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Flexible firm-level dividends in Latin America

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ABSTRACT

We show, for a sample of up to 757 industrial firms, in seven Latin American countries from 1994–2014, that these firms exhibit comparatively flexible payout behavior. Flexibility is defined in respect to (i) variability in firm payout status and amounts and (ii) parameters of the Lambrecht-Myers (2012) theory on the Lintner (1956) dividend equation. The results indicate that Latin American firms have higher speeds of adjustment and target payout ratios as well as lower rates of habit formation than found in the payout policies of United States firms. This note, thus, highlights an open question regarding conspicuously flexible payout policies in Latin American firms.

1. Introduction

Cash dividends represent *circa* 34% of earnings globally (Faccio et al., 2001) and recent studies have shown a substantial variation of dividend ratios internationally, both among developed (Denis and Osobov, 2008) and emerging markets (Goyal and Muckley, 2013; Mitton, 2004). There is, nevertheless, a relative dearth of research concerning payout policies in emerging markets such as those in Latin America.[1] An exception is that of Benavides et al. (2016), who show that Latin American firms' smooth dividends more in relatively well governed countries in the region, and that these firms show evidence of adhering to the pecking order and trade-off theories. Also, Boulton et al. (2012) indicate a catering explanation for Brazilian firm preferences to pay cash dividends rather than interest on equity, despite tax incentives to the contrary. In this paper, we establish the comparative flexibility of payout policies in Latin America, and in so doing highlight an intriguing open question in the dividend policy literature.

We report, year-by-year, from 1994 to 2014, the proportion of firms in Latin America which initiate (omit), markedly increase (decrease) their cash dividend payouts as well as the proportion of payers which pay in consecutive years or exhibits a stable dividend policy. The results suggest that Latin American firms show marked flexibility in their dividend policies. For instance, 8% of Latin American firms omit dividend payments each year on average. In contrast, in the United States only

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[1] Some studies, however, do include Latin American countries, but do not exclusively focus on them. LaPorta et al. (2000) examine agency "outcome" and "substitution" models of cash dividends in Argentina and Mexico in 1994. Chay and Suh (2009) consider the cross-sectional determination of payout policies, in particular the importance of cash flow uncertainty, with regard to small samples of firms in Argentina, Brazil and Chile.

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about 1% of firms omit each year (Skinner, 2008), while in international data Twu (2010) reports a figure of approximately 4.5%. Moreover, more than 26% of Latin American firms increase their dividends by at least 30% each year while nearly 20% reduce dividends by this amount. These are far larger figures than reported, for instance in, Denis and Osobov (2008) and Skinner (2008) who show remarkable stability in dividend payments internationally.

We also investigate the question of cash dividend flexibility using the Lambrecht-Myers (2012) theory in relation to the well-known Lintner model (1956). We use Arellano-Bover (1995) and Blundell-Bond (1998) dynamic panel regressions to show that the speed of adjustment and target payout ratios are substantively higher in Latin American firms than in firms based in the United States. Moreover, rates of habit formation are shown to be much lower in Latin America. This distinction can arise due to the relative financial immaturity of Latin American firms, and, thus, the importance of signaling (La porta et al. 2000) as opposed to agency costs (Lambrecht and Myers, 2012) in determining their payout policies. Although, we do not test this latter conjecture. Taking these findings together, we report compelling evidence that Latin American firms show remarkable (and unexplained) flexibility in their dividend policies.

The remainder of the paper is organized as follows. In Section 2, we describe the measurement of the broad concept of corporate payout flexibility. In Section 3, we report our sample and variables. In Section 4, we present the empirical findings. Section 5 concludes.

2. Payout policy flexibility and hypotheses development

To quantify the concept of payout flexibility we, initially, study the proportion of firms in Latin America which initiate (omit), markedly increase (decrease) their cash dividend payouts as well as the proportion of payers which pay in consecutive years and the proportion with a stable dividend policy.

Then, we turn to the Lintner equation (1956)

$$DIV_t = \alpha_0 + \alpha_1.NI_t + \alpha_2.DIV_{t-1} + \varepsilon_t \quad (1)$$

where DIV_t is the level of cash dividends at time t, NI_t is the net income at time t, and ε_t is the error term. Due to the lagged dividend variable, we avoid a Nickell (1981) bias, and estimate the coefficients with Arellano-Bover (1995) Blundell-Bond (1998) dynamic panel specification. α_1 is the sensitivity to earnings and $(1-\alpha_2)$ is the speed of adjustment (SOA). The target payout ratio (TPOR) is $\alpha_2/(1-\alpha_1)$.

Lambrecht and Myers (2012) show that α_2 depends on β (the market discount factor$=1/(1+r)$, where r is the risk free rate) and on habit formation, h, by the managers: $\alpha_2 = \beta * h$. Thus, habit formation is defined

$$h = (1+r) * \alpha_2 \quad (2)$$

Lambrecht and Myers (2012, Eq. 47) elaborate to show that habit formation can also be calculated, if managers have a negative exponential utility function, as γ_1 in this first differences in dividends equation:

$$\Delta DIV_t = \gamma_0 + \gamma_1.\Delta DIV_{t-1} + \varphi_t \quad (3)$$

The combination of the Lintner Eq. (1) and the habit formation Eqs. (2) and (3) facilitates our formal analyses of the distinctiveness of Latin American firms' dividend payout policies. A higher flexibility in Latin American payout policies is consistent with relatively fast SOAs and low habit formations. Finally, relatively high TPORs in Latin America may indicate the importance of cash dividend signaling in the region.

3. Data and variable construction

We test our flexibility related hypotheses with firm-specific data on 757 listed firms (up to 7876 firm-years) on exchanges (and headquartered) in seven Latin American countries (1994–2014).[2] Specifically, the annual firm-specific Latin American data is sourced in Worldscope on the following countries *viz.* Argentina (Buenos Aires SE – 72 firms), Brazil (BM&F Bovespa – 257 firms), Chile (Santiago SE – 142 firms), Colombia (Bolsa de Valores de Colombia – 41 firms), Mexico (Bolsa Mexicana de Valores – 121 firms), Peru (Bolsa de Valores de Lima – 103 firms), Venezuela (Bolsa de Valores de Caracas – 21 firms)), and the USA (NYSE and NASDAQ, 3190 firms). The Latin America exchanges are selected as they have a minimum market capitalization of US$ 25 Billion for each sample year studied (World Federation of Exchanges).

In line with the corporate payout determination literature (*e.g.* Fama and French, 2001; Denis and Osobov, 2008; Skinner 2008), our sample excludes foreign firms, ADRs, firms with negative dividends or market-to-book ratios, and firms which operate in the financial services (SIC codes 6000–6999) and utilities (SIC codes 4900–4949) sectors. We search the Worldscope database for active as well as dead and suspended listings in order to avoid survivor bias, and select companies with usable ISIN and SIC industry codes. We eliminate companies with similar ISIN codes and similar names, and companies that give error codes in downloading data. Finally, we adopt the country specific CPIs to convert the nominal firm specific accounting and financial data into real 1994 prices and then convert it to a common U.S. dollar numeraire using the year-end country-specific exchange rate. Winsorization is undertaken at the upper and lower 1% level.

[2] The sample commences in 1994 as there is limited coverage of firms headquartered outside the U.S. prior to this date (Denis and Osobov, 2008) as well as limited capital market liberalization before 1990 (Bekaert and Harvey, 1995).