large dataset of US firms from 1971 to 2014.
- The longer the time interval between dividend announcements, the larger the probability of a dividend cut.
- Early announcements increase the probability of an increase in the dividend per share.
- These results are consistent with the view that firms delay the release of bad news.

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ABSTRACT

I examine the predictability of dividend cuts based on the time interval between dividend announcement dates using a large dataset of US firms from 1971 to 2014. The longer the time interval between dividend announcements, the larger the probability of a cut in the dividend per share, consistent with the view that firms delay the release of bad news.

1. Introduction

Dividend policy is a key topic in the mainstream finance literature. A hitherto undisputed finding is that publicly listed firms tend to smooth dividends to avoid dividend cuts (Lintner, 1956).[1] Recent contributions investigate the determinants of dividend smoothing both in the US (Leary and Michaely, 2011) and globally (Javakhadze et al., 2014).

A possible reason for dividend smoothing is provided by signalling theory: dividend changes convey information to the market on the value of the firm.[2] Kalay and Loewenstein (1986) are the first to specifically study the timing of dividend announcements and its informational content. Damodaran (1989) investigates day-of-the-week effects in dividend announcement dates. Hull (2013), Hull (2015) studies the timing of dividend cuts in relation to the business cycle. Further research on this topic is, however, rather sparse.

In this paper, I investigate the timing preferences for dividend announcement dates using a large dataset of US firms from the CRSP database from 1971 to 2014. In particular, I address the following research question: Can the timing of dividend announcements predict cuts in dividend per share (DPS)?

The relationship between the timing of dividend announcements and dividend cuts has already been addressed by the literature: Kalay and Loewenstein (1986) show that dividend cuts occur more often when dividend announcements are "late". However, Kalay and Loewenstein (1986) focus on a very short time period (1978–1980), and base their analysis on a definition of "late" dividend announcement which is somewhat "arbitrary", that is, by

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[1] Michaely and Roberts (2006) provide evidence that for private firms dividend smoothing is less pronounced.

[2] Seminal studies from the end of the sixties until the mid-eighties examine the informational content of dividend changes by investigating the nexus between dividend changes and stock returns: dividend increases (decreases) tend to be associated with stock price movements in the same direction (Fama et al., 1969; Pettit, 1972, 1976; Charest, 1978; Aharony and Swary, 1980; Asquith and Mullins, 1983; Brickley, 1983).

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Table 1
Number of calendar days between dividend announcements and changes in dividends. The sample includes NYSE, NYSE MKT, and NASDAQ securities with share codes of 10 or 11 and distribution code 1232. I exclude utilities (SIC codes 4900-4949) and financial firms (SIC codes 6000-6999). "Days" is the number of trading days between two consecutive dividend announcement dates for a certain firm. "Dividend increase" and "Dividend decrease" are dummy variables equal to one if the dividend per share in a certain quarter for a certain firm is larger than, or smaller than, the dividend per share in the previous quarter, respectively. "Marg. effects" is the marginal effect for the variable "Days", where "Days" is set equal to its median. All variables are winsorized at the 1st and 99th percentile. Constant not reported but estimated for all regressions. Robust t-statistics clustered at the firm level in parentheses.

Panel A	1971–2014 Dividend increase	1971–2014 Dividend decrease	1971–2014 Dividend increase	1971–2014 Dividend decrease	1993–2014 Dividend increase	1993–2014 Dividend decrease	1993–2014 Dividend increase	1993–2014 Dividend decrease
Days	**0.001**	**0.005*****	**0.001**	**0.005*****	**0.000**	**0.004*****	**0.000**	**0.004*****
	(**0.950**)	(**8.588**)	(**0.989**)	(**8.534**)	(**0.138**)	(**3.752**)	(**0.163**)	(**3.704**)
Marg. effects	**0.0001**	**0.0003*****	**0.0001**	**0.0003*****	**0.0000**	**0.0002*****	**0.0000**	**0.0002*****
Firm age	−0.001**	0.003**	−0.002***	0.003**	−0.000	0.003	−0.001	0.003*
	(−2.217)	(1.996)	(−3.067)	(2.543)	(−0.312)	(1.544)	(−0.786)	(1.887)
Profitability	7.065***	−4.868***	6.854***	−4.558***	5.303***	−1.215	5.139***	−1.037
	(13.364)	(−5.555)	(13.079)	(−5.287)	(6.088)	(−0.864)	(5.946)	(−0.755)
Total assets (ln)	0.052***	−0.067***			0.072***	−0.061***		
	(7.396)	(−4.069)			(7.065)	(−2.711)		
Market cap (ln)			0.066***	−0.088***			0.088***	−0.082***
			(9.601)	(−5.425)			(8.633)	(−3.638)
Tangibility	−0.168***	0.278***	−0.190***	0.312***	−0.059	0.244*	−0.081	0.277*
	(−2.981)	(3.271)	(−3.373)	(3.620)	(−0.762)	(1.646)	(−1.042)	(1.849)
MA/BA	0.090***	0.060**	0.049***	0.120***	0.081***	0.011	0.033	0.060
	(5.924)	(2.165)	(3.110)	(4.437)	(3.423)	(0.278)	(1.363)	(1.574)
Earnings volatility	−5.850***	5.632***	−5.414***	5.172***	−3.176*	7.559***	−2.693*	7.026**
	(−6.219)	(3.662)	(−5.775)	(3.334)	(−1.935)	(2.761)	(−1.673)	(2.498)
SOA	−0.001	0.315	0.020	0.289	0.100	0.688	0.121	0.670
	(−0.010)	(1.232)	(0.196)	(1.100)	(0.557)	(1.407)	(0.682)	(1.325)
Beta					−0.103***	0.045	−0.109***	0.057
					(−3.245)	(0.856)	(−3.397)	(1.086)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firms	1577	1576	1577	1576	781	780	781	780
Observations	72,438	72,385	72,438	72,385	23,757	23,596	23,757	23,596

Panel B	Days	Firm age	Profitability	Total assets (ln)	Market cap (ln)	Tangibility	MA/BA	Earnings volatility	SOA	Beta
p25	84	10	0.0274	4.9292	4.5506	0.1905	0.9804	0.0041	0.0492	0.5335
Median	91	19	0.0403	6.2065	5.9971	0.3011	1.2466	0.0073	0.1097	0.8748
p75	98	33	0.0560	7.6054	7.4701	0.4578	1.7333	0.0130	0.1871	1.2584

* Denotes $p < 0.1$.
** Denotes $p < 0.05$.
*** Denotes $p < 0.01$.

means of "manual inspection of the pattern of past dividend announcement dates" (Kalay and Loewenstein, 1986, p.376). Moreover, while the literature has recently investigated the determinants of dividend smoothing both in the US (Leary and Michaely, 2011) and globally (Javakhadze et al., 2014), there is currently no empirical study that investigates predictability in dividend changes based on the timing of dividend announcements.

I provide evidence that extends the findings provided by Kalay and Loewenstein (1986). Kalay and Loewenstein (1986) find that "late" dividend announcements increase the probability of a dividend cut. This finding is ascribed to the fact that bad news (a dividend cut) tend to be delayed by firms. My findings corroborate Kalay and Loewenstein (1986): the number of calendar (or trading) days between two consecutive announcements is associated with an increase in the probability of a dividend cut. The probability of a dividend increase, on the other hand, is uncorrelated with the timing of the dividend announcement. I also provide some evidence that dividend increases are associated with "early" dividend announcements.

The rest of the paper is structured as follows. Section 2 describes the dataset and reports the main features of the sample. Section 3 investigates potential determinants of dividend changes, borrowing from the literature on the propensity to pay dividends and dividend smoothing. Finally, Section 4 concludes.

2. Sample selection and methodology

The dataset of quarterly dividend announcements dates in CRSP is available for the period starting from 1st January 1962. I consider firms whose primary exchange is the NYSE, AMEX (now NYSE MKT), or NASDAQ. Data is collected from the CRSP monthly file for share codes 10 or 11 related to ordinary dividends adjusted for splits and stock dividends (CRSP distribution code 1232). Therefore, I exclude ADRs, shares of Beneficial Interest, units or Limited Partnerships, foreign incorporated firms, closed-end funds, and REITs, consistent with recent literature (Knyazeva and Knyazeva, 2014). I also exclude financial firms (SIC 6000–6999) and regulated utilities (SIC codes 4900–4949), for comparability with previous literature on dividend policy (among others, Fama and French, 2001 and DeAngelo et al., 2006). Because I am interested in dividend announcement dates, rather than the propensity to pay dividends, all firms in the sample are dividend payers, although there may be periods for which dividend distributions are interrupted for a number of years.

My baseline regressions are based on Probit models:

$$D_{it} = \mathrm{f}(X_{it},\ C_{it}) \tag{1}$$

where D_{it} is a dummy variable equal to 1 if there is:

1. A DPS increase in quarter t relative to the previous quarter and 0 otherwise;
2. A DPS decrease in quarter t relative to the previous quarter and 0 otherwise.

I examine dividend increases and dividend decreases separately because "early" or "late" announcements are expected to increase the probability of a dividend cut, but not the probability of a dividend increase (Kalay and Loewenstein, 1986). I use the nominal