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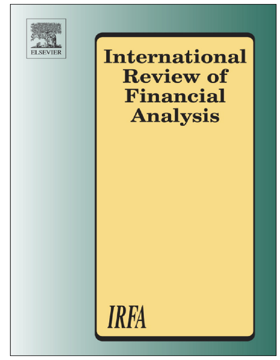

Why do CEOs agree to the discipline of dividends?

Deborah Drummond Smith, Anita K. Pennathur, Marek R. Marciniak

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Why Do CEOs Agree to the Discipline of Dividends?

Deborah Drummond Smith *
Assistant Professor
Department of Accounting
Cleveland State University
D.L.Smith11@csuohio.edu

Anita K. Pennathur
Professor
Department of Finance
Florida Atlantic University
Pennathu@fau.edu

Marek R. Marciniak
Assistant Professor
Department of Economics and Finance
West Chester University of Pennsylvania
MMarciniak@wcupa.edu

Abstract

This study investigates dividend initiation as the product of the imbalance of power between shareholders and management in U.S. firms from 2003 - 2012. We find that dividend initiation is associated with a stronger governance structure (strong shareholders' rights and board independence), in accordance with the outcome model. We do not identify a single motivation for dividend initiation. Dividend-initiating firms tend to rely on various forms of governance balanced by the interests and ownership of CEOs and directors. Firms with institutional owners are more likely to initiate dividends concurrent with the turnover of the CEO. Dual CEOs initiate dividends when they own more shares, and boards of directors initiate dividends with a higher personal ownership stake when shareholders' rights are weak. We also find that when initiation is due to stronger governance, it is significantly related to the firm's investment opportunities, while for weak governance firms, that relationship is not observed. We interpret this as evidence that, under weaker governance, the decision to initiate dividends is motivated by agency conflicts rather than investment or capital structure considerations.

Keywords: Dividend policy, corporate governance, dividend initiation, CEO power, agency theory, free cash flow hypothesis, outcome model, substitute model, dual CEOs, institutional ownership, board independence, shareholders' rights

JEL Classifications: G23, G32, G35, M12

*Corresponding author