Journal of Corporate Finance 31 (2015) 152–170

Contents lists available at ScienceDirect

Journal of Corporate Finance

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

Institutional shareholding and information content of dividend surprises: Re-examining the dynamics in dividend-reappearance era

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ARTICLE INFO

Article history:
Received 24 October 2013
Received in revised form 2 February 2015
Accepted 3 February 2015
Available online 11 February 2015

JEL classification:
G35
G23
G14

Keywords:
Dividend announcements
Information content
Institutional investors' investment horizon

ABSTRACT

We examine the role of institutional investors' investment horizon on the information content associated with dividend announcement surprises in the "dividend-reappearance era". We find that the presence of institutional investors negatively affects the announcement period cumulative abnormal return (CAR), which suggests that institutional investors reduce information content of dividend announcements. This result is primarily driven by the fact that institutional investors, especially the not-short-horizon investors, do not prefer dividend surprises – which leads to lower announcement period CAR. We do not find support for institutional investors' informed trading argument. Our study reveals that in order to understand the dynamics between institutional ownership and information content of dividend announcements, it is important to differentiate the institutional investors' investment horizons.

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1. Introduction

Institutional ownership has increased steadily in U.S. firms over the past three decades. Recently, institutional shareholders own more than 60% of the equity of U.S. firms, which was approximately 35% in the 1980s (Grinstein and Michaely, 2005; Schnatterly et al., 2008). Due to the increased presence of institutional shareholders, academicians and practitioners have paid considerable attention to how institutional investors affect corporate financial policies and firm value. For instance, in the context of payout literature, Grinstein and Michaely (2005) show that institutional shareholding is strongly associated with a firm's dividend policy. Amihud and Li (2006) further show that institutional ownership can explain the "disappearing dividend" phenomenon observed in the 1980–2000 period by linking institutional ownership to the declining information content of dividend payments. While subsequent studies confirm the importance of institutional shareholding in payout decisions (Crane et al. 2012), its relevance to information content of dividend announcements is apparently linked to the dividend-disappearance phenomenon (Amihud and Li, 2006).

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http://dx.doi.org/10.1016/j.jcorpfin.2015.02.002
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In an influential study, Fama and French (2001) document that the proportion of firms that pay cash dividends fell significantly during the 1980s and 1990s. However, DeAngelo et al. (2004) show that while the number of dividend paying firms has fallen, the total amount of cash dividends by U.S. industrial firms has increased over time. Other studies have acknowledged the dividend-disappearance phenomenon, yet they report a reappearance of dividends since 2002 (Andres et al., 2009; Chetty and Saez, 2005; Floyd et al. 2013; Julio and Ikenberry, 2004). In this study, we examine the role of institutional ownership in explaining the information content of dividend announcements during the dividend-reappearance era (i.e. in the post-2002 period). Specifically, we focus on the following research questions in the context of dividend reappearance: Is there a significant level of information content in dividend announcements? Does institutional ownership explain the level of information content (proxied by cumulative abnormal return [CAR]) associated with the dividend announcements? What aspects of institutional ownership explain the negative relationship between institutional ownership and announcement-period CARs, if any? We examine these issues using a sample of dividend-paying NYSE firms over the period 2002–2012.[4]

The dividend literature has put forward a number of explanations in the context of institutional ownership and the information content of dividend announcements – which drive our empirical set-up. We organize these explanations under three arguments, which we discuss in detail in the next section. The "Dividend relevance argument," which is based on signaling (Bhattacharya, 1979; Kalay, 1980; Ross, 1977), suggests that dividends are relevant for investors, and firms can convey important signals to the market through their dividend policy. The "Informational advantage and informed-trading argument" suggests that institutional investors – especially the short-investment horizon ones – have access to superior private information. They trade on this information prior to actual dividend announcements, which reduces the information content of dividend announcements (Amihud and Li, 2006). The "Dividend preference argument" suggests that among dividend-paying firms, dividend payments do not affect institutional clientele (Andres et al., 2013; Grinstein and Michaely, 2005) and institutional investors are less likely to prefer dividend surprises. We use these arguments to explain our empirical results.

At the outset, we would like to point out that the nature of dividend announcements and the perceptions of dividend surprise and heterogeneity among institutional investors pose some challenges in pursuing relevant empirical analyses. In this study, we address all these empirical challenges. In short, (i) we control for concurrent earnings announcements, because in approximately 90% of the cases, dividend announcements are made concurrently or within two days of the earnings announcements, (ii) we use analysts' forecast consensus as a benchmark to calculate dividend surprise (Andres et al. 2013), and (iii) we segregate the investment horizon of institutional investors (Gaspar et al. 2005; Yan and Zhang, 2009).

Our multivariate results show that dividend surprise does not explain CAR, whereas earnings surprise shows a significant and positive effect. Our results imply that – consistent with the findings during the dividend-disappearance period – dividend change announcements do not show any significant information content in the dividend-reappearance period. Further, consistent with Amihud and Li (2006), we find that institutional shareholding has a negative and significant effect on dividend announcement period CAR. The results may indicate that the presence of institutional investors reduces the information content of dividend announcements.

Subsequently, we examine the plausible explanations for the negative relationship between institutional shareholding and announcement period CAR by examining institutional investors' informed-trading activities and dividend preferences. Our results show that long-horizon institutional shareholders do not prefer dividend surprises. We further find that within dividend paying firms, higher dividends do not attract institutional clientele. These results present some plausible explanation as to why the institutional investors are less enthusiastic about surprise dividend announcements, which in turn lead to lower CAR around the announcement dates. Unlike Amihud and Li's (2006) prediction, we do not find any evidence that the presence of institutional shareholding leads to an increased level of informed trading in the pre-announcement period.

Overall, our results show no definitive indication that the dividend announcement is informative in the post-2002 dividend-reappearance period. Therefore, we do not find support for the "Dividend relevance argument". Also, our results do not support the view that short-horizon institutional investors, who are considered better informed (Yan and Zhang, 2009), drive up the informed trading level prior to the dividend announcements. In other words, the "Informational advantage and information content argument" fails to explain the negative relationship between institutional ownership and announcement period CAR. Our results show support for the "Dividend preference argument", which posits that institutional investors do not prefer dividend surprises and higher dividends do not attract institutional clientele.

Our study contributes to the dividend policy literature in the following ways. First, by examining the information content of dividend announcement in the dividend-reappearance era, this study contributes to the literature on dividend disappearance and reappearance debate (e.g., Amihud and Li, 2006; Booth et al., 2013; DeAngelo, DeAngelo, and Skinner, 2004; DeAngelo et al. 2006; Denis and Osobov, 2008; Fama and French, 2001; Ferris et al. 2009; Hoberg and Prabhala, 2009; von Eije and Megginson, 2008). Second, we contribute to the debate on whether short- and long-term institutional ownership has an informational advantage. The empirical evidence is inconclusive on whether short- and long-term institutional ownership has an informational advantage. Several studies claim that short-term institutional investors are better informed (Grinblatt and Titman, 1989; Wermers, 2000; Yan and Zhang, 2009) and investors with informational advantage trade early on negative or positive news (Hotchkiss and Strickland, 2003; Ke and Petroni, 2004; Ke, Petroni, and Yu, 2008). But Chen, Harford, and Li (2007) argue that long-term institutional investors, who specialize in monitoring and influencing firms' policies, have better information and ability to gather and process information more efficiently. Moreover, a growing stream of studies show that ownership and trading by short-term investors are associated with mispricing, overconfidence, amplification of market-wide crisis, stock returns anomalies, higher idiosyncratic volatility, and myopic investment

[4] We start the sample period from 2002, as recent literature shows that dividend-reappearance phenomenon started around 2002 (Andres et al., 2009; Chetty and Saez, 2005; Julio and Ikenberry, 2004). We document similar results in Fig. 1 for industrial firms up to 2012.

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