Is National Culture a Missing Piece of the Dividend Puzzle?

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Summary of: Is National Culture a Missing Piece of the Dividend Puzzle?

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INTRODUCTION

In this paper, we investigate the link between national culture and corporate dividend behavior, which is one of the most debated and unsolved topics in modern corporate finance (Brealey and Myers, 2003). Dividend policy was first theorized to be irrelevant to investors (Miller and Modigliani, 1961). Given established investment decisions, a corporation can either employ internally accumulated funds or distribute them as dividends to investors and pursue external financing alternatives (debt or new equity issuance). Neither will affect shareholders value creation because dividends income received by shareholders is offset by a simultaneous loss in share value in a ‘perfect capital market’ context. However, this dividend irrelevance theory is inconsistent with the observations that firms tend to adopt extremely deliberate dividend payout strategies (Lintner, 1956). Extensive prior theoretical and empirical research have provided several explanations of this dividend policy puzzle mainly rooted in the agency, asymmetric information, and ‘bird in hand’ theories. Despite the substantial research and debate surrounding the dividend policy issue, it is still far from being solved even in the context of the U.S. where dividends are taxed at a higher rate than capital gains prior to 2003. Moreover, the dividend puzzle has been recently shown to prevail internationally even after tax and legal systems are taken into consideration (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 2000; Faccio, Lang and Young, 2001).

Substantial international business research has incorporated national culture to explain cross-country differences in various business practices, including management practices (Newman and Nollen, 1996), managerial attitudes (Kelley, Arthur and Reginald, 1987), organizational design (Harrison et al., 1994), compensation practices (Schuler and Rogovsky, 1998), foreign market entry modes (Kogut and Singh, 1988), the choice of financial systems (Kwok and Tadesse, 2006), investors’ stock trading decisions (Grinblatt and Keloharju, 2001), firm’s capital structures (Chui, Lloyd, and Kwok, 2002), life insurance consumption (Chui and Kwok, 2008) and so forth.

In the spirit of this line of research, our study relies on culturally-based arguments to explain firms’ motivations for paying dividends. More specifically, we discuss and present testable hypotheses on how
national culture, which we capture with Schwartz’s (1994) cultural dimensions—namely conservatism and mastery—relate to traditional finance theories of dividend policy and explain the differences in corporate dividend policies around the world. Using a large sample of more than 2,639 firms from 22 countries, we find that firms in high Conservatism (Mastery) countries have higher (lower) dividend payouts. These effects are robust to controlling other determinants of dividend policy, including the quality of legal protection on investors and dividend’s tax advantage over capital gains, and to specifying alternative culture proxies and time periods. Collectively, we interpret our findings as implying that traditional dividend theories are valid in an international context because they serve as linkages through which national culture works on international variability in dividend policies, and that national culture have a say in people’s attitudes towards such issues as agency and signal usage.

The following sections outline the theoretical motivations for linking national culture to corporate dividend policies and state our hypotheses, present the empirical design, and summarize our main results.

**MOTIVATIONS AND TESTABLE HYPOTHESES**

How can culture affect firm dividend policy? Is it possible that investors of a particular national culture would prefer cash dividends more than investors of another culture? Cash should be of the same value in eyes of every culture, unless dividend by itself carries functions which are more important to some cultures than to others. In other words, the reason for a particular culture to be associated with more dividend payouts might be that this culture puts more emphasis on the functions carried by dividend policy. The major theories that are traditionally invoked to explain corporate dividend policy are agency theory, signaling effect theory, ‘bird in hand’ theory, and pecking order theory. According to the agency theory, dividends allow shareholders to extract cash out of the firm and therefore limit potential expropriation by insiders. The signaling theory of dividends states that managers, who are more
informed than investors about the firm’s future prospects, tend to pay high dividends in high quality firms with this policy being difficult to maintain in low quality firms. ‘Bird in hand’ theory assumes that investors prefer dividend-paying firms given that dividends are more secure than uncertain future capital gains. Pecking order theory identifies firm internal cash as the most efficient and economical funding for investment as opposed to outside alternatives.

Following Chui, Lloyd, and Kwok (2002), we use Schwartz’s (1994) condensed national culture dimensions, *Conservatism* and *Mastery*, as cultural dimensions of interest. Values within *Conservatism* include emphases on self-discipline, security and public image, which are closely related to agency, ‘bird in hand’ and signaling effect theories about dividend policy respectively. From an agency perspective, managers in a conservative society are self-disciplined and have less incentive to keep cash with them for personal goals. Therefore, conservative managers are more likely to adopt a high dividend policy. From a signaling effect perspective, because high dividend is considered as a good signal about a firm’s future prospects by outside investors, firms located in countries with high conservatism will pay high dividends to establish a good public image. From a ‘bird in hand’ perspective, conservative shareholders may prefer keeping earnings in their own hands to investing in risky projects.

**Hypothesis 1: Companies in Conservative countries tend to have higher dividend payouts.**

Values in *Mastery* emphasize independence and success. From an agency perspective, ‘mastery’ shareholders have more respect for management’s independence in operation as part of job satisfaction and ‘voluntarily’, and therefore tend to leave more cash in managers’ hands. Besides, both independence-pursuing shareholders and managers in a high mastery context like to keep more cash for financial flexibility and independent investment decisions. Success-
pursuing shareholders and managers also have more eagerness to capture possible profitable projects in the future. According to pecking order theory, internal funds are most efficient for financing investment and make investment success more likely. ‘Mastery’ shareholders and managers thus tend to keep more cash within firm, which translates into our second prediction:

*Hypothesis 2: Companies in Mastery countries tend to have lower dividend payouts.*

**EMPIRICAL DESIGN AND RESULTS**

Our sample results from the merge of two data sets: Schwartz’s (1994) culture values data covering 22 countries and Worldscope, which we use to collect firm-level financial information, including dividends. For the main tests, we focus on the period 1994-1996 and end up with a sample of 2639 firms from 22 countries, which does not include unprofitable and financial firms. We evaluate the effects of Schwartz’s Conservatism and Mastery values on dividend payouts by estimating several specifications of the following regression model at both the firm- and country-levels (subscripts suppressed for notational convenience):

\[
DIVIDEND = \alpha_0 + \alpha_1 CONSERVATISM + \alpha_2 MASTERY + \alpha_3 CONTROLS + \varepsilon
\]

We follow previous studies and use dividend/cash flow ratio, dividend/sales ratio and dividend/book value assets ratio to measure dividend policies, where both common and preferred cash dividends are included. Variables which have been identified to explain dividend payouts are also controlled for: Anti-director right (La Porta et al., 1998), Dividend’s Tax Advantage over Capital Gains (La Porta et al., 2000) and Legal Reserve (La Porta et al., 1998) serve as country-level institutional control variables; Debt Ratio, Profitability, Growth Prospect, Firm Size and Ownership Concentration enter as firm-level control variables. Based on firm- and country-level regressions that control for other potential determinants, we find that
**CONSERVATISM (MASTERY)** consistently has significantly positive (negative) effects on dividends payouts. These findings suggest firms in countries with high conservatism or low mastery scores adopt higher dividend payout policies. In additional tests, we show that our results are robust to alternative time period (2002-2004) and alternative proxies for conservatism and mastery. Collectively, we interpret our findings as implying that national culture matters to dividend polices.

**DISCUSSIONS**

The findings of this study not only improve our understanding of cross-country differences in corporate dividend policies, but also bring forth suggestive insights into the interplay between culture and people’s perceptions towards agency, signal usage and security. As hypothesized, our findings imply that culture may influence corporate dividend policies through agency and signaling considerations. Related cross-country studies mainly adopt an agency perspective to explain dividend policies (e.g., La Porta et al., 2000; Faccio et al., 2001). Therefore, we tentatively pay more attention to the effects of culture on investors’ attitudes towards agency problems. Our findings suggest that Conservative (Mastery) investors and management attribute more (less) importance to agency problems. In contrast to these previous studies emphasizing how objective factors affect the severity of agency problems within firms, this study helps to enrich the literature by showing the other side of the story: how culture affects subjective perceptions of agency conflicts within firms. Our research has several implications to domestic firms and policy makers who stay in a single-culture context and also to MNCs who operate cross-culturally.
REFERENCES


