

**Gordon Institute  
of Business Science**  
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Drivers that shape corporate payout policy in South Africa

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## ABSTRACT

This study sought to explore and develop a better understanding of the factors that drove corporate payout policy decisions in South Africa. Recent trends the world over indicate a growing trend of stock repurchases, largely at the expense of dividends, as the preferred payout method firms use to return excess cash.

The study was inspired by the research work done by Brav et al., (2005) in the United States of America (US). The study was conducted using fifty survey responses from a sample size of 175 companies listed on the Johannesburg Stock Exchange.

The results reported evidence that financial flexibility, catering theory of dividends and price support positively affected a company's payout policy choice. The results were mixed on the signalling theory as an important factor which confirmed the ambiguity of signalling theory. The South African results mirror those of the US results, and the study contributed to growing literature on factors that influence corporate payout policy decisions.

## KEYWORDS

Payout policy, dividends, share repurchases, financial flexibility, signalling theory

## DECLARATION

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Bekithemba Sibanda

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Date



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## CHAPTER 1. INTRODUCTION

Corporate payout policy dynamics have stimulated a new dimension of research interest post the global financial crisis period. More importantly, it has emerged that more companies/managers now favour paying out more residual cash flow through share repurchases (Bonaimé, Hankins, & Jordan, 2016; Brav, Graham, Harvey, & Michaely, 2005; Renneboog & Trojanowski, 2011). The association between dividends and earnings has weakened as the growth in the dividend payout has been subdued. This shift in balance has dominated the mainstream of finance and economics research (Andres, Doumet, Fernau, & Theissen, 2015; Bhargava, 2010; Bildik, Fatemi, & Fooladi, 2015; Bonaimé et al., 2016; Floyd, Li, & Skinner, 2015). Research has documented that there are three primary forms of corporate payout, namely, the dividend payout, the share repurchases, and the special dividends.

The emergence of buybacks as an economically significant phenomenon has generated vigorous debate in the finance literature (Jain, Shekhar, & Torbey, 2009). Literature has documented corporate payout policy in the developed markets, but there has been relatively limited research investigating the payout policies in emerging markets and South Africa in particular. Accordingly, countless empirical studies have been conducted globally to look at the financial flexibility advantage and the dividend substitution hypothesis.

In economic practice, companies are valued based on potential earnings from their operating assets, that is, fixed assets and net working capital. Companies with vast sums of cash and other non-operating assets are usually referred to as having lazy balance sheets or being unproductive. A company can choose to return capital to shareholders as dividends or buy back part of issued shares. Alternatively, firms can use the cash to fund growth (Andres et al., 2015; Fama & French, 2005; Lintner, 1956).

Recent trends the world over reflect a growing trend of stock repurchases as the leading payout method offering a more flexible way of returning excess cash to



shareholders(Bonaimé et al., 2016). The purpose of this research is to explore the factors that drive dividend and share repurchase decisions in South Africa. The paper will seek to determine from a management perspective the motivation behind this growing trend. As part of the investigation, the research will examine the level of earnings dedicated to stock buybacks, dividends and special dividends in South Africa.

The rest of this research paper is organised as follows. In section 2 insight is drawn from global evidence by analysing the environment for share repurchases in Europe and the United States of America (US). Section 3 discusses the literature review with a particular focus on the growth of share repurchases relative to paying dividends. Section 4 briefly describes the proposed research methodology.

## 1.1 THE BURNING ISSUE

Brav, Graham, Harvey, and Michaely (2005) surveyed financial executives to determine the factors that drive dividend and share repurchase decisions in the United States of America (U.S.). Their findings indicate that regarding priority maintaining the dividend level is at par with investment decisions, whereas share buybacks largely came from the excess cash after investment spending consideration.

Similar to Lintner, (1956), Brav et al., (2005) found supporting evidence that the stability of future earnings still affects dividend policy. They noted that the link between dividends and earnings has weakened as most managers preferred repurchases than dividends. Subsequent studies (Bonaimé et al., 2016) have attributed the weakening link to the flexibility advantage of share repurchases.

In the German market, Andres, Doumet, Fernau, and Theissen (2015) analysed the choice of payout policy of firms and documented that flexible payout methods were used to disburse transitory earnings. In a bid to avoid large shocks to payout policy firms prefer to use excess cash to buy back issued shares(Renneboog & Trojanowski,

2011). A higher dividend payout may have unintended repercussions in future if the company fails to maintain higher expectations.

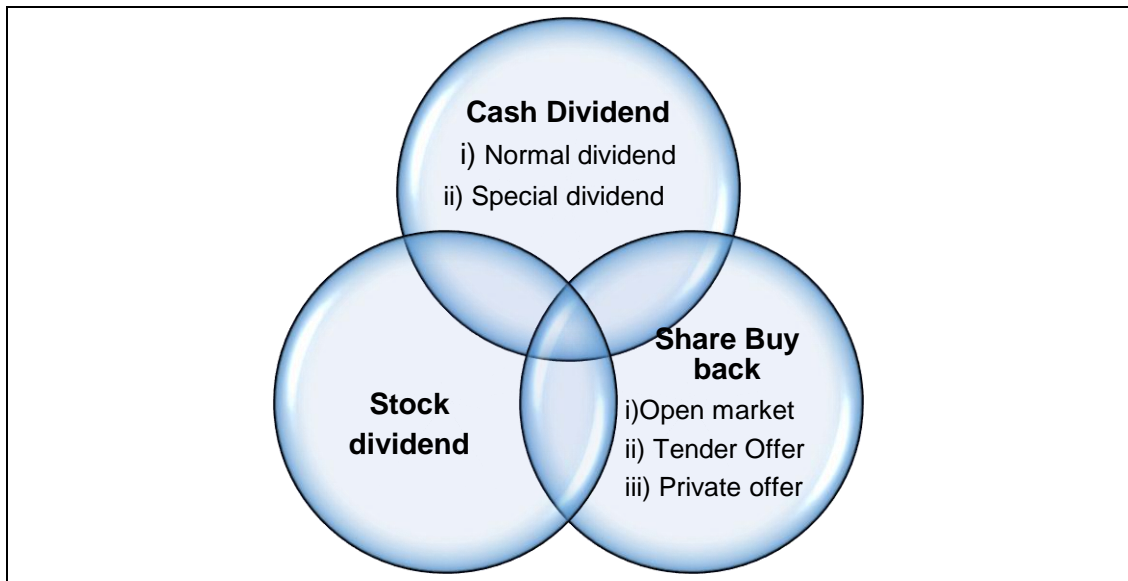
From the survey results, Brav et al. (2005) noted that the executives believe that investors are indifferent between dividends and repurchases. This then increases the likelihood of the agency problem as conflicted executives incentivised through stock options may end up using cash flow surplus to carry out buybacks (Geiler & Renneboog, 2015). Shareholders may also be concerned that not much was spent on growth and development. To identify probable dangers and abuses of policies due to the nature of agency arrangement within companies and how that impacts on the company and the shareholders.

The aim of the study is to provide insight into corporate payout policy decisions. The research will critically evaluate the factors that drive payout policy decisions for companies listed on the Johannesburg Stock Exchange. The research will also look at whether companies are prioritising dividends or share buybacks.

## 1.2 THEORETICAL FRAMEWORK

Figure 1 below illustrates the most common and preferred methods of returning capital to the shareholders. Historically dividends have been the preferred payout choice, but recent research shows a growing trend of companies using share buybacks and stock dividends as an alternative payment method (Andres et al., 2015; Floyd et al., 2015; Hoberg, Phillips, & Prabhala, 2014; Liu & Swanson, 2016).

**Figure 1: Earnings distribution channels**



Source: Author's own

### 1.3 EMPIRICAL EVIDENCE

Rather than investing retained profits in growth prospects, companies are resorting to stock buybacks. Lazonick, (2014) noted that 449 firms that were listed on the S&P 500 from 2003 through 2012 used 54% of the earnings (\$2.4 trillion) to buy back own stock. Dividends absorbed an extra 37% (\$1.6trillion) of the earnings which left 9% (\$0.4 trillion) to fund productive capabilities.

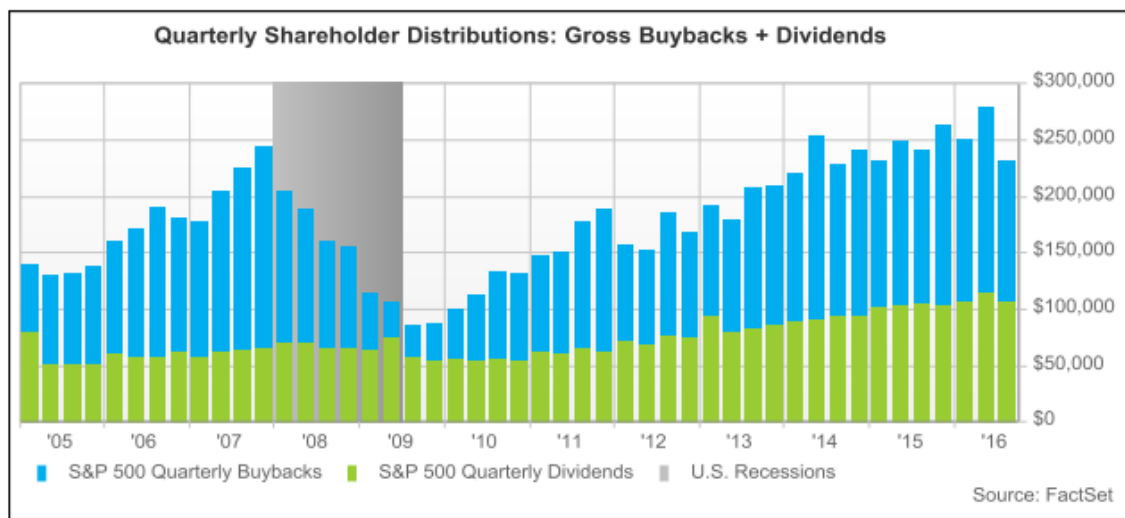
In South Africa, the level of share repurchases has not been quantified, but listed companies have been repurchasing shares in the open market. It will be of interest to see how the local stock market compares relative to the rest of the world. Thus the evidence is inconclusive on whether that phenomenon has filtered down to the South African market.

Figure 2 below shows quarterly shareholder distributions split between dividends and share buybacks in the U.S.(Birstingi, 2016). Post the financial crisis in 2009 it is evident that there has been a significant increase in share buybacks whereas dividends

have grown at a stable rate. It is evident from the graph that US companies are spending more money buying back shares than on paying out dividends.

Besides a few quarters, growth in dividends has rather been smooth whereas buybacks have grown in stature. In 2009 buybacks were tiny fractions of less than 30% of quarterly shareholder's distributions as dividends dominated. The trend has completely changed in 2016 with dividends now attributing less than 40% of distributions.

**Figure 2: Shareholder distributions**

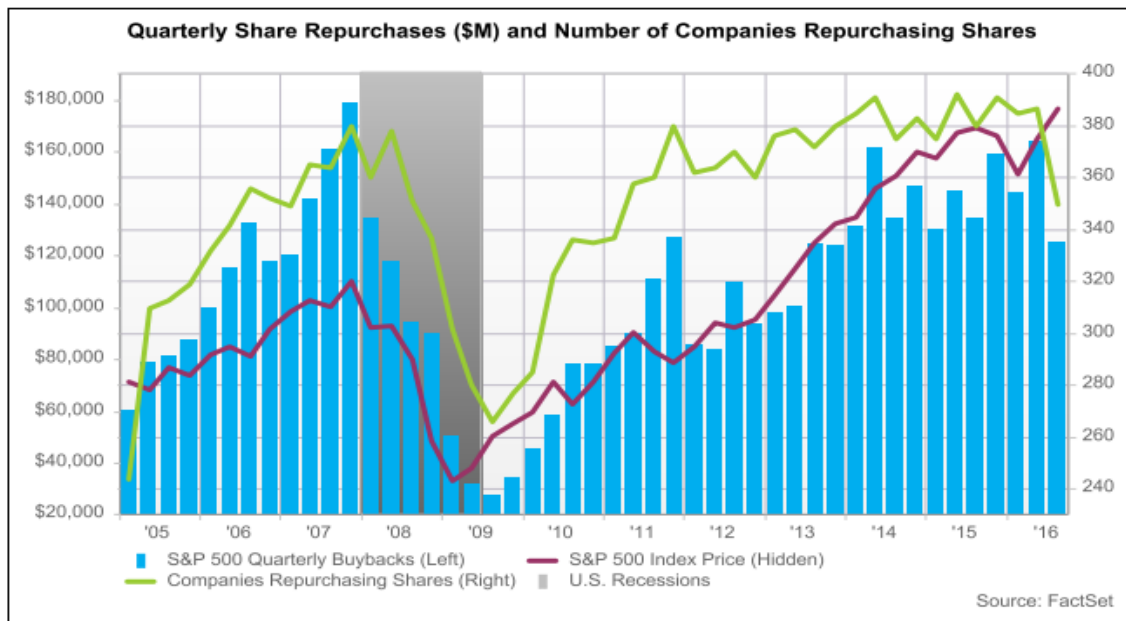


Source: Birstingi (2016)

Figure 2 above is consistent with the substitution hypothesis noted by Grullon and Michaely, (2002). Firstly, even though firms are not cutting dividends, the growth rate remains significantly lower. Secondly, firms have exhibited a higher propensity to pay out cash through repurchases. An inference can be made that repurchases have been financed from funds that could have potentially increased dividend payout.

Figure 3 (Birstingi, 2016) below shows that the number of companies repurchasing shares has grown by approximately 41% post-financial crisis to 380 companies in January 2016. In monetary terms, shares repurchased have increased by about 360% to \$136 billion per quarter.

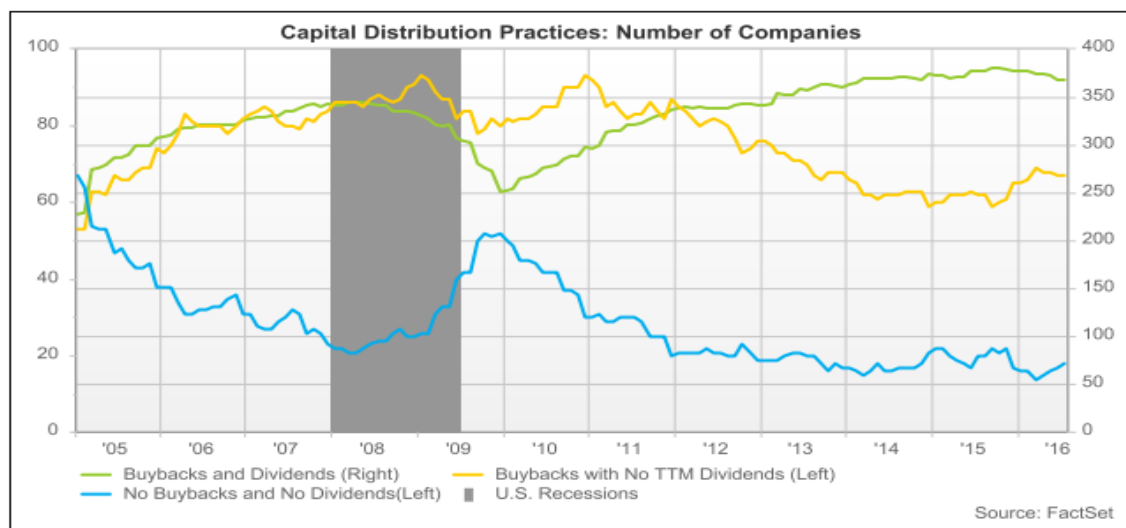
**Figure 3: Share repurchases and the companies buying back shares.**



Source: Birstingi (2016)

Figure 4 below shows that the majority of companies on the S&P 500 Index in the US actively pursue both dividend payout and share buybacks. On the other hand, the number of companies neither paying a dividend nor repurchasing shares is at ten-year historical low.

**Figure 4: Capital distribution practices in the US**



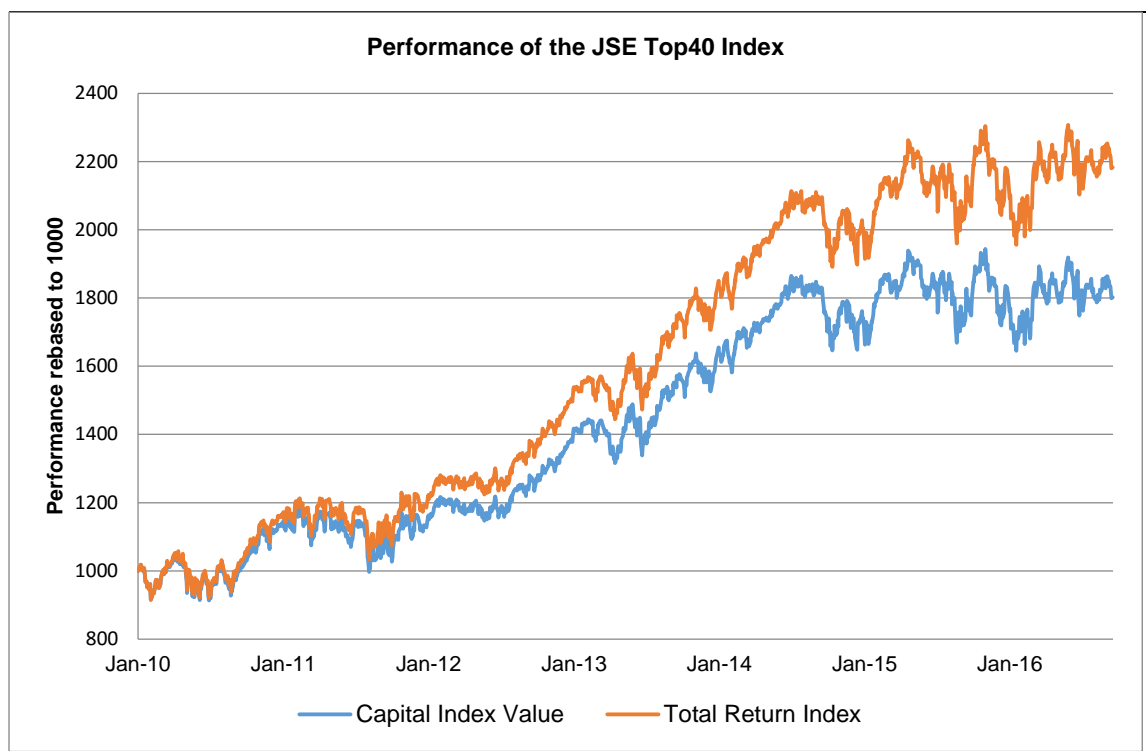
Source: Birstingi (2016)

Overall, Figure 4 highlights an increasing trend of buybacks and dividend paying stocks and a downtrend in the number of companies carrying out buybacks only.

## 1.4 INVESTMENT RETURNS ON THE JSE

Figure 5 below indicates that one thousand Rands invested in January 2010 on the capital index would have returned 83.2% by the end of August 2016. On the other hand, if dividends were re-invested into the top 40 index when they were paid out, the return would have been 121.4%. This illustrates the compounding influence and significance of dividends for an investor. Another notable highlight is the potential value some investors may place on dividends and dividend paying stocks.

**Figure 5: Investing on the JSE**



Source: Data sourced from the JSE (2016)

## 1.5 SUMMARY

This chapter briefly outlined the research problem and the need for the study. It also highlighted the increasing prevalence of buybacks. While the impact of buybacks on investors is yet to be quantified, the growth has seen the emergence of by-product instruments such as buyback indices and buyback exchange traded funds. The next section reviews the literature on payout policy choices with a particular focus on dividends and stock repurchases.

## CHAPTER 2. LITERATURE REVIEW

This chapter builds on the impetus from the preceding section. A synthesis and analysis of current knowledge, substantive findings and theoretical contribution to the corporate payout policy topic will be provided. The focus on literature review has been split into several sections.

Firstly, the economic and theoretical background on corporate payout policy is discussed with particular emphasis on dividends and share repurchases. The report then critically reviews global academic literature that deliberates on corporate payout policy dynamics. The following section then narrows down the academic literature to the South African context. The final section concludes with the key elements and themes pertinent to this study.

### 2.1 THEORETICAL BACKGROUND OF THE PAYOUT POLICY

Literature has put forward various arguments to explain the notable increase in share buybacks. The majority of arguments were developed and clustered around Signalling Theory, Price Support Hypothesis, Financial Flexibility Hypothesis, Dividend Substitution Hypothesis, and Agency Theory.

The theories are briefly defined below

- Signalling Theory envisages that investors will value dividend payers at a higher premium when the need to signal future profitability is greater (Huang, 2015). Thus the theory postulates that firms pay dividends to signal their better prospects to differentiate themselves from their peers
- Flexibility Hypothesis refers to the capability of a company to react appropriately to deviations in the organisation's cash flows (Andres et al., 2015)
- Dividend Substitution Hypothesis argues that management considers dividends and buybacks to be substitute corporate payout instruments (Jiang, Kim, Lie, & Yang, 2013).



- Catering Theory of Dividends postulates that firms initiate dividends or buybacks to cater to investors' demand for dividends (Baker & Wurgler, 2004)
- Agency Theory is centred on the notion that paying out cash as dividends can alleviate the probable cash-induced agency dispute between managers and shareholders. Investors will value dividend payers with a higher premium when the need to moderate the potential agency problem was bigger (Fama & French, 2005).

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### 2.1.1 AGENCY THEORY

According to Bansal (2013) and Fama and French, (2005), the Agency Theory postulates that investors must monitor and control managers from the so-called free-rider problem to safeguard the owners' residual claims from the excesses of self-interested managers. The issue arises due to information asymmetries between the parties and their different incentives. In many instances, managers who act as an agent for shareholders, have superior information about the company compared to shareholders. Thus, a manager may be motivated to act in a manner that was not in the shareholders' best interest if they are presented with an incentive to act in this way.

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### 2.1.2 SIGNALLING THEORY

The widely accepted explanation to companies choosing share repurchase is the Signalling Theory. This theory postulates that share repurchase were seen as a disclosure by the management of new information that will improve the value of the company's prospects, signalling that the shares were undervalued (Grullon et al., 2000). According to the theory, investors would buy into the stock anchored on the belief that management has inside information. As reported by Grullon and Michaely (2002), open-market share repurchasing was the most popular modus operandi for companies to repurchase their shares.

The Signalling Theory is predicated on the notion that management's actions can be used to convey or signal a message to the market. In the case of a share buyback, management who have superior information about the company could potentially be conveying that either the stock was undervalued or the dearth of investment projects offering superior returns.

However, Fried, (2011) adds ambiguity to the buyback Signalling Theory by propositioning that managerial opportunism was a more reasonable motive for the share repurchase. The study (Fried, 2011) counter-argued that management could use share buybacks as a decoy thereby sending a wrong signal to the market

Babenko, Tserlukevich, and Vedrashko, (2012) argued that although the share buyback announcements were commonly associated with equity undervaluation, the market treats them with scepticism. Even though supporting the signalling hypothesis, the intention to mislead investors was also noted by Chan, Ikenberry, Lee, and Wang, (2010). However, Grullon and Michaely (2002) claim that intense regulation makes the buyback alerts a safe harbour from stock price manipulation.

Huang, (2015) argued that hostile takeover pressures before a buyback announcement could be a reliable signal of undervaluation. Much of the empirical findings propose that the takeover probability and share buybacks seem to create a double-signal for transmitting company undervaluation to the market.

Share repurchases have risen in popularity among listed companies that use them as an alternative to traditional dividends (Jiang et al., 2013). Babenko et al., (2012) argued that stock repurchases can be used by outside investors to assess the integrity of the undervaluation signal conveyed by such announcements. In line with the signalling theory, Peyer & Vermaelen, (2009) documented that share repurchase announcements exhibited positive abnormal returns. Hence, the prevalence of share buybacks has increased, and the signal sending capacity was clear. However, the exact motivation from management as well as how the market perceives these remains an area of debate.

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### 2.1.3 FINANCIAL FLEXIBILITY

Financial flexibility refers to the capability of a company to react in a timely and value-maximising way to unforeseen deviations in the organisation's cash flows. Rapp, Schmid, and Urban, (2014) proposed a novel tactic to quantify the significance that investors allocate to financial flexibility. The study noted that companies with shareholders who prioritised financial flexibility tend to have higher cash holdings exhibited lower dividend payout and preferred share buybacks to dividends. The findings concur with prior survey evidence by Brav et al., (2005) that financial flexibility considerations shape corporate payout policy.

Denis, (2011) concurred that financial flexibility considerations affected the form of payout. The author (Denis, 2011) argued that share buybacks represented a better flexible form of payout as they could be adjusted depending on earnings and cash flows compared 'sticky' dividends. Brav et al., (2005) surveyed Chief Financial Officers(CFO) and reported that more than 90% of the respondents noted that consequences for cutting dividends were serious, only less than 20% stated that the same was true for reducing buybacks.

As alluded to by Denis, (2011), the implications are that buybacks were predominately used in circumstances where companies generate significant excess cash flows but do not intend to constrain future flexibility by increasing dividends. Moreover, the substitution of repurchases for dividends should be more prevalent in those circumstances where a company has high hedging needs that are otherwise unmet.

Bonaimé et al., (2016) extended these findings by evaluating whether the preferred form of the payout was impacted by the firm's risk management policy. The study posits that the desire for financial flexibility in corporate payout was reduced if the company hedged its cash flows(Bonaimé et al., 2016). Consistent with the flexibility hypothesis, the study noted that the degree to which a company hedges with derivatives impacted both the level and form of corporate payout. Moreover, they

argued that the linkage between payout policy and financial flexibility could only be contextualised within the company's overall risk management policy.

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#### 2.1.4 THE CATERING THEORY

The Dividend Substitution Hypothesis is similar to the Financial Flexibility Hypothesis, but it is centred on the notion that management considers dividends and buybacks to be substitute corporate payout instruments (Jiang et al., 2013). In the same vein, Kulchania, (2013) documented catering as a stimulus for the changeover between share buybacks and dividend payments. The Catering Theory of Dividends postulates that firms initiate dividends to cater to investors' demand for dividends (Baker & Wurgler, 2004).

Kulchania, (2013) argued that companies 'cater to investor demand' by buying back shares when investors put a higher value on the share price of companies that repurchase shares. In the same vein, they cater to investor demand by paying dividends when doing so commands a premium in the market.

Thus Kulchania, (2013) argued that companies directed higher proportions of payment where the premium was higher – a phenomenon they aptly named "the difference premium." The study postulated that the market reaction to dividend changes was more favourable when firms acted in accordance with the Catering Theory of Dividends hypothesis. The study concluded that catering played a pivotal part in the substitution between repurchases and dividends.

## 2.2 GLOBAL LITERATURE REVIEW

Numerous explanations have been presented for the popularity of share buybacks, and the majority of them emphasised the prospective benefits of share repurchases. However, the jury is still out on whether managers act with honest intentions or rather act in the best interest of investors when they buy back shares. Chan et al., (2010) suggested that managers may launch a repurchase program to manipulate or mislead investors.

One major argument was that share repurchases have a positive influence on executive compensation. Thus managers stand to amass personal wealth when they opportunistically pursue share repurchases. Thus, share repurchase announcements can be either agency or value signalling driven. Since these two theories (agency vs. signalling) can occur simultaneously, it is unknown if the market can distinguish value signalling announcements from false signs (Chan et al., 2010).

It is unknown if executives add credibility to the repurchase undervaluation signal by trading parallel to their signal. Which begs the question, do insiders and listed companies trade in the same direction during share repurchases? In the same vein, it is also unknown if managers have historically borne any reputational penalty for pronouncing and then failing to buy back shares or sending a misleading signal (Bonaimé & Ryngaert, 2013).

Globally, share repurchases have risen in popularity and in terms of total value among listed companies that use share repurchase as an alternative means for distributing capital to shareholders (Bonaimé, Öztekin, & Warr, 2014). They are also relevant because they play a crucial role in determining shareholder's return on investment. There is a growing school of thought among investors that one of the most efficient stock selection strategies was to buy stocks that are in the midst of repurchasing their shares (Jiang et al., 2013).

In search of alpha, new products such as Indices and Exchange Traded Funds (ETFs) have been created in developed markets whose primary constituents are stocks which had repurchased their shares. On the other hand, the compounding power of total return investing is as old as the hills. Total returns investing is achieved through re-investing back dividends paid out by companies. Hence, the appreciation of the ramifications of share repurchases vis-à-vis dividend payout is of paramount importance, given the prevailing low-interest rate environment and cash piling by companies.

Bhargava, (2010) analysed data on share buybacks and dividend payments of more than 2000 US companies for the period between 1992 and 2007. The study investigated the interrelationships between dividend payments and stock repurchases and noted that dividend decisions preceded decisions regarding repurchases. They also pointed out that the effect of repurchases on dividends was insignificant whereas higher levels of dividend payout reduced the magnitude of buybacks.

Renneboog and Trojanowski (2011) examined the firm's decision to distribute excess cash and the choice of payout channel in the United Kingdom (U.K.), and they noted an increase in the importance of share buybacks. Despite this growth, the study documented that dividends were still the dominant choice of payout channel.

The paper reached three significant conclusions on the choice of payout channel. First, there was a notable increase in the combined use of buybacks and dividends. The study also noted a decline in the number of firms only using dividends as their payout channel.

Regarding the size of the amounts distributed the study pointed out that even though repurchase plans were less popular than dividends, the average amount spent on the former was more than twice the amount spent on the later. The findings are consistent with what has been observed in the US market (Birstingi, 2016). Thus in value terms, one could argue that listed firms are spending more on repurchases than actually paying out dividends.

Secondly, consistent with findings in the US, Renneboog and Trojanowski, (2011) in their study concluded that firms that paid out dividends were likely to be bigger companies which were more profitable, faced less attractive investment opportunities and used less debt in their capital structure. Thirdly, they noted an increased likelihood of a dividend payout together with share repurchases when directors held more voting power. The results were inconsistent with the Agency Theory which postulates that the agent's interests may not be aligned with that of the principal which could lead to wasteful expenditure and agency costs.

Liu and Swanson (2016) provided evidence that companies increased share buybacks when market returns have declined and are likely to decline further. Their study investigated whether share repurchases were being undertaken as a mechanism to provide price support for firms. Consistent with price support the study noted that the association was positive and statistically significant over the ten year period from 2003 to 2014(Liu & Swanson, 2016).

Another important finding was that the price support period was followed by a multi-period decline in return on assets (ROA), but on a per share basis, the decrease in earnings was muted as a result of the decreased shares outstanding(Liu & Swanson, 2016). Subsequently, abnormal returns after the price support period were positive and significant. The study concluded that price support was a significant motive for increasing share repurchases (Liu & Swanson, 2016).

Consistent with price support Bonaimé et al., (2016) documented a positive and significant correlation between repurchases and earnings management. Their study noted that share repurchases had become the major payout channel over the last two decades. The dominance was attributed to the financial flexibility advantage in terms of amount and timing.

Their study further looked at the costs of the financial flexibility advantage. The conclusion was that on average; repurchase investments underperformed hypothetical investments that automatically re-invested back the equivalent repurchased value by

nearly two percent per year. Thus they argued that the financial flexibility advantage comes at a cost because it was value destructive. Thus they concluded that the cost of financial flexibility was associated with an incentive to manage earnings and executive entrenchment.

Taking into account access to inside information and experience one would expect executives to use the financial flexibility advantage to add value through timing share buybacks when the stock price was depressed or undervalued (Bonaimé et al., 2016). Thus the study critiqued whether repurchases enhanced shareholder value in the long term and they concluded that the payout flexibility came at a cost to shareholders.

Dittmar and Field, (2015) compared average buyback prices paid by repurchasing firms with the market price of the same stock over numerous time periods. They observed that firms earned positive returns if they bought back stock at lower prices.

As highlighted above, current research reasonably supports finance theory that price support was a motivating factor for share repurchases (Liu & Swanson, 2016). Almeida, Fos, and Kronlund, (2016) concur and further posit that managers were willing to trade off investments and employment for stock repurchases that allow them to meet analysts' earnings forecast (Almeida et al., 2016).

Almeida et al., (2016) investigated the impact of share buybacks on the firm's research and development, investment and employment. The study provided evidence that earnings per share driven repurchases were associated with a reduction in investment, employment and research and development. Pressure to meet analyst forecasts and performance-based incentives have been cited as a major reason for earnings management. The findings support the Principal Agency Theory as valuable investments could be sacrificed to finance share buybacks.

Grullon and Michaely (2002) found a substitution effect between share repurchases and dividends. Their study noted that share repurchases were not only an important form of payout for U.S. corporations but also that companies were ultimately funding



buybacks with residual cash that would have been used to increase dividends. Another crucial finding was that firms were neither reducing dividends nor replacing them with repurchases. However, firms preferred buying back shares instead of increasing the dividend payout ratio.

Young firms were found to prefer repurchases when initiating a cash payout (Grullon & Michaely, 2002). Such a strategy would be justifiable as earnings for young firms were likely to be volatile as their earnings and cash flows were unstable. Dividends were predominately paid from stable excess cash flows, hence it will not be ideal for young firms. Grullon and Michaely (2002) observed that large firms were reluctant to cut dividends but had a higher propensity for share buybacks. The study concluded that U.S. firms were gradually substituting share repurchases for dividends.

Fama and French (2001) noted a declining incidence of firms paying cash dividends. They attributed the lower propensity to pay to the changing characteristics of listed firms. They noted that the majority of young firms have low profitability and strong growth opportunities that would rather prefer share buybacks instead of dividends.

Floyd et al., (2015) noted that dividends were concentrated on firms that also carry out share buybacks. Consistent with the survey evidence from Brav et al., (2005) the study also noted the staying power of dividends as managers were reluctant to cut dividends. In support of the Financial Flexibility Hypothesis, Andres et al., (2015) also documented that dividends were more rigid or sticky than total payouts in the German market.

Bildik, Fatemi, and Fooladi (2015) compared the dividend payout behaviour of US firms to the rest the world and noted a lower proportion of dividend payers in the US relative to the rest of the world. Their study also documented that dividends were concentrated among larger firms with the rest of the world having a higher degree of concentration.

DeAngelo, DeAngelo, and Skinner, (2004) argued that in real terms, aggregate dividends paid out had increased in contrast to Fama and French, (2001) who had

observed that dividends were disappearing. Fama and French, (2001) argued that dividend payers had more than halved. Angelo et al., (2004) cited three main reasons. Firstly, only those companies paying relatively small amounts of dividends constituted the majority of firms whose dividends have disappeared. Their study noted that the typical payout ratio had remained relatively unchanged and there was no evidence in support of the reduced propensity to pay dividends.

Secondly, higher dividends from top-paying firms countered or overwhelmed the reduction in dividends from numerous dividend small payers. Their findings were in line with observations by Grullon and Michaely (2002) of increasing earnings concentration with top dividend payers accounting for the lion's share of the aggregate dividends. An important finding was the emergence of a two-tier structure in which few companies aptly referred to as "top-tier firms" with stable and high growth earnings dominated the dividend supply and stock repurchases whereas firms with modest and volatile earnings opted for re-invest. The findings were in contrast to the young firm's observation noted by Grullon and Michaely (2002) and Fama and French (2001). Their findings raise possible inconsistencies on the importance of dividend clientele and signalling hypothesis.

Boudry, Kallberg, and Liu, (2013) examined the motivation of share buybacks on a sample data of real estate investment trusts. The study noted that firms increases in share buybacks when faced with unprofitable projects which were not value accretive. In principle, such firms will be operating within the goals of maximising shareholder value.

Consistent with other findings (Bildik et al., 2015; Bonaimé, 2012), their study (Boudry et al., 2013) argued that there was a negative association between investment prospects and share buybacks. The study found no support that share buybacks were fuelled by option incentives to senior executives.

Jain, Shekhar, and Torbey, (2009) assessed corporate payout initiation choice by Initial Public Offering (IPO) firms and found supporting evidence for buybacks over dividends.

The study determined that firms initiating payout were thrice more likely to opt for buybacks instead of repurchases. Their findings were consistent with Skinner (2008) who argued that firms with no history of dividends were more likely to adopt repurchases as the payout initiation tool. The authors concluded that the Signalling Theory was an influential factor in choosing buybacks over repurchases.

Von Eije & Megginson, (2008) investigated the payout policies of European companies of the nations that were EU members. Consistent with findings in the U.S, their study documented evidence that the propensity to pay dividends had reduced as noted by Fama and French, (2001). At the same time, the study noted that the propensity to buy back shares had grown inexorably. However, the study concluded that buybacks and dividend payments were compliments as they did not find supporting evidence of Dividend Substitution Hypothesis and the Catering Theory.

Skinner, (2008) investigated how the relationship between earnings and the payout policy had transformed over time. In contrast to the two-tier structure noted by Grullon and Michaely (2002), Skinner noted three main groups which comprised of companies that paid dividends and made regular buybacks, companies that made regular buybacks, and companies that made infrequent buybacks. The study noted that companies paying dividends only were becoming extinct and buybacks were gaining traction at the expense of dividends. Their findings were consistent with Fama & French (2001) who contended that dividends were disappearing.

Previous research has documented that special dividends have all but disappeared (DeAngelo et al., 2004). The study concluded that buybacks had become the principal method of payout even for firms that were still paying dividends. The study's findings were consistent with the Dividend Substitution Hypothesis but in contrast to von Eije and Megginson's, (2008) views.

Denis and Osobov, (2008) investigated listed companies in the UK, U.S., Canada, Germany, Japan, and France, and observed that the inclination to pay dividends was greater in bigger, more profitable companies and those with a greater proportion of

retained earnings in their total equity. The study attributed the observed decline in paying dividends to newly listed firms' failure to initiate dividends. Similar to Grullon (2002), the study concurred that total dividends were concentrated amid the stable, biggest and more profitable companies. Essentially the findings are in line with agency theory but cast further doubt on catering and signalling theories.

## 2.3 SOUTH AFRICAN CONTEXT

Despite a growing interest and extensive global research in share buybacks, from a South African context research on this topic has been limited (Bester, Wesson, & Hamman, 2010; Chivaka, R; Siddle, A; Bayne, L; Cairney, C; Shev, 2009; Vermeulen, 2014). There are also a few empirical studies that have extensively investigated the payout policy of South African firms (De Vries, Erasmus, Hamman, & Wesson, 2012). Even in the rare case of an attempt of investigating corporate payout dynamics, research was predominately conducted on a single payout method in isolation. This section reviews literature that has covered share repurchases and dividend payout policies in South Africa.

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### 2.3.1 FINDINGS

Chivaka et al., (2009) used an archival analysis method to understand the motivation for repurchases by companies listed on the JSE. This was an exploratory research to bridge the gap between finance theory and practice. In line with finance theory, Chivaka et al., (2009) noted that the two primary reasons cited on circulars as the main causes for repurchasing shares were enhancing shareholder value and sweeping up odd lots of shares. Sweeping up odd lots of shares is more of an administrative issue as it targets buying back shares from shareholders who own a limited number of shares.

Vermeulen, (2014) investigated share buybacks within the mining sector but noted that a significant portion of repurchases were not announced on the Stock Exchange News

Service(SENS). The study pointed out that 60% of buybacks done by companies with a primary listing on the JSE were not published on SENS. In contrast to Chivaka et al., (2009), Vermeulen, (2014) argued that any research on share buybacks only based on SENS announcements or circulars will be inaccurate as it does not exhaust the total universe of actual shares repurchased. In fact, it was likely to understate both the level and value of share repurchases in South Africa (Bester et al., 2010)

In line with global trends recent research (Wesson, Bruwer, & Hamman, 2015) documented that share repurchases were becoming an attractive payout method in South Africa. The study also noted that the payout value was dominated by a small number of big businesses that consistently paid out dividends and frequently bought back shares. The findings were consistent with U.S. evidence on dividends and share repurchases from Floyd et al., (2015) and Bildik et al., (2015).

Similar to Grullon and Michaely (2002), Wesson et al., (2015) noted that with regards to volume, small firms dominated the repurchase activity in South Africa. However, the large market capitalisation companies dominate in terms of the value of share repurchases. The study concluded that dividends were still the preferred payout method but share repurchases showed a substantial increase in value. This was consistent with findings from Floyd et al., (2015) who documented the staying power of dividends and the growth of repurchases.

Research has shown that the experience of share buybacks in South Africa mirrored that of the U.S. stock repurchases (Bhana, 2007). Bhana, (2007) found evidence in support of the Signalling Theory and concluded that share buybacks led to higher stock prices as the market bought into the dependable managerial signal that the firm's stock was undervalued. This could also imply that the market believed in the management's contention that long-term prospects were at a premium of what was being reflected in the share price.

De Vries, Erasmus, Hamman, and Wesson, (2012) investigated the impact of stock buybacks on dividend payout ratio over two ten year periods pre and post the repurchases. The results indicated that payout ratios did not differ significantly for the

firms involved in particular share repurchases. The results were more in line with the flexibility advantage of buybacks and found no support for the substitution hypothesis.

On the back of existing literature, the payout ratios would have deteriorated if the Substitution Hypothesis held. The findings also support the stickiness of dividend payout ratios globally as noted by Grullon and Michaely (2002) and others (Andres et al., 2015; Bhargava, 2010; Bildik et al., 2015; Brav et al., 2005; Floyd et al., 2015). The findings further assert the reluctance of firms to reduce or increase dividends during periods of subdued or abnormal earnings growth respectively. The research was constrained by the lack of a comprehensive share repurchase records (Wesson et al., 2015).

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### 2.3.2 DRAWBACKS

While Chivaka et al., (2009) did a thorough comparative analysis of empirical evidence and finance theory, it was merely based on circulars issued by the listed companies through the JSE's SENS portal. Chivaka et al., (2009) solely looked at the circulars to ascertain reasons for share repurchases. Their study neither determined the actual value of share repurchases nor verified whether listed firms in South Africa were substituting share repurchases for dividends. Another important critique is that the circulars analysed only signalled an intention to repurchase shares over a specified period but did not disclose the actual shares bought back. It would have been ideal also to look at the actual shares that were eventually repurchased.

Similarly, Bester et al., (2010) argued that the omission of unannounced share buybacks led to an underestimation of the repurchase level in South Africa. The research was based on a small sample data due to lack of detailed historical records of the share repurchase activities in South Africa. One major drawback of the study was that it did not explore the underlying rationale for share repurchases.

## 2.4 SUMMARY

From the articles reviewed it is evident that share repurchases have become an essential agenda item. Given such irregularities a survey interview of executives of the companies listed on the JSE will be better placed to understand the factors driving the preferred payout channel.

The research sought to contribute to the literature on corporate payout policies by analysing the underlying factors associated with share repurchases and dividend payout programmes. Furthermore, the study tested the relevance of the arguments put forward.

Arguments in favour or against the following factors affecting corporate payout policy were noted from the literature review:

- Price Support hypothesis
- Dividend Catering hypothesis
- Signalling Theory
- Financial Flexibility Hypothesis
- Dividend Substitution Hypothesis

Only senior management executives could shed more light into the share repurchase and dividend policy conundrum in South Africa. It is unknown if the managers will add credibility or clarity to the corporate payout policy. Thus an exploratory research is proposed.

This then poses numerous questions that the existing research has failed to conclusively address

- What are the factors that drive dividend and share repurchase in South Africa?
- Are listed firms prioritising stock repurchases at the expense of dividends?
- Does share repurchases impact on dividend payout policies?
  - Are the effects of repurchases on dividends significant?

- Are share repurchases motivated by the incentive to manage earnings and meet analyst forecast?
- Are new firms likely to initiate payout through buybacks rather than repurchases?
- What factors influence the choice between dividends and repurchases?

Literature has put forward various arguments to explain the notable increase in share buybacks. The majority of cases developed were clustered around signalling hypothesis, price support hypothesis, financial flexibility hypothesis, dividend substitution hypothesis, and agency theory. Given the arguments advanced in this section, this research project seeks to examine the factors affecting corporate payout policy decision. This study also aims to contribute to the literature by assessing whether dividend substitution hypothesis and other theories put forward hold.



## CHAPTER 3. RESEARCH HYPOTHESES

This chapter builds on the theory outlined in the literature review section. Given the growing significance of share buybacks and dividend payout policies, this chapter provides an overview of the research questions and the subsequent hypothesis developed.

### 3.1 BROAD AREAS REQUIRING RESEARCH

The following research questions are based on the gaps identified from the literature review. Of all the issues outlined in the previous chapter, the ones below were the predominant areas of ambiguity in the research to date.

- Describe factors that affect a company's payout policy
- What factors influence the choice between dividends and repurchases?
- Do share buyback affect the dividend payout policy?
- Do companies employ the dividend payout ratio for target payout decisions?

From the set of questions outlined above the research sought to test the following hypotheses described in the next section.

### 3.2 HYPOTHESES

Given the broad areas requiring research defined in the preceding section, the following hypothesis tests were conducted.

#### Hypothesis 1

H<sub>0</sub>: Financial Flexibility considerations have no significant influence on corporate payout policy

H<sub>1</sub>: Financial Flexibility considerations have a significant influence on corporate payout policy

## Hypothesis 2

H<sub>0</sub>: Signalling Theory considerations have no significant effect on corporate payout policy

H<sub>1</sub>: Signalling Theory considerations have a significant effect on corporate payout policy

## Hypothesis 3

H<sub>0</sub>: There is no significant relationship between the Catering Theory of Dividends and the corporate payout policy

H<sub>1</sub>: There is a significant relationship between the Catering Theory of Dividends and the corporate payout policy

## Hypothesis 4

H<sub>0</sub>: Price support has no significant effect on corporate payout policy

H<sub>1</sub>: Price support has a significant effect on corporate payout policy

## 3.3 SUMMARY

The questions and hypothesis outlined in this chapter focus on the factors that drive corporate payout policy. Furthermore, the hypothesis will test the significance of dividends compared relative to share repurchases in a South African context. The consistency matrix in **Error! Reference source not found.** below summarises the framework for the research project.

**Table 1: Consistency matrix**

<b>Hypothesis</b>	Literature Review	Data collection	Analysis
a) Financial Flexibility considerations shape corporate payout policy	(Bonaimé, 2012; Brav et al., 2005; Denis, 2011; Rapp et al., 2014)	Question 7 a & 7b Question 8a & 8b	Hypothesis testing
b) Signalling theory considerations affect the corporate payout policy	(Chan et al., 2010; Huang, 2015; Yung, Li, & Jian, 2015)	Questions 9a & 10a. 7k & 8k	Hypothesis testing
c) There is a significant relationship between the catering theory of dividends and the corporate payout policy	(Baker & Wurgler, 2004; Jiang et al., 2013; Kulchania, 2013)	Questions 7h & 8h 11g & 12 g	Hypothesis testing
d) There is a significant relationship between price support and the corporate payout policy	(Alice A. Bonaimé & Ryngaert, 2013; Alice Adams Bonaimé et al., 2014; Boudry et al., 2013; Liu & Swanson, 2016)	Questions 7j & 8j	Hypothesis testing

## CHAPTER 4. RESEARCH METHODOLOGY

This chapter looks at the research methodology adopted for this research project. The purpose of this section is to explain the methodology and research design adopted. The project mirrored on research work done by Brav et al., (2005) entitled “Payout Policy in the 21<sup>st</sup> Century” published in the Journal of Applied Economics. The authors sought to determine factors that drove the choice of payout policy in the US. The researchers surveyed 384 executives and interviewed 23 senior managers of companies listed in the US.

The rest of the chapter outlines the following

- The nature of the study
- The population and sampling method
- Data collection and analysis
- Validity and reliability of data
- Research limitations
- Research ethics.

### 4.1 THE NATURE OF THE STUDY

The study used the questionnaire developed by Brav et al., (2005) on companies listed on the main board of the JSE. Some of the questions were refined to align with South African settings. For example, companies are classified into sectors on the JSE using the Industry Classification Benchmark (ICB) developed by FTSE whereas the original questionnaire used the Global Industry Classification Standards (GICS) taxonomy. Some survey questions were excluded as they were deemed not appropriate for this research and the South African context. The questionnaire survey is attached in Appendix 1.

The questionnaire was sent electronically by email, and the executives were asked to complete an online survey. The survey took less than 12 minutes to complete. One advantage of using a survey instead of an interview is that responses from the later can be harder to quantify and interpret (Brav et al., 2005).

The majority of the questions used a Likert rating scale. This is a form of interval data that uses a scale ranging from strongly disagree to strongly agree with regards to a statement or opinion (Wegnor, 2012). According to Wegnor (2012), a wider range of statistical techniques can be applied to interval data as it has sufficient numeric properties to be treated as numeric data.

## 4.2 POPULATION, SAMPLING METHOD AND SIZE

The research project looked at the companies listed on the JSE. The population is defined as a complete set of the target universe (Saunders & Lewis, 2012). For the purposes of this study, the population was defined as all the companies listed on the main board of the JSE. According to Saunders and Lewis (2012), a sample is a subgroup of the population. For this study, 175 companies were selected using a stratified random sampling method explained below.

Sampling is the process of picking units from the overall population in such a way that studies from the sample can be inferred to represent the population. Given that the population size was finite and known a probability sampling method was acknowledged as the most appropriate for the research. A probability sampling method incorporates some form of random selection and ensures that different entities in the population have equal chances of being selected (Saunders & Lewis, 2012). A stratified random sampling was chosen to make sure that all industries and sectors were represented in the survey. A representative sample seeks to accommodate various subgroups of an entire population.

According to Wegnor, (2012), a stratified random sampling generally has more statistical accuracy than simple random sampling. This was more relevant in this research setting as there were companies from various industries listed on the stock exchange. Thus to reduce sector bias and improve mathematical precision the stratified random sampling method was chosen.

As shown in Table 2 below, the final sample selected closely mirrored the population in that all stratas or key subgroups were proportionally represented. Conditional formatting was used to depict the relative size of each sectors. There was no major change in relative weightings between the listed companies and the chosen sample.

**Table 2: Stratified random sampling by industry**

Sector	Listed	Sample	Listed Weight	Sample Weight
Basic Materials	55	26	18.0%	14.9%
Consumer Goods	21	17	6.9%	9.7%
Consumer Services	41	24	13.4%	13.7%
Financials	102	59	33.3%	33.7%
Health Care	7	3	2.3%	1.7%
Industrials	63	36	20.6%	20.6%
Oil & Gas	4	3	1.3%	1.7%
Technology	8	5	2.6%	2.9%
Telecommunications	5	2	1.6%	1.1%
<b>Total</b>	<b>306</b>	<b>175</b>	<b>100.0%</b>	<b>100%</b>

Source: Own (2016)

As of the 30th of June 2016, the JSE had more than 321 companies listed on the main board but the top 160 companies constitute more that 80% of the total market capitalisation. At the time the research was conducted fifteen firms were suspended, thus they were excluded from the sample data. According to the JSE's listing requirements, a suspension can either be voluntary in that the company would have requested temporary halting of trading for a period of time or imposed by the JSE when a firm fails to meet listing regulations.

The data required to select companies listed on the Main Board of the JSE was available from reputable data vendors such as Bloomberg, Thompson Reuters, I-Net, and the JSE. For the purposes of this research, the list of companies and their underlying sectors was obtained from the JSE.

As shown in Figure 6 below, the sample size was chosen based on a 95% confidence interval with an implied 5% margin of error.

**Figure 6: Sample size calculator**

Required Sample Size									
Population Size	Confidence = <b>90.0%</b>				Confidence = <b>95.0%</b>				
	Degree of Accuracy/Margin of Error				Degree of Accuracy/Margin of Error				
	<b>0.05</b>	<b>0.035</b>	<b>0.025</b>	<b>0.01</b>	<b>0.05</b>	<b>0.035</b>	<b>0.025</b>	<b>0.01</b>	
300	143	195	235	287	169	217	251	291	
310	145	199	241	296	172	222	258	300	

Source: Manoj (2016)

Since the study sought to explore key factors that determined the choice of payout policy it was deemed crucial to focus on companies that were listed on the main board. This was in line with academic research which noted that dividends tend to be concentrated on big firms that also carry out share buybacks (Bildik et al., 2015; Floyd et al., 2015).

#### 4.3 PRETESTING AND SURVEY DISTRIBUTION

A pilot group was used to test the clarity of the questions being administered. The five respondents who were chosen work in the finance and investor relations departments. They use common financial jargon that would be familiar to the intended target audience of the survey. A couple of questions and answers were refined after the pilot project as the respondents felt that they were not clear.

The survey was sent by electronic means to the investor relations of the selected companies. The respondents were made aware that participation is voluntary, and that all the information provided will be kept confidential and anonymous.

#### 4.4 UNIT OF ANALYSIS

The unit of analysis encompasses the major entity being analysed in a study (Wegnor, 2012). For the purposes of this study, the unit of analysis was the group of companies listed on the JSE as represented by senior executives. The survey was sent to senior executives of companies which included any of the following:

- Chief Executive Officer
- Chief Financial Officer
- Head of Investor Relations.

Data was collected at the company level, but the analysis was done at aggregate level hence the unit of analysis is the group of companies.

#### 4.5 MEASUREMENT INSTRUMENT

Measurement entails observing and recording the remarks that were gathered as part of the research. The observations were collected using a survey research. As previously mentioned, senior management executives of listed companies were asked to participate in the survey. A standardised survey questionnaire was sent to the investor relations department of 175 companies, and 52 responses were received. Only two of the responses received were discarded as they were incomplete.

The questionnaire survey was used to ascertain from a management perspective the factors that drove share buybacks and dividend decisions (Brav et al., 2005). Follow-ups were made as the response rate was low. The questionnaire survey is attached in



the appendix. An excerpt from the Likert-type scale survey questionnaire is provided in Figure 7.

**Figure 7: Example of questions from the survey**

4. Do these statements agree with <u>your company's views</u> ?										
Dividends						Repurchases				
Strongly Disagree		Strongly Agree				Strongly Disagree		Strongly Agree		
-2	-1	0	1	2		-2	-1	0	1	2
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	We make dividend / repurchase decisions after our investment plans are determined	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Dividend / repurchase decisions convey information about our company to investors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Paying dividends / repurchasing makes a firm's stock less risky (vs. retaining earnings)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	There are negative consequences to reducing dividends / repurchases	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Rather than reducing dividends / repurchases, we would raise new funds to undertake a profitable project	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Dividends / repurchases are as important now to the valuation of common stocks in our industry as they were 15 to 20 years ago	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	We use our dividend / repurchase policy as one tool to attain a desired credit rating	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	We use our dividend / repurchase policy to make us look better than our competitors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	We use our dividend / repurchases to show we can <u>bear costs</u> such as borrowing costly external funds or passing up investment, to make us look better than our competitors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Source: Brav et al., (2005)

#### 4.6 DATA GATHERING AND ANALYSIS APPROACH

A descriptive research methodology was used for this study. A quantitative study method was employed as the tools used to collect data returned quantifiable results. The questionnaire survey was used to ascertain from a management perspective the factors that drive share buybacks and dividend decisions (Brav et al., 2005).

According to Saunders (2012), one important advantage of using the scaling format above was that it associated the qualitative concepts with quantitative metric units. For the majority of the survey questionnaire, respondents were asked to rate each item question.

Table 3 below shows the Likert response and scaling format used.

**Table 3: Likert response scaling format**

Likert Scale	Likert Scale	Coding format	Association
Very Important	Strongly agree	2	++
Somewhat Important	Agree	1	+
Neutral	Neutral	0	0
Less important	Disagree	-1	-
Not important at all	Strongly disagree	-2	--

Incomplete surveys were cast-off from the analysis. Frequency tables and descriptive statistics were created to display and analyse results. The Cronbach alpha test was used to evaluate whether the survey reliably measured what it intended to measure. A p-value hypothesis testing for each single population parameter was conducted.

Data analysis involved the following three steps:

- Data preparation which included the collection of data, followed by checking it for accuracy, and organising data for analysis
- Descriptive statistics which entailed describing the basic features of data collected for the study
- Inferential statistics involves testing the hypothesis and making inferences from the sample data to general settings.

#### 4.7 VALIDITY AND RELIABILITY

Validity refers to a study's ability to provide sound conclusions. According to Saunders and Lewis, (2012), validity discusses how well a test measures what it is supposed to measure. Reliability refers to the level to which an assessment tool produces stable and consistent results (Wegnor, 2012). The suitability of the dataset is one of the main issues encountered when determining the feasibility of reliability and factor analysis. The Cronbach Alpha Test was used to evaluate whether the survey reliably measured what it intended to measure. This is in line with gauging the internal consistency and reliability of the survey questionnaire.

## 4.8 RESEARCH LIMITATIONS

The study had numerous limitations, with the main one being the low response rate. The following limitations were noted for this research study:

- The reliability of responses from online web survey was a limitation as the survey could be conducted in an uncontrolled environment. Similarly, the respondents may not have been the target audience.
- The choice of the sample could be considered biased given the low response rate. Every effort was made to try and get more respondents to participate, but the rate of reply remained low.
- The low response rate was a threat to validity of the research project
- Online surveys offer no probing as respondents cannot elaborate reasoning.
- No opportunity to review or explore further.

## 4.9 RESEARCH AND ETHICS

The research report complied with the ethical requirements for sound research and the below are applicable:

- The research was approved by the Ethics Committee of the Gordon Institute of Business Science
- Confidentiality and anonymity of all participants was ensured.
- No participants were named in the research project
- Participation was voluntary, and no incentive was offered to participants
- All information provided was voluntary, and no feedback was provided to participants

## 4.10 SUMMARY

This chapter described the research methodology adopted. A quantitative approach was followed, and the study used a descriptive research method in the form of a survey to gather data. Since the study sought to explore key factors that determined the choice of payout policy it was deemed crucial to focus on companies that were listed on the main board. This was in line with academic research which noted that dividends tend to be concentrated on big firms that also carry out share buybacks (Bildik et al., 2015; Floyd et al., 2015). The next chapter discusses the results of the research.

## CHAPTER 5. RESULTS

This section presents the results based on the analysis of Chapter 4. The first section describes the response rate and the reliability of the survey. The second section details the descriptive statistics. The third section displays the results from the hypotheses tests conducted. The last section outlines the results of hypotheses tests conducted.

### 5.1 RESPONSE RATE AND RELIABILITY OF THE QUESTIONNAIRE

The survey was sent out electronically to the investor relations representatives of 175 firms selected through a stratified sampling method. 52 responses were received which translated into a 30% response rate. Only two of the responses received were discarded as they were incomplete.

The Cronbach Alpha Test was used to evaluate whether the survey reliably measured what it intended to measure. This is in line with gauging the internal consistency and reliability of the survey questionnaire. A Cronbach alpha of 0.69 indicates that 69% of the variance in the scores is reliable variance. Thus, the data collected has a lower error variance, good reliability, and good consistency. The results are shown in the Table 4 below

**Table 4: Testing the reliability of the survey questionnaire**

<b>Anova: Two-Factor Without Replication</b>						
<i>Source of Variation</i>	<i>SS</i>	<i>df</i>	<i>MS</i>	<i>F</i>	<i>P-value</i>	<i>F crit</i>
Rows	131.1402	45	2.9142	3.2502	0.00	1.3850
Columns	154.6293	19	8.1384	9.0766	0.00	1.5987
Error	766.6207	855	0.8966			
Total	1 052.3902	919				
Cronbach's alpha	<b>0.6923</b>					

## 5.2 DESCRIPTIVE STATISTICS

As shown in Figure 8 below 48% of the companies surveyed paid out dividends and also repurchased shares during the past three years. Thirty-six percent only paid out dividends over the same period whereas 16% neither bought back shares nor paid out dividends.

**Figure 8: Payout policy distribution**

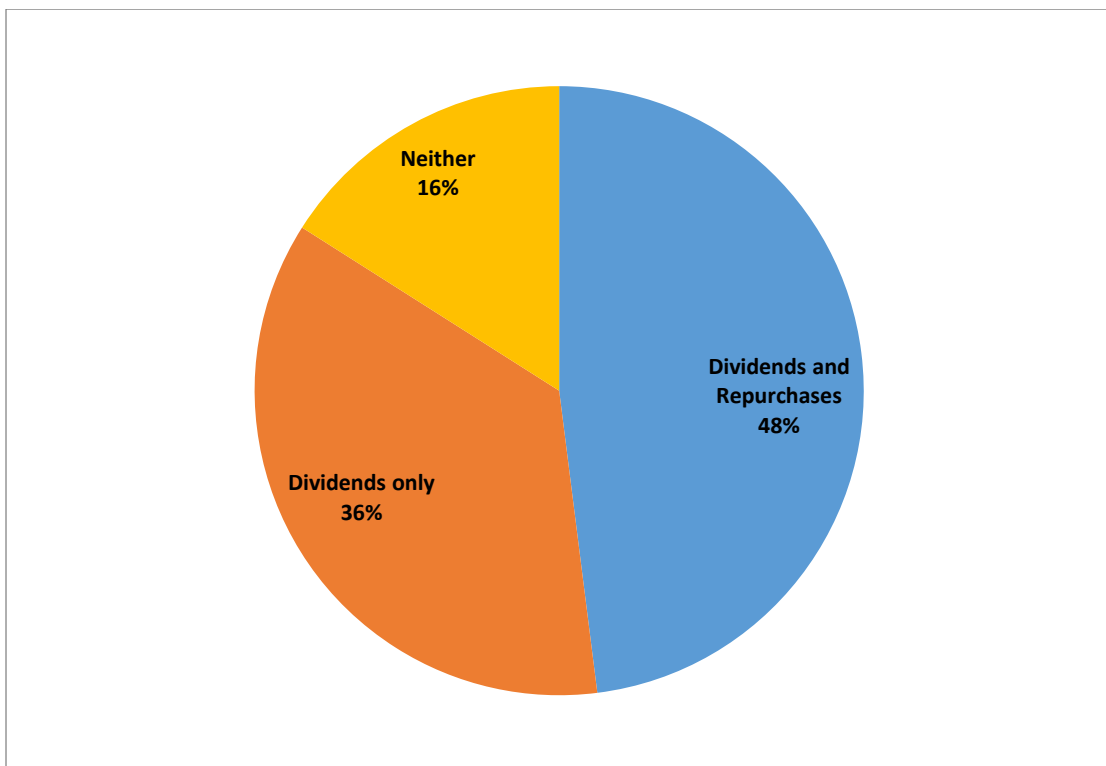
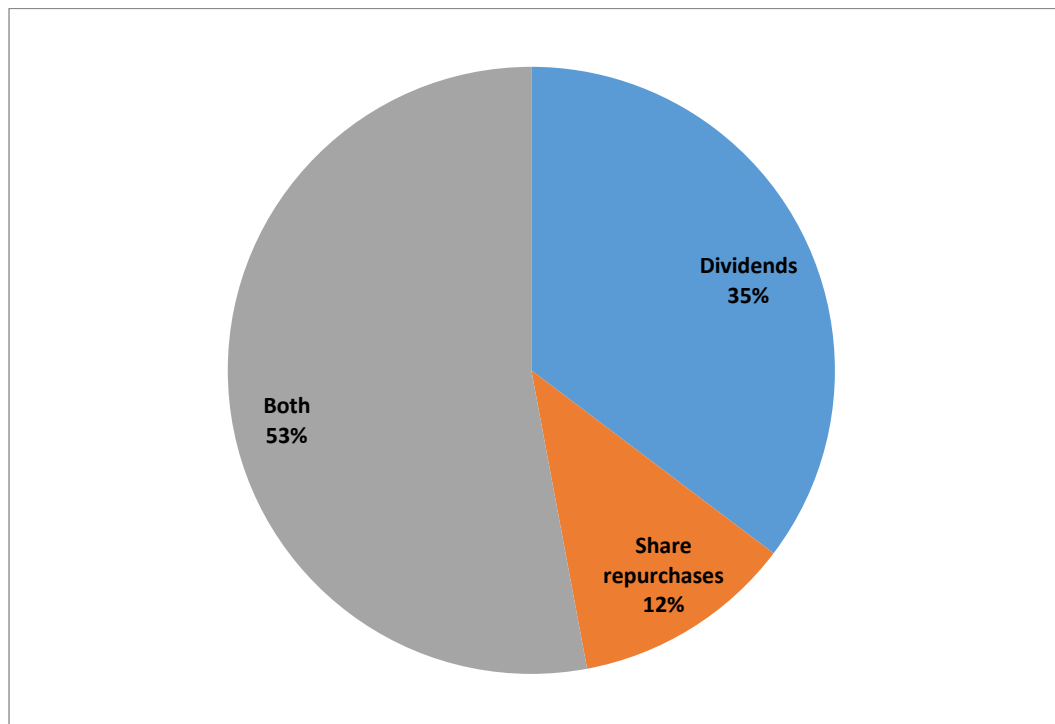


Figure 9 below provides the responses when firms were asked which payout option they would prefer if they were hypothetically paying out capital for the first time. The results feedback largely mirror that of the payout distribution policy over the last three years. 53% of the respondents preferred a combination of dividends and repurchases. However, 35% of the respondents preferred dividends only, and 12% opted for buybacks as their preferred payout channel.

**Figure 9: Preferred method when paying out capital for the first time**

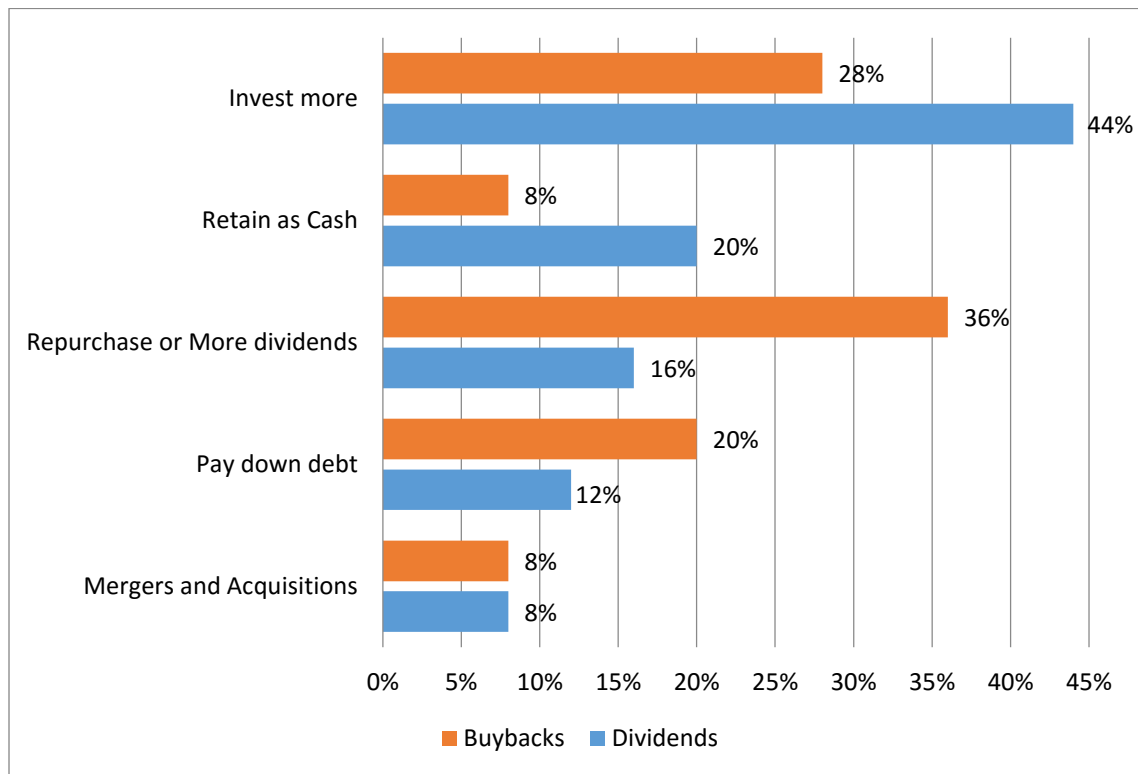


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#### 5.2.1 LIKELY ALTERNATIVE FOR THE FUNDS USED TO PAY DIVIDENDS OR BUYBACKS?

As shown in Figure 10 below, 44% of the respondents would have used the money paid out as dividends to re-invest into the business, 20% said they would have retained it as cash and 16% stated that they would have used it to buy back shares. 12% of the respondents would have used the money to pay down debt and 8% for acquisitive growth.

**Figure 10: Alternative use of funds paid out as dividends or buybacks**



From a buyback perspective, the responses indicate that 36% of the respondents would have used the money spent on buybacks to pay more dividends and 28% would have preferred to re-invest into the business. 20% of the respondents would have reduced debt, and 8% apiece would have either retained it as cash or used it to acquire new businesses.

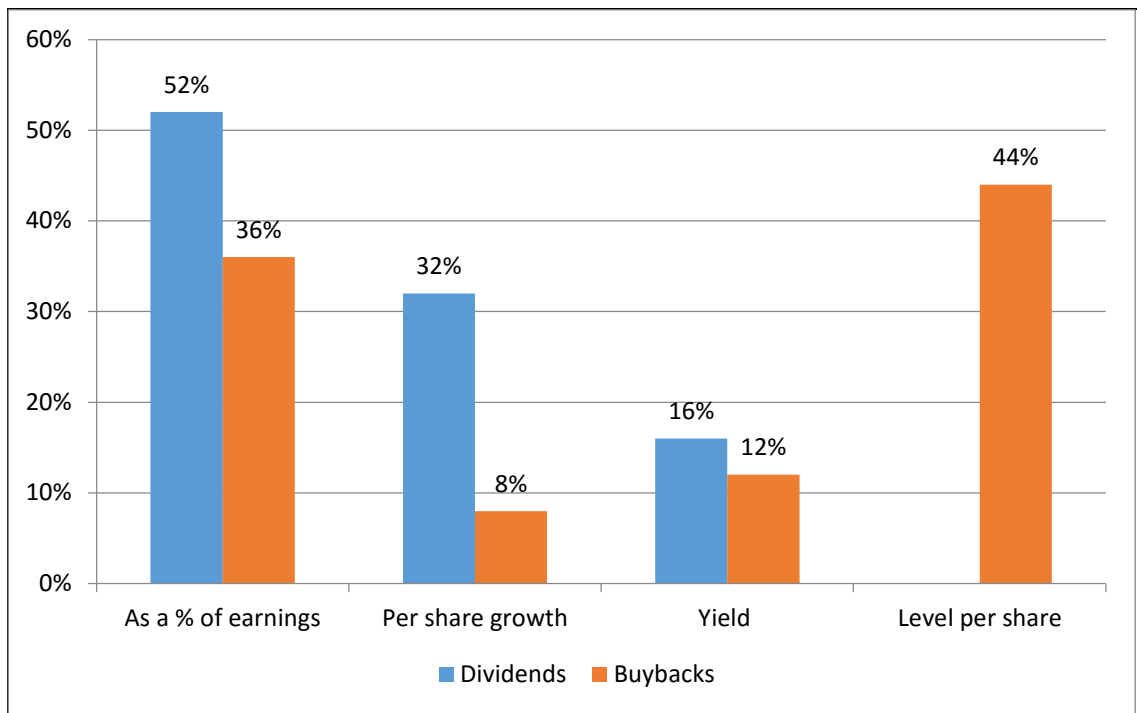
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### 5.2.2 WHAT IS THE TARGET PAYOUT POLICY EMPLOYED?

The dividend payout ratio was the preferred target method with 52% of the respondents as shown in Figure 11 below. 32% of the respondents target the dividend growth rate whereas 12% stated that they use dividend yield method to decide how much capital should be returned to investors.



**Figure 11: Target payout policy employed**



From a buyback perspective, 44% of the respondents preferred to use the level of buybacks and 36% stated their preference of targeting repurchases as a percentage of earnings. 12% indicated they used the buyback yield and 8% used the growth in repurchases.

### 5.2.3 WHAT ARE THE IMPORTANT FACTORS TO YOUR COMPANY'S PAYOUT POLICY DECISION?

Table 5 below provides a summary of the survey responses from the construct of the importance of different factors to a company's payout decision. 100% of the respondents strongly agreed (92%) or agreed (8%) with the statement that the stability of future earnings was a major factor in a company's dividend decision. Similarly, 88% of respondents also strongly agreed (64%) or agreed (24%) that this factor was relevant to a company's buyback decision. 4% of the respondents were neutral, and 8% said it was less important.

**Table 5: Important factors to a company's dividend decision**

	Very Important & Somewhat Important	Neutral	Less important or Not Important
Stability of future earnings	100%	0%	0%
A sustainable change in earnings	96%	4%	0%
The availability of good investment opportunities	92%	4%	4%
Excess cash relative to our desired cash holdings	80%	12%	8%
Maintaining consistency with our payout policy	80%	12%	8%
Attracting investors to purchase our stock	80%	4%	16%
Merger and acquisition strategy	72%	16%	12%
Market price of our stock	68%	16%	16%
A temporary change in earnings	58%	21%	21%
Industry payout policies/levels	56%	24%	20%
Signalling to investors that we are running low on profitable investors	36%	40%	24%

From a buyback perspective, 96% of the respondents stated that a sustainable change in earnings was the second most important factor in a company's payout decision. From a buyback perspective, 96% of the respondents were expressed that the stability of future earnings and the availability of profitable investment opportunities were important factors on payout decision. 80% expressed that the market price of the stock and excess cash relative to optimal cash holding were important factors.

**Table 6: Important factors to a firm's buyback decision**

	Very Important & Somewhat Important	Neutral	Not Important & less important
A sustainable change in earnings	96%	4%	0%
Stability of future earnings	88%	4%	8%
The availability of good investment opportunities	88%	8%	4%
Excess cash relative to our desired cash holdings	80%	12%	8%
Market price of our stock	80%	16%	4%
A temporary change in earnings	72%	8%	20%
Maintaining consistency with our payout policy	67%	21%	13%
Merger and acquisition strategy	64%	20%	16%
Attracting investors to purchase our stock	64%	28%	8%
Industry payout policies/levels	60%	12%	28%
Signalling to investors that we are running low on profitable investors	48%	20%	32%

Notably, the four factors that came out as the most important for a company's payout policy were the stability of future earnings, sustainable change in earnings, the availability of sound investment opportunities and excess cash relative to desired cash holdings.

## 5.2.4 RELATIVE IMPORTANCE ASSIGNED TO PAYOUT POLICY

Table 7 below presents a summary of the descriptive statistics on the hierarchy of investment decisions, dividends, and buybacks. The results indicated that 88% of the respondents with a median rating of two strongly agreed or agreed that investment decisions were made prior to payout policy. Similarly, 88% of the respondents at least agreed that dividend payout decision was important to the valuation of companies.

83% of the respondents with a median rating of one affirmed that dividend payout decision conveys information about the company to investors. 67 % strongly felt that there were negative consequences to reducing a dividend payout. Only 33% of the respondents agreed that the payout policy was used to make the firm look better than competitors.

**Table 7: The hierarchy from a dividend payer's perspective**

Dividend payer	Strongly Agree or Agree	Median rating
<b>We make payout after determining our investment plans</b>	<b>88%</b>	<b>2</b>
<b>Payout decision is important to the valuation of companies</b>	<b>88%</b>	<b>1</b>
<b>Payout decisions convey information about our company to investors</b>	<b>83%</b>	<b>1</b>
<b>There are negative consequences to reducing payout</b>	<b>67%</b>	<b>1</b>
<b>We would raise new funds to undertake a profitable project instead of reducing payout</b>	<b>50%</b>	<b>1</b>
<b>Payout makes a firm's stock less risky (vs retaining earnings)</b>	<b>42%</b>	<b>0</b>
<b>We use our payout policy to make us look better than our competitors</b>	<b>33%</b>	<b>0</b>

Table 7 above presents the descriptive feedback from a buyback perspective. 87% of the respondents with a median rating of one strongly agreed or agreed that buyback decisions conveyed information about the company.

78% of the respondents with a median score of two affirmed that investment decisions preceded payout decisions. In contrast to dividend payers, only 26% of the respondents expressed that there were negative consequences of reducing a buyback.

**Table 8: The hierarchy from a dividend payer's perspective**

<b>Buyback</b>	<b>Strongly Agree or Agree</b>	<b>Median rating</b>
<b>Payout decisions convey information about our company to investors</b>	<b>87%</b>	<b>1</b>
<b>We make payout after determining our investment plans</b>	<b>78%</b>	<b>2</b>
<b>Payout makes a firm's stock less risky(vs. retaining earnings)</b>	<b>52%</b>	<b>1</b>
<b>Payout decision is important now to the valuation of companies</b>	<b>48%</b>	<b>0</b>
<b>We would raise new funds to undertake a profitable project instead of reducing payout</b>	<b>39%</b>	<b>0</b>
<b>We use our payout policy to make us look better than our competitors</b>	<b>39%</b>	<b>0</b>
<b>There are negative consequences to reducing payout</b>	<b>26%</b>	<b>-1</b>

From the different view noted above, it can be deduced that buybacks are treated as residual cashflows as pointed out by Brav et al., (2005) whereas dividends rank higher than buybacks but lag investment decisions. The findings also tie in with the feedback that the availability of good investment opportunities affected the payout decision.

## 5.3 HYPOTHESIS TESTING

Two questions related to each hypothesis were asked as shown in Table 9 below. A p-value hypothesis testing for each single population parameter was conducted.

**Table 9: Variables used for each factor**

Factor	Item	Variable
Financial Flexibility	1	A temporary change in earnings
	2	Reluctance to make dividend changes that might be reversed in future
Signalling Theory	1	Signalling to investors that we are running low on profitable investors
	2	Payout decisions convey information about our company to investors
Catering Theory	1	Attracting investors to purchase our stock
	2	To attract investors that may be subject to prudent investor rule
Price Support	1	Market price of our stock
	2	Market undervaluation of our stock

### 5.3.1 HYPOTHESIS 1: FINANCIAL FLEXIBILITY

As outlined in the literature review, financial flexibility considerations include variables such as a temporary or sustainable change in earnings, the stability of future earnings and excess cash relative to the desired cash holdings. These factors were part of question 7 in the survey questionnaire.

The hypothesis was stated in chapter 3 as follows

$H_0$ : Financial flexibility considerations have no significant influence on corporate payout policy

$H_1$ : Financial flexibility considerations have a significant influence on corporate payout policy

A hypothesis testing for single population parameter was conducted, and the results are shown below.

HYPOTHESIS 1A.

**Table 10: Financial flexibility considerations**

Descriptive Statistics		Significance Test		1.00%
		Target	P-Value	SIG?
<b>AVERAGE:</b>	0.5	0.000	0.0030	TRUE
<b>STD DEV:</b>	1.2028			
<b>SKEW:</b>	-0.61	0.000	0.0521	FALSE
<b>EXCESS-KURTOSIS:</b>	-0.44	0.000	0.1898	FALSE
<b>MEDIAN:</b>	1			

Step 1: Outline the null and alternative hypotheses

$H_0$ :  $\mu = 0$  (a temporary change in earnings has no significant effect on the payout policy)

$H_1$ :  $\mu \neq 0$  (a temporary change in earnings has a significant effect on the payout policy)

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.003 as shown in Table 10 above.

Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value of 0.003 indicates substantial sample

evidence to reject the null hypothesis. There is a relatively low probability (0.3%) that the null hypothesis is true.

Step 4: Draw management conclusion

It can be concluded with 99% confidence that financial flexibility considerations do have a significant effect on corporate payout policy.

## HYPOTHESIS 1B

The results for the second question are highlighted below

**Table 11: Reluctance to make dividend changes that could be reversed**

Descriptive Statistics		Significance Test			1.00%
		Target	P-Value	SIG?	
<b>AVERAGE:</b>	1.08	0.000	0.0000	TRUE	
<b>STD DEV:</b>	0.9864				
<b>SKEW:</b>	-1.49	0.000	0.0000	TRUE	
<b>EXCESS-KURTOSIS:</b>	2.55	0.000	0.0021	TRUE	
<b>MEDIAN:</b>	1				

Step 1: Outline the null and alternative hypotheses

$$H_0: \mu = 0$$

$$H_1: \mu \neq 0$$

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.0 as shown in Table 11 above.

Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value of 0.0 indicates strong sample evidence to reject the null hypothesis.

Step 4: Draw management conclusion

It can be concluded with 99% confidence that financial flexibility considerations do have a significant effect on corporate payout policy.

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5.3.2 HYPOTHESIS 2: SIGNALLING THEORY

The hypothesis was stated in chapter 3 as follows

$H_0$ : Signalling theory considerations have no significant effect on corporate payout policy

$H_1$ : Signalling theory considerations have a significant effect on corporate payout policy

HYPOTHESIS 2A:

**Table 12: Signal low investment opportunities to the market**

Descriptive Statistics		Significance Test			1.00%
			Target	P-Value	SIG?
<b>AVERAGE:</b>	0.36		0.000	0.02	FALSE
<b>STD DEV:</b>	1.241461				
<b>SKEW:</b>	-0.07		0.000	0.43	FALSE
<b>EXCESS-KURTOSIS:</b>	-1.26		0.000	0.03	FALSE
<b>MEDIAN:</b>	0				

Step 1: Outline the null and alternative hypotheses

$H_0: \mu = 0$

$H_1: \mu \neq 0$

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.02 as shown in Table 14 above.



Step 3: Draw statistical conclusion

The p-value is greater than 0.02, thus we cannot reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value of 0.02 indicates weak sample evidence to reject the null hypothesis.

Step 4: Draw management conclusion

We cannot reject the null hypothesis that at 99% confidence that signalling theory considerations have no significant effect on corporate payout policy.

HYPOTHESIS 2B

A second test was done to ascertain whether payout decisions convey information to investors and the results are highlighted in Table 13 below.

**Table 13: Payout decisions convey information to investors**

Descriptive Statistics		Significance Test			1.00%
		Target	P-Value	SIG?	
<b>AVERAGE:</b>	1.2083	0.000	0.00	TRUE	
<b>STD DEV:</b>	0.9215				
<b>SKEW:</b>	-1.12	0.000	0.00	TRUE	
<b>EXCESS-KURTOSIS:</b>	0.56	0.000	0.36	FALSE	
<b>MEDIAN:</b>	1				

Step 1: Outline the null and alternative hypotheses

$$H_0: \mu = 0$$

$$H_1: \mu \neq 0$$

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.00 as shown in the table above.

### Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value of 0.00 indicates strong sample evidence to reject the null hypothesis. There is a relatively low probability that the null hypothesis is true.

### Step 4: Draw management conclusion

It can be concluded with 99% confidence that signalling considerations have a significant effect on corporate payout policy.

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### 5.3.3 HYPOTHESIS 3: CATERING THEORY

Two questions relating to catering theory of dividends were asked. The first question sought to probe if payout policy was used to attract investors to purchase a company's stock. The second question further investigated if there were specific types of investors companies sought to cater for through a payout policy.

The hypothesis as stated in Chapter 3 was as follows

$H_0$ : There is no significant relationship between the catering theory of dividends and the corporate payout policy

$H_1$ : There is a significant relationship between the catering theory of dividends and the corporate payout policy

The results for the first question are outlined below

HYPOTHESIS 3A

**Table 14: Payout policy used to attract investors**

Descriptive Statistics		Significance Test		1.00%
		Target	P-Value	SIG?
<b>AVERAGE:</b>	1.04	0.000	0.00	TRUE
<b>STD DEV:</b>	1.1599			
<b>SKEW:</b>	-1.22	0.000	0.00	TRUE
<b>EXCESS-KURTOSIS:</b>	0.58	0.000	0.35	FALSE
<b>MEDIAN:</b>	1			

Step 1: Outline the null and alternative hypotheses

$$H_0: \mu = 0$$

$$H_1: \mu \neq 0$$

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.00 as shown in Table 10 above.

Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value indicates strong sample evidence to reject the null hypothesis.

Step 4: Draw management conclusion

It can be concluded with 99% confidence that catering theory considerations have a significant effect on corporate payout policy.

## HYPOTHESIS 3B

Results for the second question are shown and discussed below

**Table 15: Catering for target investors**

Descriptive Statistics		Significance Test		1.00%
		Target	P-Value	SIG?
<b>AVERAGE:</b>	0.8	0.000	0.00%	TRUE
<b>STD DEV:</b>	1.17803			
<b>SKEW:</b>	-0.53	0.000	7.48%	FALSE
<b>EXCESS-KURTOSIS:</b>	-0.64	0.000	12.76%	FALSE
<b>MEDIAN:</b>	1			

Step 1: Outline the null and alternative hypotheses

$H_0: \mu = 0$ , i.e. Companies do not use payout policy to cater for specific target investors

$H_1: \mu \neq 0$ , i.e. Companies use payout policy to cater for specific target investors

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.00 as shown in Table 15 above.

Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value indicates substantial sample evidence to reject the null hypothesis.

Step 4: Draw management conclusion

It can be concluded with 99% confidence that catering theory considerations have a significant effect on corporate payout policy.

### 5.3.4 HYPOTHESIS 4: PRICE SUPPORT

Two questions relating to price support were asked as was the case with other hypotheses being tested. The first question sought to probe if the stock price of the firm was a crucial factor in a company's payout policy. The second question was similar to the first one but looked at whether the market undervaluation of the share price had any significant effect on corporate payout policy.

The hypothesis as stated in Chapter 3 was as follows

$H_0$ : Price support has no significant effect on corporate payout policy

$H_1$ : Price support has a significant effect on corporate payout policy

#### HYPOTHESIS 4A

The results are discussed below.

**Table 16: Market price of our stock**

Descriptive Statistics		Significance Test		1.00%
		Target	P-Value	SIG?
<b>AVERAGE:</b>	0.92	0.000	0.0000	TRUE
<b>STD DEV:</b>	1.3068			
<b>SKEW:</b>	-0.99	0.000	0.0036	TRUE
<b>EXCESS-KURTOSIS:</b>	-0.16	0.000	0.2968	FALSE
<b>MEDIAN:</b>	1			

Step 1: Outline the null and alternative hypotheses

$H_0: \mu = 0$

$H_1: \mu \neq 0$

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.00 as shown in Table 16 above.

Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value indicates strong sample evidence to reject the null hypothesis.

Step 4: Draw management conclusion

It can be concluded with 99% confidence that price support considerations do have a significant effect on corporate payout policy.

HYPOTHESIS 4B

Results for the second question are highlighted below

**Table 17: Market undervaluation of our stock**

Descriptive Statistics		Significance Test		1.00%
		Target	P-Value	SIG?
<b>AVERAGE:</b>	0.6087	0.000	0.001	TRUE
<b>STD DEV:</b>	1.2198			
<b>SKEW:</b>	-0.42	0.000	0.139	FALSE
<b>EXCESS-KURTOSIS:</b>	-0.91	0.000	0.076	FALSE
<b>MEDIAN:</b>	1			

Step 1: Outline the null and alternative hypotheses

$H_0: \mu = 0$  (Market undervaluation of our stock has no effect on payout policy)

$H_1: \mu \neq 0$ , (Market undervaluation of our stock has a significant effect on payout policy)

Step 2: Calculate the p-value and define the significance level

The significance test level is 1%, and the p-value is 0.001 as shown in Table 17 above.

### Step 3: Draw statistical conclusion

The p-value is less than 0.01, thus we reject the null hypothesis ( $H_0$ ) at the 1% level of significance. The p-value of 0.001 indicates strong sample evidence to reject the null hypothesis. There is a relatively low probability (0.1%) that the null hypothesis is true.

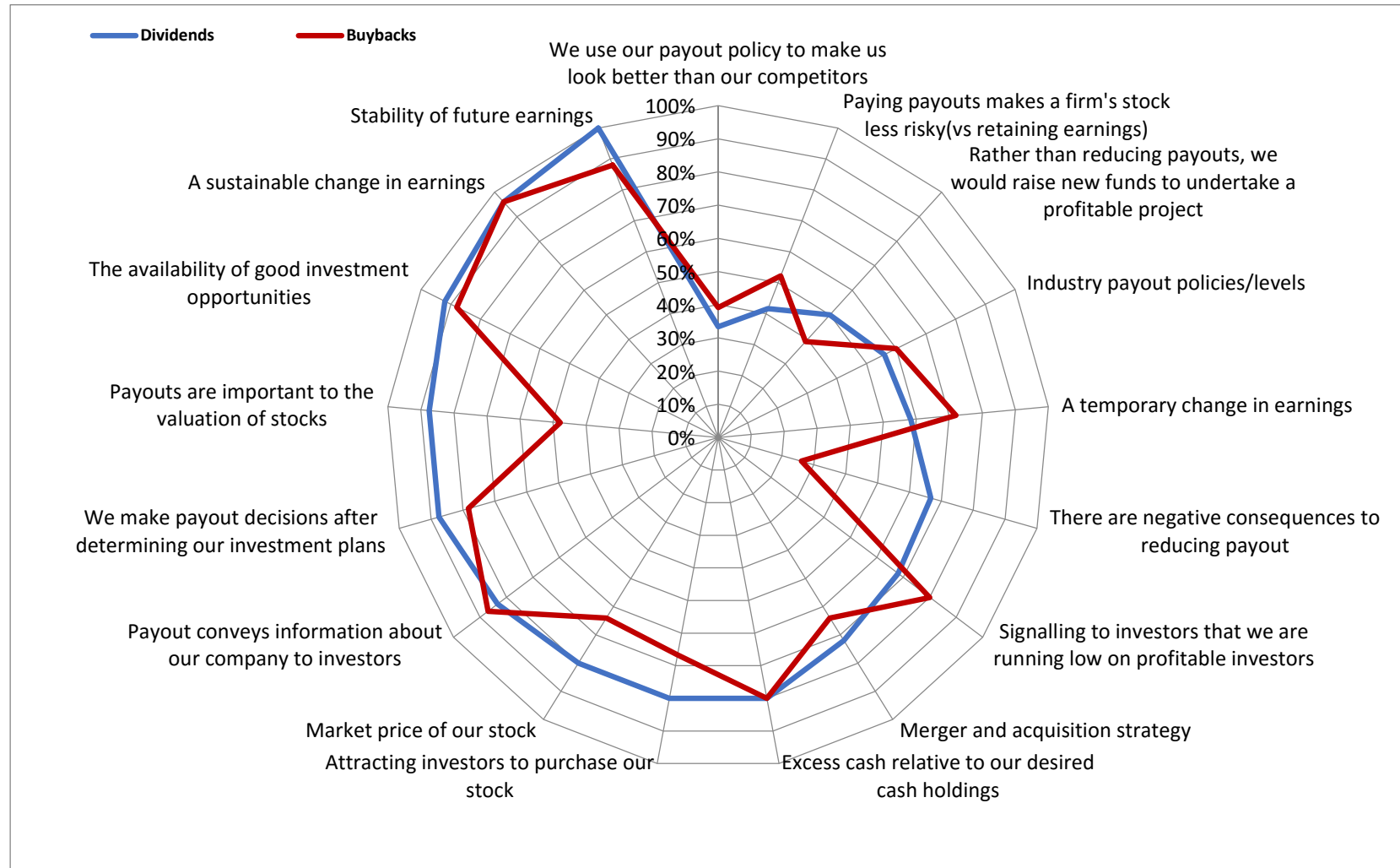
### Step 4: Draw management conclusion

It can be concluded with 99% confidence that price support considerations do have a significant effect on corporate payout policy.

## 5.4 SUMMARY

Figure 14 on the next page summarises the most important factors affecting corporate payout policy in South Africa. For each question, Figure 12 reported the percentage of respondents who answered very important (2) and important (1) on a scale of minus two to two.

Figure 12: Factors that influence corporate payout policy





## CHAPTER 6. DISCUSSION OF RESULTS

### 6.1 OVERVIEW

In this chapter, the research results will be discussed with reference to the literature review. The research findings will be examined by interpreting data from Chapter 5 using literature reviewed in Chapter 2. The chapter is similar to the preceding chapter and discussions are structured in accordance with research hypotheses formulated in Chapter 5.

### 6.2 DESCRIPTIVE STATISTICS

When asked about the most likely alternative use for the funds paid out as dividends or buybacks, the top three of the five options were to re-invest the capital into the business, pay more dividends, and retain as cash. The majority of the respondents paying dividends expressed that reinvesting excess capital would be their top priority while companies buying back shares stated that they would pay more dividends.

From a dividend payer perspective, the results confirmed the stickiness of dividends as noted by Andres et al., (2015), Bhargava, (2010) and Grullon and Michaely, (2002). From a buyback perspective, the option to pay more dividends confirms the dividend substitution hypothesis as noted by Jiang et al., (2013) and Floyd et al., (2015). The majority would have used the money to pay more dividends which indicate the likelihood that buybacks were being used to substitute dividends.

The third most prevalent option of retaining excess capital as cash adds to the financial flexibility considerations as noted by numerous researchers (Bonaimé et al., 2016; Brav et al., 2005; Rapp et al., 2014). By cash piling, firms will be building a war chest to react timely in case of unexpected deviations in the organisation's cashflows. The

findings also confirm Denis' (2011) proposition that the retention of cash was driven by the desire not to constrain future financial flexibility.

When asked about their payout policies almost half of the respondents were paying dividends and buying back shares followed by a third of the respondents who were paying dividends only. These findings are consistent with those of Renneboog and Trojanowski, (2011) who documented that dividends were still the dominant choice of payout channel in the United Kingdom.

Renneboog and Trojanowski (2011) also noted a growing uptrend in the combined use of buybacks and dividends, and a decline in the number of firms only using dividends as the payout channel. The findings are consistent with what has been observed in the U.S. market (Birstingi, 2016).

### 6.3 HYPOTHESIS 1: FINANCIAL FLEXIBILITY

The findings of this hypothesis were that financial flexibility considerations have a statistically significant effect on corporate payout policy. There was a relatively low probability that the null hypothesis holds.

The findings are consistent with those of Denis, (2011) who posited that financial flexibility considerations affected the form of corporate payout. Denis, (2011) argued that buybacks were used when companies generated significant excess cashflows but had no intentions of constraining future flexibility by increasing dividends.

In support of the flexibility hypothesis Andres et al., (2015) documented that in the German market, dividends were “stickier” than total payouts. The findings confirm previous survey evidence by Brav et al., (2005) that financial flexibility considerations shape corporate payout policy.

Similar to the findings by Brav et al., (2005), the results from this study showed that 66% (more than 90% for Brav et al., (2005)) of the respondents stated that the consequences of cutting dividends were severe. Only 26% (less than 20% for Brav et al.,(2005)) indicated that reducing buybacks had serious consequences. The South African results mirror those of the US results as documented by Brav et al. (2005).

#### 6.4 HYPOTHESIS 2: SIGNALLING THEORY

The results were inconclusive with regards to the two questions asked on signaling theory. The first question sought to find out if the payout policy signaled to investors that the company was running low on profitable investment opportunities. Sample evidence was weak. Thus the null hypothesis was not rejected. Based on this question it was concluded that signalling theory considerations had no significant effect on corporate payout policy.

However, the outcome of the second question was in stark contrast. The second question probed whether payout decisions conveyed undervaluation information about a company to investors. The null hypothesis was rejected, and the conclusion was that Signalling Theory had a significant impact on corporate payout policy. The results confirmed the findings by Grullon et al., (2000) that buybacks could signal that the company stock was undervalued. Signalling Theory postulates that a payout policy in favour of share repurchase can be seen as a disclosure by the management of new information that will improve the value of the company's prospects and stock price.

The mixed results confirm the argument of the ambiguity of buyback Signalling Theory as noted by Huang, (2015) who argued that managerial opportunism was a more reasonable motive for the buybacks. Similarly, Fried, (2011) contended that management could use payout policy as a decoy thereby sending a wrong signal to the market.

Even though supporting the signalling hypothesis, Chan et al., (2010) noted the intention to mislead investors. The results were in line with the findings of Babenko, Tserlukevich, and Vedrashko, (2012) findings that although the repurchase announcements were associated with equity undervaluation, the market treated them with scepticism. However, Grullon and Michaely (2002) counter-argued that intense market regulation made it impossible for payout alerts to be manipulated.

The Signaling Theory is predicated on the notion that management's actions can be used to convey or signal a particular message to the market. Management is assumed to have superior insider information about the company, but the results were mixed hence there was no conclusive evidence on the significance of signalling theory on corporate payout policy.

## 6.5 HYPOTHESIS 3: CATERING THEORY

Results from the two questions indicated that Catering Theory considerations have a significant effect on corporate payout policy. The p-value showed strong sample evidence to reject the null hypothesis. The results were in line with the findings of Baker and Wurgler, (2004) and Kulchania, (2013).

Kulchania, (2013) found that companies catered to investor demand through buybacks when investors put a higher value on the share price of companies that repurchase shares. Similarly, firms catered to investor demand by paying dividends when doing so commanded a premium in the market.

Thus, the results add to the argument that firms initiate payout policies that cater to investors' demand for either dividends or buybacks. Baker & Wurgler (2004) advanced that catering played a pivotal role in the substitution between dividends and buybacks.

## 6.6 HYPOTHESIS 4: PRICE SUPPORT

The findings from this hypothesis were that price support considerations had a significant influence on corporate payout policy. The p-value of less than 0.01 was observed, which resulted in the rejection of the null hypothesis as there was a low probability that it held.

The results confirm the findings of Liu and Swanson (2016) and Bonaimé et al., (2016) who noted a positive and statistically significant association between buybacks and price support. Liu and Swanson (2016) provided evidence that companies increased share buybacks when market returns had declined. Bonaimé et al., (2016) concluded that buybacks were used as a mechanism to provide price support.

From a South African perspective, Bhana, (2007) found evidence in support of the Signalling Theory and concluded that share buybacks led to higher stock prices as the market rallied behind managerial signal that the firm's stock was relatively cheap. This could also imply that the market believed in the management's contention that long-term prospects were at a premium of what was being reflected in the share price. As highlighted above current research reasonably supports finance theory that price support is a motivating factor for share repurchases as noted by Liu and Swanson, (2016).

## 6.7 SUMMARY

This chapter discussed the research results in view of the literature reviewed. The research findings were consistent with the literature. The paper investigated the factors affecting corporate payout decision. The results reported evidence that Financial Flexibility, Catering Theory of Dividends and Price Support positively affect a company's payout policy choice. The results were mixed on the Signaling Theory as an important factor in payout policy decision.

## CHAPTER 7. CONCLUSION

The aim of this research was to examine factors that affect corporate payout policy. The research findings are summarised in this chapter. The limitations are highlighted and taken into consideration. The chapter is organised as follows, Section 7.1 recaps the major research findings of the study, Section 7.2 discusses the implications for management, Section 7.3 looks at the limitations of the study, Section 7.4 suggests areas for future research and Section 7.5 concludes the chapter.

### 7.1 PRINCIPAL FINDINGS

The aim of this research was to examine factors that affect corporate payout policy. The research findings were broadly consistent with the literature. The paper investigated the factors affecting corporate payout decision. The results reported evidence that financial flexibility, catering theory of dividends and price support positively affected a company's payout policy choice. The results were broadly consistent with findings by Bonaimé et al.,(2016), Brav et al., (2005); Jiang et al., (2013), and Kulchania, (2013).

The results were mixed on the signaling theory as an important factor in payout policy decision. The mixed results confirm the argument of the ambiguity of buyback signalling theory as noted by Huang, (2015) who argued that managerial opportunism was a more reasonable motive for the buybacks. Such opportunism could signal agency theory as managers pursue own self interests. Similarly, Fried, (2011) contended that management could use payout policy as a decoy thereby sending a wrong signal to the market. Such an act would be contrary to stewardship theory which postulates that managers can act as responsible stewards.

## 7.2 IMPLICATIONS FOR MANAGEMENT

Several inferences or conclusions can be drawn from this study. Based on this study, there is reasonable expectation that factors such as Financial Flexibility, Catering and price support broadly affect the payout decision. The desire by companies to attain and preserve financial flexibility has been more pronounced after the financial markets crash. Firms have become more prudent as they sought not to constrain future flexibility and circumvent financial distress. The impact of financial flexibility on a company can be huge when there is a growth opportunity or when the company is going through difficulties.

The mixed finding that Signalling Theory has no significant effect on corporate payout policy may be aligned to the intense regulation of the South African financial market. This has resulted in the JSE being ranked as one of the top regulated exchanges worldwide by the World Economic Forums' (WEF) Global Competitiveness Index.

## 7.3 LIMITATIONS OF THE RESEARCH

A major downside of this study was the low response rate. The low response rate was a threat to the validity of the research project. The following limitations were also noted and should be taken into consideration when doing further studies

- The reliability of responses from online web survey was a limitation as the survey could be conducted in an uncontrolled environment. This increases the likelihood of getting responses that are compromised and therefore not an accurate reflection.
- Similarly, the respondents may not have been the intended target audience. With online surveys, it is hard to guarantee that the respondent was the chief financial officer or a random subordinate.
- The choice of the sample could be considered biased given the low response rate. Every effort was made to try and get more respondents to participate, but the rate of reply remained subdued.

- Online surveys offer no probing as respondents cannot elaborate reasoning. To overcome this limitation, it is recommended that a mix of interviews and online surveys be undertaken. This could increase the response rate and also offer an opportunity to review and further explore the reasoning behind the answers.

#### 7.4 FUTURE RESEARCH

While the study looked at factors affecting corporate payout policy decision, it was exploratory hence it lacked an in-depth analysis of each factor identified. Future studies should examine one factor in isolation to provide an extensive analysis of how it impacts payout policy. Another area of study should be the interrelations amongst the factors. For example, testing the relationship between financial flexibility and price support or signalling theory and catering theory could bring new insight.

Similarly, future studies could investigate a broader set of trade-offs between stock repurchases, dividends, and special dividends. For example, undertaking a cost-benefit analysis from an investor perspective of the opportunity cost or real cost of conducting buybacks instead of paying out a special dividend.

Finally, it is recommended that further studies explore other factors that could affect payout policy decision such as the bird in hand theory emanating from a bird in the hand is worth two in the bush adage. From an investor perspective, the lure of the certainty of a dividend could outweigh potential higher future capital gains. For example, this could apply to investors seeking to diversify or de-risk their portfolios.

#### 7.5 CONCLUDING REMARKS

The aim of this research was to examine factors that affect corporate payout policy. This study, inspired by the research work done by Brav et al., (2005) contributes to the



growing literature on factors that influence corporate payout policy choice. The research results indicated that catering theory of dividends, price support and financial flexibility considerations shape corporate payout policy. The results were mixed and therefore inconclusive with regards to the signalling theory's impact on corporate payout policy choice. The South African results mirror those of the US results as documented by Brav et al. (2005).

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## APPENDIX 1: SURVEY QUESTIONNAIRE & CONSENT LETTER

### Drivers that shape corporate payout policy in South Africa

- 1. During the past three years my company has (check one)**
- Both paid dividends and repurchased shares
  - Only paid dividends
  - Only repurchased shares
  - neither paid dividends nor repurchased shares

- 2. Of funds that could be used to pay dividends the most likely alternative use would be to:(check one)**
- Retain as cash
  - Invest more
  - Mergers /Acquisitions
  - Repurchase shares
  - Pay down debt
  -

- 3. Of funds that could be used to repurchase shares the most likely alternative use would be to:(check one)**
- Retain as cash
  - Invest more
  - Mergers /Acquisitions
  - Pay more dividends
  - Pay down debt
  -

- 4. If you were hypothetically deciding to pay out capital for the first time, would your first payout be**
- Dividends only
  - Share repurchases only
  - Some combination of dividends and repurchases
  -

- 5. When you make your dividend decisions, do you target**
- Level of dividend per share
  - Growth in dividends per share
  - Dividends as a % of earnings
  - Dividend yield
  - Do not target at all

- 6. For the shares you repurchase, do you target**
- Level of repurchases
  - Growth in repurchases
  - Repurchases as a % of earnings
  - Do not target at all
  - Not applicable



**7. How important are the following factors to your company's dividend decision?**

	Not important at all	Less important	Neutral	Somewhat important	Very important
A temporary change in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
A sustainable change in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Stability of future earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Excess cash relative to our desired cash holdings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Industry payout policies/levels	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The availability of good investment opportunities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Merger and acquisition strategy	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Maintaining consistency with our payout policy	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Attracting investors to purchase our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Market price of our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Signalling to investors that we are running low on profitable investors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**8. How important are the following factors to your company's share repurchase decision?**

	Not important at all	Less important	Neutral	Somewhat important	Very important
A temporary change in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
A sustainable change in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Stability of future earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Excess cash relative to our desired cash holdings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Industry payout policies/levels	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The availability of good investment opportunities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Merger and acquisition strategy	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Maintaining consistency with our payout policy	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Attracting investors to purchase our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Market price of our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Signalling to investors that we are running low on profitable investors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>





**9. Are the following statements in line with your company's view on dividend payout?**

	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree
We make dividend decisions after determining our investment plans	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Dividend decisions convey information about our company to investors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Paying dividends makes a firm's stock less risky(vs retaining earnings)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
There are negative consequences to reducing dividends	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Rather than reducing dividends, we would raise new funds to undertake a profitable project	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Dividends are as important now to the valuation of common stocks in our industry as they were 10 or 15 years ago	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We use our dividend policy to make us look better than our competitors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**10. Are the following statements in line with your company's view on share buybacks?**

	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree
We make repurchase decisions after determining our investment plans	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Repurchase decisions convey information about our company to investors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Repurchases make a firm's stock less risky(vs retaining earnings)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
There are negative consequences to reducing repurchases	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Rather than reducing repurchases, we would raise new funds to undertake a profitable project	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Repurchases are as important now to the valuation of common stocks in our industry as they were 10 or 15 years ago	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We use our repurchase policy to make us look better than our competitors	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**11. If you have paid dividends: Do these statements describe factors that affect your company's payout decision?**

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
We consider the level of dividends per share that we have paid in recently	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We consider change or growth in dividends per share	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We try to maintain a smooth dividend stream from year to year	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We try avoid reducing dividends per share	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We pay dividends to show that our firm is strong enough to pass up some profitable investments	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We are reluctant to make dividend changes that might have to be reversed in the future	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
We pay dividends to attract investors that may be subject to "prudent man" investment restriction	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>



**12.If you have not paid dividends: What factors might get your company to consider paying dividends in the future?**

	Not important at all	Less important	Neutral	Somewhat important	Very important
A temporary increase in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
A sustainable increase in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Our company having extra cash/marketable securities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The dividend policies of competitors or other companies in our industry	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The influence of shareholders	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Having fewer profitable investments available(e.g.,as industry matures)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Market undervaluation of our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To attract new investors subject to investment restrictions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**13.If you have repurchased shares: How important are the following factors to your company's buyback decision?**

	Not important at all	Less important	Neutral	Somewhat important	Very important
Increasing earnings per share	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Accumulating shares to resist a hostile takeover	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Changing our debt to equity ratio so it is closer to desired level	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Offsetting the effect of stock options	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The float or overall liquidity of our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**14.If you have not repurchased shares: What factors might get your company to consider buybacks in the future?**

	Not important at all	Less important	Neutral	Somewhat important	Very important
A temporary increase in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
A sustainable increase in earnings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Our company having extra cash/marketable securities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The repurchase policies of competitors or other companies in our industry	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The influence of shareholders	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Having fewer profitable investments available(e.g.,as industry matures)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Market undervaluation of our stock	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Accumulating shares to increase the chance of resisting a hostile takeover	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Offsetting the dilutive effect of stock option plans	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>



## Gordon Institute of Business Science

University of Pretoria

I am conducting a research as part of my MBA studies to understand the factors that drive corporate payout policy decisions in South Africa. To that end you are kindly invited to participate in a research survey which should take no longer than 15 minutes of your time.

Your participation is voluntary and you may withdraw at any time without any penalty. All the information collected is anonymous and will be kept confidential. By completing this survey you consent to the above.

Should you have any concerns, please contact me or my supervisor. Our details are provided below

Contact details

MBA research student: **Bekithemba Sibanda** ([15388710@mygibs.co.za](mailto:15388710@mygibs.co.za))

Supervisor: **Bradley Carter** ([bradley.carter@sasol.com](mailto:bradley.carter@sasol.com))

Survey link: [click here](#)

## ETHICAL CLEARANCE FORM

Dear Mr Bekithemba Sibanda

Protocol Number: **Temp2016-01105**

Title: **Drivers that shape corporate payout policy in South Africa**

Please be advised that your application for Ethical Clearance has been APPROVED.

You are therefore allowed to continue collecting your data.

We wish you everything of the best for the rest of the project.

Kind Regards,

Adele Bekker