# Pay out policy decisions in France A managerial perspective

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# Pay out policy decisions in France
# A managerial perspective

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**Résumé**

Cet article s'attache avant tout à bousculer l'approche purement quantitative des politiques de dividende ou de rachat d'actions en présentant une description qualitative de ces politiques. Notre étude terrain auprès de 12 décideurs français apporte certes un éclairage hexagonal mais il permet surtout une meilleure compréhension des éléments explicatifs ou d'influence des politiques de distribution.

Notre étude présente la distribution de liquidités aux actionnaires comme le résultat d'un consensus entre plusieurs variables : capacité financière de l'entreprise, influences externes et pression de l'actionnariat. Nos résultats confortent la fonction de signal de la distribution et la politique de lissage des dividendes. De nouveaux éléments venant renforcer la réflexion apparaissent : existence d'une culture de la distribution, influence des caractéristiques des managers et des concurrents. Enfin cet article remet en question le rôle de distribution des rachats d'actions et souligne la forte influence des actionnaires majoritaires.

**Abstract**

This paper tries to complement the purely quantitative approach of pay out policies by providing a qualitative description of dividend and share repurchase policies in France. Through a field study with 12 French decision-makers, it helps to understand explanatory elements of pay out policies.

Our study provides evidence that pay out decision is the result of a consensus between various elements: financial capacity of the firm, external influences, and shareholding pressure. The paper supports elements from the literature: influence of financial variables, signal function of pay out and smoothing of dividend policy. It introduces new elements that may lead to interesting questioning: existence of pay out culture in firms, influence of managers' characteristics or competitors' behavior. And at last, it questions the share repurchase role of pay out, the role of taxes in pay out decisions and underlines majority shareholders' great influence.

**JEL classifications:** G35

**Key Words:** Dividend, Share repurchase, Managers Survey, France, Agency theory

Understanding pay out policies has been a puzzle for nearly half a century. Theory has difficulty in explaining firms' dividend and share repurchase behavior. In this paper, we decided to advance in this puzzle through a managerial approach and not an economic one. Our process focuses on pay out policies from inside the firm.

We make the hypothesis that a better knowledge of field reality can provide a way to progress in the puzzle solving. Through a qualitative approach where we have interviewed big decision-makers inside French listed companies, we think we can better understand pay out policies. This can be an interesting step to new theories and new links between variables. Moreover, concentrating on the French market enables to study pay out policies in a different context than the usual Anglo-Saxon one.

This paper provides an elaborated description of decision process, of variables influencing pay out and of players' feelings about pay out policies. Our research supplies a number of observations on pay out policies in the French context. Some new variables emerge, some others question theory.
This qualitative approach has limits. It is only a preliminary work to more quantitative studies, our results cannot be generalized. The aim of the paper is to identify new variables or links between variables, in an exploratory process.

Tackling pay out policies requires first to establish the references that come under literature. Its extent forces to take a bias on the approach. The agency theory approach has been chosen. In the first part of this paper, we survey literature, focusing on recent contributions. To present this literature, we distinguished who takes the decision. Depending on whether there is conflicting relations between shareholders and managers, the decision-maker will be either a manager or a shareholder. This discrimination enables to present main theoretical influences on pay out process.
Our choice of a qualitative analysis, rarely used in pay out policy studies, require a methodological process we have wanted rigorous. The second part of this paper presents the methodology.
At last, in the third part, we expose the contributions of that paper. We describe the decision process, the motivations for pay out and the potential explanatory factors of those policies. We confront those results with the ones from the literature.

# I. A multi-facetted literature.

Let's first define pay out policy. In this paper, we will focus on cash pay out policy, which means cash flows going out from firm to shareholders. These cash flows can be dividends or share repurchases.

## 1. The Dividend Puzzle

First, a few observations are necessary to understand the dividend puzzle. Every year, public firms pay out big part of their earnings to their shareholders (Allen and Michaely (2002)). Pay out can be observed even when firms are cash demanders. In France, firms finance their stock repurchase by debt and cash (Dereeper and

Romon (2003)). Observation shows that investors ask for dividends whereas they are heavily taxed on it and that stock prices rise after pay out. In United States, in the last years, stock repurchases importance has been growing to the detriment of dividends' one (Grullon and Michaely (2002)).

Empirical observations don't match up with the classic theoretical frame defined by Modigliani and Miller (1961): on perfect and efficient markets, firm value is only determined by investment. There is no dividend premium on stock prices and investors have no preference between dividend and capital gain.

The gap between theory and empirical studies was called the "dividend puzzle" by Black, in 1976. This puzzle wonders why investors like dividends whereas they are heavily taxed on it and so on why firms pay out big amounts of money every year. The puzzle has become more complex with the growing importance of share repurchases.

This paper surveys research on pay out policies focusing on the firm point of view. It sets up some answers to why firms pay out. We will not focus on explanations of share price reactions or investment strategies linked to pay out policies. We will only focus on what happens inside the firm.
To follow this path, we have chosen to classify concepts depending on who takes the decision in the firm: shareholders or managers. If there is no agency conflict, decisions will be in accordance with shareholders' wishes. Otherwise, managers will influence pay out policies.
Of course, shareholders' wishes are not homogeneous and some shareholders may be more influential than others. In French firms, the major agency conflict is not between managers and shareholders, but between controlling shareholders and minority shareholders. (Ginglinger and L'Her (2002)). In this case, shareholders' influence is main shareholder's one.

# 2. Why firms pay out?

## 2.1. No agency conflict between shareholders and managers.

If there is no conflict between shareholders and managers or if this conflict has been resolved, managers stick to shareholders stakes. Pay out can then be justified by various theoretical explanations:

- *Pay out happens because shareholders want it :*

First, shareholders may ask for pay out if they need regular cash and if dividend is the cheapest way to get it. This happens if transaction costs on capital gains are superior to dividend taxes. On a second hand, shareholders may face institutional constraints that require them to invest in paying out firms. Empirical support for those two explanations is weak: few institutional constraints exist (in particular in France) and most of the times, transaction costs are smaller than dividend taxes.
Shareholders may also ask for pay out because they like it. Behavioral finance shows that some human bias may lead to such non-rational preferences (Shefrin and Statman (1984), Baker and Wurgler (2004)). Empirical support of that theory is growing.

- *Pay out is observed because of information asymmetry between shareholders and managers.*

Managers are better informed of firm's future cash flows and signal this information to shareholders through pay out. Theory tells pay out is a good signal because it is costly and because bad signals are penalized (Albouy (1997)). This signal hypothesis leads to various theoretical models where managers adjust dividend to their forecasts: if they are good, they increase dividend and vice versa. (Bhattacharya (1979); Miller and Rock (1985)).

Empirical support of the signal theory is ambiguous. On one hand, dividend changes are followed by variation of stock price, which shows that information is integrating in prices. Moreover analysts modify their forecasts after pay out. But, on the other hand, earnings vary much more than dividends, so what does it signal? Moreover, big companies, where information asymmetry is weaker because of transparence legislation, are the one paying the biggest amounts of dividends.

## 2.2. Existence of an agency conflict between managers and shareholders.

In case of an agency conflict between shareholders and managers, various theories justify cash pay out. First, shareholders use pay out to monitor managers. Second, private interests of managers may influence pay out policies.

- *Shareholders use pay out to monitor managers*

According to Jensen and Meckling (1976), public firm's managers have self interests differing from shareholders' ones. They spend firm's money to promote their own interests and not shareholders' ones. Jensen (1986) shows that pay out enables to minimize cash under managers' control. This situation leads managers to regularly ask the market for money and face shareholders' monitoring (Rozeff (1982); Easterbrook (1984)).

Allen and Michaely (2002) underlined limits of that theory: if shareholders know that managers overinvest, why would they not impeach them a different way? This leads us to question efficiency of corporate governance mechanisms.

Once more, empirical support of that theory is ambiguous, mainly because it is difficult to measure managers' overinvestment. In our opinion, proxies are the heart of the matter because of the difficulty to measure Tobin's Q, main proxy used for overinvestment. Some pinpoint the weakness of that theory (Lang and Litzenberger (1989); Yoon and Starks (1995)), some others support it, for example, Borokhovich et al (2005) using more precise proxies to measure agency conflict than those traditionally used.

- *Managers' own interests influence pay out policies*

Sometimes shareholders do not monitor managers because they cannot or do not want to. What consequences does it have on pay out policies?

* Managers can use pay out to consolidate their entrenchment. Hu and Kumar (2004) show influence of entrenchment factors on pay out policies. Fuller and Thakor (2004) present a model where managers' value operating flexibility and increase it by reducing dividends and conserving cash.

* Managers' values or psychology may influence pay out policies. Carnegie School researchers show that complex decisions are more the consequence of behavioral factors than of economical optimization (Cyert & March (1963), March & Simon (1958)). The more complex a decision is, the more behavioral factors matter. Hambrick and Mason (1984) proposed a model where strategic choices are partly the reflection of decision-makers' characteristics. Bertrand and Schoar (2003) support this theory showing that CEO's characteristics are important determinants of various policies, such as dividend ones.

Using the agency theory frame and the concept of conflicting relations between managers and shareholders, we have presented various theoretical justifications to pay out policies. Using the same frame, let's now survey explanations on shapes pay out policies take: dividend or share repurchase.

# 3. Choice between stock repurchase and dividend.

As mentioned in introduction, cash pay out policies have two possible shapes: dividend and share repurchase. Those two means being distinct, firms are often confronted with the choice of the pay out tool. Research is also interested on that point and speculates on the links between those tools. In our opinion, three main interrogations come into view: are dividend and repurchase only pay out tools? Are they complementary tools of pay out thanks to their particular features? Is a substitution of one tool by the other possible?
To the first question, we can answer that dividend is only a mean of pay out, but share repurchase has other functions. For example, it might be used as a relution tool.
Concerning the substitute or complement hypothesis, Grullon and Michaely (2002) have supported the substitution hypothesis of dividend by share repurchase. But Dereeper and Romon (2003) showed that in France amounts paid in dividend have not decreased since share repurchases are allowed. This supports the complementary hypothesis. Anyway, most theories make the hypothesis that dividend and share repurchase are potential substitutes.

Let's now see the main theoretical justifications to the use of one or the other tool for pay out.

## 3.1. No agency conflict between managers and shareholders.

If there is no conflict of interest between managers and shareholders, the firsts follow the wishes of the lasts. In consequence, the choice between share repurchase and dividend results from the potential following situations.
Dividend will be chosen if shareholders have a preference for dividend (regular need of cash or irrational preference as reported by Behavioral Finance).
Shareholders may also prefer share repurchase for its special attributes:
- In most countries, share repurchases are less taxed, so shareholders might prefer such a pay out (Dittmar (2000)). Barclay et al. (2004) do not support the tax clientele hypothesis. They find no evidence that dividends are higher in firms that have corporate blockholders, whereas corporations should have an interest in dividend paying firms. On the contrary, Blouin and Nondorf (2004) demonstrate that the tax status of influential shareholders plays a significant role in firms' pay out policies.

- Repurchase can enhance shareholder value. It can be used to cancel lost due to stock options dilution. Moreover, it helps to reevaluate stock prices (Dittmar (2000)). Repurchase also enables risk transfer from shareholders to debtholders by reducing the amount of capital (Dittmar (2000)).
- At last, stock repurchases enable non-selling shareholders to consolidate their control of the firm.

## 3.2. Presence of agency conflict between managers and shareholders.

In presence of agency conflict, two situations appear:
- *Shareholders compel managers through mean of pay out*
On one hand, dividend helps to attract some particular institutional investors better at monitoring managers than current shareholders (Allen, Bernardo and Welch (2000)). This model is supported in France by Debaere (2003) and is inconsistent with Grinstein and Michaely (2005) study.
On the other hand, repurchase is good for corporate governance: Oswald and Young (2005) show that after stocks repurchase, the quality of firm's governance improves. So shareholders may force managers to repurchase stocks to improve their control.

- *Managers choose to do repurchase or dividend because it is in their interest. Each tool might have specific advantages for managers:*

 * Repurchase is less restricting than dividend. Repurchase does not have to be regular through time, so managers undergo fewer constraints from shareholders using this tool. Moreover, managers can use stock repurchases to protect from market control: facing a takeover that threatens their job, managers can buyback shares. This leads the takeover to be more expensive and so less likelihood. (Dittmar (2000)).

 * Dividend helps to strengthen managers' entrenchment (Hu and Kumar (2004)).

 * If managers have stock options, they have an incentive to repurchase shares. Because repurchase helps to minimize dilution effect of dividends and increases Earnings per Share, it enhances managers' stock options value. This hypothesis receives a strong empirical support (Fenn and Liang (2000), Weisbenner (2000), Kahle (2002)).

This survey of main theories explaining why firms pay out and why there are dividends or stock repurchases has shown limits of actual research. Empirical support to those theories is either limited or ambiguous. Afterwards, it is hard to know how to move forward the resolving of the dividend puzzle.
We think the solution of the dividend puzzle may lie in a complex integrated model, with many variables. Theories presented here might lack some important variables. Ways to find new explanatory variables have to be found. One direction researches have taken is to study practitioners' understanding of pay out policies.

## 4. Managers’ point of view

One way to lighten the puzzle may be to investigate practitioners understanding of pay out policies. So, we now survey the results of those studies, and in particular Lintner’s one.
Lintner (1956) pioneering contribution shows that the determinant factor of dividend policy is the change in dividend. Most managers suppose shareholders prefer and value stable or growing pay out ratios. Changes in dividend rate must be justified by reasons understandable to shareholders, like for example a variation in earnings. Lintner shows that managers believe that it is necessary to pay out substantial part of their earnings in dividends. Even managers less worried about shareholders or dividends are convinced that dividend must reflect firm’s earnings, otherwise it can have a bad effect on some factors (such as the stability of their own position).
Surveyed firms have a target pay out ratio. This target ratio is an aim and not something to be applied immediately. Target ratio and speed of adjustment vary depending on firms, sectors and economic situations.

Results of managers surveys made in the last 20 years confirm Lintner’s results, showing that pay out policies determinants have not much evolved in the last fifty years. Moreover, those surveys show stock repurchase motivations are various and hazy. On the whole, repurchase are not considered as a dividend substitution or as a mean of pay out (Baker, Powell and Veit (2003); Brav et al. (2005); Gillet (2000))

Those surveys underline the importance of past pay out policies and of managers’ beliefs. They also question the role of stock repurchase. But their interest is tempered by their limits: they are either old or limited. Lintner’s paper is 50 years old and more recent papers use only quantitative surveys, which tend to induce too much the answers.

# II. Justification of a qualitative approach

Facing those researches and their limits, it is difficult to progress in the puzzle solving. Which research ways have to be followed to overcome the puzzle?
In this paper, we make the hypothesis that a better knowledge of field reality can provide a first way. Through a qualitative approach, we think we can understand better pay out policies from inside the firm. This might be an interesting step to new theories and new links between variables.
This idea is reinforced by the suspicion we have that current theories cannot apply perfectly to the French market. Those theories form a coherent frame inspired by Anglo-Saxons markets. But given the complexity of the puzzle, it seems difficult to put aside the effect of context variables such as legislation or culture (La Porta et al (2000)).
The process of this paper is to focus on pay out policies, from inside the firm, in France. We try to provide an elaborated description of decision process, of variables influencing pay out and of players’ feelings about pay out policies. We propose to bring a contribution to the solving of the puzzle at a national, then global level.

To enable that description we have chosen a qualitative process. We interviewed individually important decision-makers inside French listed companies. To warrant the scientific character of our process, we now present the methodology we used for that study.

**Study methodology**

- Presentation of the population

The quality of our study is first linked to the people we have interviewed. The following table gives marks to judge the reliability and expertise of our respondent, while respecting the anonymity we have warranted.

*Table 1: Presentation of the population of respondents*

| RESP. | POSITION | STOCK MARKET AND FIRM SECTOR[1] |
|---|---|---|
| 1 | CEO, former CFO | Eurolist A / Industry |
| 2 | CEO, former CFO | Recently gone out of market / Industry |
| 3 | Former CEO<br>+ Board director of two other French listed firms | Eurolist A / Finance<br><br>Eurolist A / Consumption goods |
| 4 | Member of executive committee of the group, CEO of one subsidiary | Eurolist A / Consumption goods |
| 5 | CFO | Eurolist C / Industry |
| 6 | CFO | Eurolist B / Services |
| 7 | Financial manager | Eurolist A / Technology |
| 8 | Financial manager | Eurolist A / Finance |
| 9 | Financial manager : Chief of group financing operations | Eurolist A / Services |
| 10 | Financial manager : Treasurer | Eurolist A / Resource |
| 11 | Financial Analyst | Distinguished by the profession. Work in an Investment Bank. |
| 12 | President | Minority Shareholders Association |

The size of our sample has been determined thanks to the saturation criteria. From the tenth interview, we thought we had reached a saturation of information collected and stopped after the twelfth interview.

- Method and interview guide

We choose to do semi-structured interviews. This lets freedom of speech to the interviewee, while avoiding the conversation to get out of hand. We made three guides: one for the managers, one for the analyst and one for the president of the minority shareholders association. The following table shows the main themes of the guide.

[1] Sector classification used is from the French economic newspaper “Les Echos”.

*Table 2: Presentation of main themes tackled during managers' interviews.*

| | |
|---|---|
| Theme 1 | <u>Decision Process.</u><br>⇒ Identity of people or boards involved in dividend and share repurchase decisions. |
| Theme 2 | <u>Factors taken into account to decide dividend and share repurchase policies.</u><br>⇒ Managers' motivations to pay out: why do they repurchase shares, why do they pay dividends?<br>⇒ Internal variables explaining pay out: financial factors taken into account to determine pay out. But we also tried to understand firm cultural characteristics or managers psychology. |
| Theme 3 | <u>External influences on pay out policies</u><br>⇒ What are the external influences? Markets, shareholders… |

We ran the interviews with respect for main principles advised for qualitative surveys (Huberman and Miles (2003)).

<u>- Data analysis</u>

Analysis followed two steps. First, we did the coding of the texts, then we quantitatively analyzed them. Each interview has been entirely retranscribed to enable a rigorous study.

Coding is the action of "cutting the content of a speech or a text in analysis units and integrating them in categories chosen in accordance with research aims" (Thiétart (1999)). Analysis unit can be defined as "the element by which the researcher will proceed to the cutting of the speech or text" (Thiétart (1999)).
In our study as in many management studies, we chose to base coding on meaning units or themes. This choice is related to the fact that we want our analysis to result in questionings and thoughts about pay out policies.
As the analysis unit is theme, its size will vary from word to paragraph. To help us in the coding, we used the NVIVO software. When each theme had been affected with no doubt to a category and that there were enough regularities, we decided to stop the analysis. At that point, we thought we had reached saturation.
As a whole, in our 12 interviews, we coded 1367 themes and affected them to 197 categories and sub categories. The 4 main categories are the following: *Decision Process*, *Motivations to pay out*, *Explanatory factors* and *Description of pay out policies*

Thanks to those categories, we started content analysis. There are two types of content analysis: quantitative and qualitative ones. First one computes the frequency of a theme in a category, second one tries to estimate the importance of a theme a qualitative way. "Difference between qualitative and quantitative analysis lies in the way they understand the notion of importance of a category: "number of times" for quantitative analysis and "value of a theme" in qualitative analysis." (Thiétart (1999)).
We thought, considering the kind of interviews we did that the best method to estimate the importance of our themes was to look at their repetition. So we chose to do a quantitative content analysis.
We counted themes in each category and computed frequency of apparition of each category inside its main category. This enables us to know the importance of a theme inside its category.
Frequency computation analyzes repetition in the whole amount of texts, leaving aside who told it. So we completed our analysis by computing the number of respondents who stated each theme.

At the end of our analysis, two pieces of information permitted to quantify the importance of a theme: the frequency of apparition of a theme inside a category and the number of respondents who stated that theme.

Our 1367 themes have been divided in 4 main categories. *Explanatory factors* category received 62% of the themes, 18% went to the *Decision Process*, 10% to *Motivations to pay out* and 10% to *Description of pay out policies*. Inside each of those 4 categories, themes have been divided in sub categories for which we also computed frequencies.

# III. Light on pay out policies

In the scientific literature, pay out can have two shapes: dividend or share repurchase. Two kinds of dividends exist: ordinary dividend and special dividend. One current research issue is to determine the relation between dividends and share repurchases. Are they substitutes or complements? Is share repurchase the potential substitute of ordinary dividend or of special dividend? Before presenting our results, it is important to give respondents' definition of pay out policy and more specifically of stock repurchase.
First, in their opinion, share repurchase is not a substitute to ordinary dividend. Then, two definitions of pay out emerge:

- For a minority, share repurchase is understood as a substitute to special dividend. Pay out policy has two levels. First the payment of an ordinary dividend stable and smoothed. Then, a second payment, less regular, through repurchase or special dividend.
- For a majority of respondents, share repurchase is not a mean of pay out. It answers to others aims such as relution or stock price management. In this case, pay out policy is only dividend policy.

Now that we have made clear what is pay out policy for our sample, let's present our results. First, we will describe the decision process of dividend and repurchase policies (1). In a second section, we will expose the managers' motivation to pay out dividends and stocks repurchase (2). Last, we will present explanatory factors of pay out policies (3).

## 1. Description of the decision process

Themes about decision process helped us to understand the way the decision is taken, going beyond the legal process.
Various people or boards take part in that decision: board of directors, chairman, CEO, CFO and the shareholders' meeting.
The board of directors is undeniably the main decision-maker. Its role was underlined by 11 out of 12 respondents. 48% of the "identity of dividend decision-maker" category (so 38 themes) and 24% of "identity of repurchase decision-maker" category (8 themes) support the essential role of the board.
In France, on a legal level, shareholders' meeting is the actor that ratifies the pay out proposition made by the board. In reality its power is limited. Four respondents only (11% of themes from the "identity of dividend

decision-maker” category and 24% of “identity of repurchase decision-maker”) underlined its decision-maker role, whereas 8 respondents told us its role was limited. In fact, shareholders always ratify the board proposition. Only one of our respondents told us shareholders’ meeting could sometimes oppose the board. He commented on the rejection that the shareholders’ meeting had done to a dividend proposal, the year before the interview. Shareholders leaded by a few institutional investors had voted a higher dividend than the board proposal. The power of the board questions its homogeneity. Who are the directors? How much do they agree with average shareholder’s point of view?

The financial management has a key role in the determination of pay out policy. It builds pay out proposals and advises decision-makers (10 respondents out of 12 underlined this role). This role of consultant is sometimes shared with bank counselors who help firms to finalize their pay out decisions. The CFO usually implements share repurchases. He might also be the initiator of repurchase programs.

Those elements summarize the decision process as our respondents presented it. They all described a quite similar situation. Yet, 7 out of 12 respondents told us their feeling of being a particular case in the way they run their pay out policy. This feeling is usually linked to a particularity of their firm; still it does not lead in our opinion to different processes.

It is also interesting to see that the interviewees described the pay out decision as simple and non-strategic. The decision seems evident and is taken quickly. The gap between the huge amount of literature about the dividend puzzle and managers’ feeling that pay out is a very simple decision is striking. Here are a few verbatim to illustrate this point.

Respondent n° 6 “Those decisions are neither strategic, nor very important”

Respondent n° 7 “In our firm, the dividend policy is very, very simple”

Respondent n° 4 “It is not sophisticated, it is really not sophisticated. We are more in the emotional reasoning”

Let’s now see how and why those pay out decisions are taken.

## 2. Motivations to pay out

To understand pay out policies, it is essential to know why those decisions are taken. In this section, we will present results about motivations that drive managers to pay dividends or to vote repurchase programs. Literature shows various potential motivations, we will compare them to the ones issued from this study.

A first result of interest is the fact that respondents have more talked about their motivations to do share repurchase than about their motivations to pay dividend. For respondents, it doesn’t seem necessary to talk about dividend motivations because they are obvious: it is a shared feeling that it is necessary to pay out dividends. According to 4 respondents, it is normal to pay out dividends if the firm can. There must be no talking about it: dividend is the normal remuneration for shareholders. For the others, payment of dividend is a way to satisfy shareholders (33% of the category “dividend motivations”, that is to say 12 themes), to send a positive signal

(22% or 8 themes) and to supply shareholders with cash they asked for (14% or 5 themes). Pay out is not linked to any clientele effect.

On the other hand, there are numerous motivations to vote and implement a repurchase program. Relution effect of repurchases is the first motivation brought up. Relution effect is mainly used to block dilution linked to stock options, but also convertible bonds (11 of out 12 respondents talked about this motivation, and it represents 44% of the category “repurchase motivations” or 36 themes). Stock repurchase is also a tool to manage stock price (15%) by improving volatility and liquidity. It is also used to finance external growth (10%) or to revalue the stock price (10%).
Revaluation may be a motivation, but respondents showed they were not sure of repurchase effect on stock price. They agreed on the fact that dividend causes an increase in price but disagreed on repurchase effect. Respondents thought its effect on stock price was either positive or negative, but mentioned the difficulty to measure repurchase consequences on stock prices. This is consistent with the results from the literature. Some studies show a positive reaction of stock prices after a repurchase. But according to Allen and Michaely (2002) those results are ambiguous.

Even if the repurchase program is not going to be implemented, respondents think it is necessary to vote it (9%):
<u>Respondent n°6</u>: “It is nearly an obligation to have a share repurchase program” – “I can’t imagine a listed company not having a stock repurchase program” – “We have had that program for a long… long time. Above all, for comfort reasons”
<u>Respondent n°9</u>: “But it seems weird - as there is only one shareholders’ meeting a year – to not have a repurchase program voted, in case of. ”

Those results do not entirely match the motivations listed by the literature. Here are a few examples:
*Share repurchase and pay out:* Let’s note that the repurchase program does not seem motivated by paying out unlike what literature assumes. No respondent clearly displayed as a motivation for repurchasing the fact of paying out. Nevertheless, 5 respondents listed annulment of shares as a motivation (6%) and this is technically associated to pay out. This result is amazing knowing that some managers mentally associate repurchase to pay out (as we will see later on).

*Takeovers:* Repurchase, as a protection against takeover is neither a motivation displayed by managers. Of course, this motivation may not be the kind managers would tell first, but some of the firms interviewed have recently been threatened by a takeover, so it could have appeared as a motivation. This result is consistent with Brav et al (2005). In their survey only 14% of their respondents consider stocks repurchase as a protection against takeovers.

*Signal:* Contrary to what the literature says, signal doesn’t come out of that study as a motivation for pay out, but more as a consequence of pay out. Our respondents has mentioned 57 times the fact that pay out sends a signal, but they only mentioned it 8 times as a motivation for their pay out policy.

Once again those results are consistent with the ones from Brav et al (2005). On page 17, they sum up this fact : “Payout policy conveys information, however it rarely is thought of as a tool to separate a company from competitors”

We found the signal sent by dividend pay out is different from the one sent by special dividend or share repurchase. This is consistent with signal theory.

On one hand, ordinary dividend sends a positive signal, indication of managers’ trust in future firm’s earnings. The stability and slight growth of dividend make the signal better, whereas cutting the dividend sends a bad signal.

On the other hand, special dividend and share repurchase send negative signals. They signal an excess of cash and a lack of investment opportunities. This point is shared by half of the respondents.

This difference in signal has been theorized and tested by Guay and Harford (2000) and Jagannathan et al. (2000). They show that dividend is used to pay out regular cash, contrary to repurchase used to pay out temporary cash.

To conclude, it appears that in the French case, dividend is the normal remuneration of shareholders. Share repurchase is a financial tool, which use is motivated by relution and stock price management. The pay out motivation of repurchase program does not appear clearly, even if some respondents talked about annulment of shares.

Let’s now take an interest in explanatory factors of dividend and repurchase policies.

# 3. Explanatory factors of pay out policy

Let’s now present elements taken into account by decision-makers to decide on their pay out policy. Those elements can be objective or subjective and have a direct or indirect influence.

We conclude from our study that decision of pay out policy is the result of a consensus between several variables with different importance. We classified those factors in three categories: internal and financial variables (3.1), elements linked to managers and shareholding (3.2), and elements external to the firm (3.3).

We will first present those factors, and then we will comment factors explaining the choice made between dividend and repurchase (3.4).

## 3.1. Internal and Financial factors

Those elements are important explanatory factors if we refer to their frequency of quotation: 33% of the category “Explanatory factors” or 278 themes.

Some financial elements have an influence on pay out policies: earnings, cash, investment opportunities and debt level. These results support anterior researches.

***Earnings:*** Level of earnings is one of the first elements firms take into account when deciding pay out (13% of category "Internal and Financial factors" or 36 themes). This is not surprising because dividend is seen as a share of benefits between shareholders.
But, 5 respondents questioned the influence of earnings. Managers smooth ordinary dividend and insofar as it is possible, they will avoid cutting it. So dividend is not going to be the exact reflect of earnings and will sometimes be totally disconnected. So pay out is more linked to average firm performance than to net earnings.

Early, influence of earnings on level of payout has been underlined by empirical literature. Lintner (1956) showed that the main factor justifying change in dividend payment is change in earnings. However smoothing of dividends make the relation unclear. Later, Benartzi et al (1997) found that changes in dividends result from changes in past earnings and not futures earnings [2].

***Level of debt:*** For 9 interviewees, debt level is an essential adjustment factor for dividend (15% or 42 themes). Sometimes, it is the first criteria: if debt is high, firm cannot pay out too much cash in order to be able to improve its situation. At the opposite, if debt is low, firm pays out to avoid that the level of net debt becomes negative and damages firm value.
Importance of debt on pay out policy is also underlined by Brav et al (2005).
A survey of literature shows a substitution between debt and dividends (Calvi-Reveyron (1998)). When debt is high, pay out is low and vice versa. In France, Calvi-Reveyron (1999) found long term debt rate has a negative influence on dividend yield. This is consistent with our results.

***Investment opportunities:*** Respondents underlined several times the influence of investment opportunities on pay out policy (29% of category "Internal and Financial factors", 78 themes). Level of investment of the firm's sector plays on long-term level of ordinary dividend. In case of higher than average investment, ordinary dividend is not reduced but special dividends and repurchases are cancelled.
Level of ordinary dividend is fixed according to the average level of investment the firm does. Those three verbatim illustrate that point:
<u>Respondent n° 7</u>: "He *(the CEO)* said: the firm has to invest a lot, we are in an activity in which we need to do research, in which we need to invest in men […] and he considered that a third of benefits would go to shareholders and that the rest had to be reinvested in the firm"
<u>Respondent n° 8</u>: "We are on a long term logic, we say to ourselves the group earns 3 billions euros, we pay 1 in dividends and we keep 2 billions to finance internal or external growth"
<u>Respondent n° 2</u>: "The business was on a very good market segment. This segment is developing and is profitable. As a result, we could say that optimization of capital consisted in not paying dividends […] and that it is better to keep the maximum amount of money to be able to finance growth."

If there is a big investment, ordinary dividend is not cut, even if it means looking for new funding (according to two respondents). Sporadic investments influence above all the level of repurchases or special dividends. Firm

[2] See Allen and Michaely (2002) for a literature review on links between dividend and future earnings.

will pay out this way if it hasn't any investment opportunities (15 themes and 8 respondents). In case of big investments, ordinary dividend growth is slowed down, repurchases or special dividends are cut.

Respondent n° 1: "For us, the dividend is something on what shareholders must be able to count, except accident or permanent drop in earnings. On the contrary, if we have a big investment, at this condition, of course, there will be no special dividend"

Respondent n° 4: "No, *(in case of big investment)*, we would not decrease the dividend […], we would look for an increase in capital or we would increase debt or we would sell an other asset, but I don't think that dividend policy would be broken, for all that."

Respondent n°11: "For example, firm X *(one middle size firm on French stock market)*: if they decided to pay out special dividend last year, it is because they judged that in the firm's strategy, there was no way to value the share, because keeping the cash would have not created development opportunities"

***Cash level:*** Cash level independently from earnings level, has an influence on pay out, especially on special dividend and repurchase. The use of those two means of pay out seems to be highly motivated by the presence of cash inside the firm (41 themes or 15% of the category and 11 respondents).

Influence of cash level and investment opportunities on pay out policies remind us Free Cash Flow theory. Jensen (1986) defined FCF as the cash remaining after having invested in good project. Level of FCF plays a role on the determination of pay out. Shareholders ask for pay out because it decreases cash under management control and though helps managers monitoring. The effect of FCF on pay out policy has been underlined in many studies (Lang and Litzenberg (1989), Nohel and Tarhan (1998) for USA, Stouraitis and Wu (2004) for Japan). Our survey underlines once more the importance of FCF.

Moreover, the two financial institutions interviewed underlined the influence of level of equity on pay out policy. This specificity is explained by the bank regulation.

***Other internal factors:*** One point little developed by the scientific literature (except by Frankfurter and Wood (2003)) has been quoted by our respondents. It is the existence of a pay out (or non-pay out) culture in some companies (10% of themes in "Internal and Financial factors" or 28 themes). This culture pushes decision-makers to pursue past pay out policies. They will be inclined to pay out dividend if the firm has always done so and not pay out if the firm has never done so. Nine respondents mentioned the existence of pay out culture. Here are two verbatim to illustrate that point:

Respondent n°11: "The proposition that is made is function of last financial year, inevitably and then function of historical pay out policy of the firm"

Respondent n°7: "Firm culture is to pay out a third of benefits if there are benefits and nothing if there are losses. It has always been the case" – "As a conclusion, it seems to me that the dividend results of an arbitrary decision, decided a long time ago"

## 3.2. Elements linked to shareholding and managers.

Those elements are essential if we refer to their frequency of quotation (40% of themes of category “explanatory factors” or 348 themes).

Our respondents underlined the importance of shareholding structure, of shareholders’ preferences and of chairman or CEO characteristics. Moreover, managers interviewed exposed their principles or conceptions of how pay out policies must be run. These principles strongly influence the decision.

***Shareholding structure:***

Our results show that two determinants of shareholding structure influence pay out decisions: the existence of a majority shareholder (35% of the category “Influence of shareholding structure” or 21 themes) and the amount of floating capital (17% or 10 themes).

<u>- Presence of a majority shareholder:</u>

Respondents exposed the consequences of having a majority shareholder. Depending on who is the main shareholder, we note different patrimonial interests that play on pay out (17 themes and 6 respondents). The way the shareholder financed its shares is an important determinant: if he borrowed money, he needs a steady cash flow to refund its loan and will ask for dividend. On the contrary, if he inherited his shares, he slows down pay out. Our study also shows that majority shareholders try to limit dilution of cash and power and favor pay out that limits both kind of dilution, depending on their priorities (10 themes and 4 respondents). Here are two verbatim to illustrate this influence:

<u>Respondent n° 8:</u> “We have a very strong demand from X *(the majority shareholder)* and we know that we can’t […] cut or double a dividend”

<u>Respondent n° 3:</u> “At the last board meeting, the CFO of X *(majority shareholder of firm 3bis)* kindly remarked that the more we pay out, the more there would be flight of capital outside the group. This is fair, knowing that their main worry is to manage their funded debt”

<u>- Part of floating capital:</u>

When floating is high, managers are less influenced by shareholders desires and are more free to decide pay out. But, in one of the ten companies we studied, it appears that the high floating capital had given back power to the shareholders’ meeting. And that it has driven to a failure of board dividend proposition.

***Shareholders’ preferences:***

Shareholding structure gives more or less power to one shareholder, to a group of shareholders or to managers. Influence on pay out policy will depend on the will of the ones who decide.

Respondents commented on shareholders’ preferences and their influence. First, investors, mainly individuals, like dividends. Moreover, according to 5 respondents, individuals tend to wary of share repurchases, they don’t understand it and are suspicious about it.

Anyway, for a majority of respondents, individual preferences and taxes (except majority shareholder’s one) are not taken into account at the time of the pay out decision. The global state of the market is more influent than individual preferences. For example, at the end of 2004, firms thought about the impact of the new dividend tax system, but they did not put interest in individual taxes. Only the preferences of influent shareholders can play on the choice of pay out policy.

Our results on shareholders' influence found an echo in literature. They tend to support the agency theory and not the tax theory. Empirical evidence on the influence of taxes on pay out policies is once more weakened (Allen and Michaely (2002), Brav et al. (2005)), except for the tax influence of main shareholders (Consistent with Lie and Lie (1999) that showed managers are more aware of their shareholders' taxes when institutionals hold large blocks).

Our first result coherent with agency theory is the influence of shareholders concentration and the non-influence of minority shareholders on pay out. The presence of a large shareholder enables less monitoring and enables less dividends. This link has been supported by Rozeff (1982), Moh'd, Perry and Rimbey (1995), Dempsey and Laber (1992) and Lloyd, Jahera and Page (1985).
Some recent papers also underlined the influence of large shareholders' identity on dividend level. Correia Da Silva et al (2004)'s study in Germany showed that firms which main shareholder is a bank tend to pay out less than firms with other types of main shareholder or no main shareholder. Perez –Gonzalez (2000) also showed that pay out is more impacted when the main shareholders is an individual than when it is an institutional, or when there is no main shareholder.
At last, neutrality of minority shareholders on pay out policies is supported by many empirical studies (Crockett and Friend (1988), Grinstein and Michaely (2005), Jain (1999), Lie and Lie (1999))

***Managers' characteristics:***
Let's tackle now the influence of management's characteristics on pay out policies. The category "Influence of chairman or CEO" holds 21% of the themes of its upper category "Influence of Managers". The rest of this category is held by the category "Managers' conceptions of pay out policy"

Our results show that chairman characteristics such as its education, its personality or the fact that he is at the same time chairman and CEO or shareholder might influence pay out policies.

***Managers' conceptions of how to run pay out policies***
In the course of interviews, respondents discussed about their conceptions of how to run pay out policy. They mostly stated on how to run a dividend policy and on the relationship between share repurchase and dividend. Those themes are often mentioned and undeniably influence pay out policies. Managers tend to agree on dividend smoothing, but disagree on the position share repurchase holds.

<u>- Dividend smoothing:</u>
Respondents agreed on the necessary stability of ordinary dividend (10 respondents said so and 36 themes have been counted). Dividend has to be stable and if possible slightly growing. Managers avoid cutting it. They will neither increase it if it has to be cut the year following.

This is not a surprising result as the importance of smoothing dividend has been underlined in many studies based on managers surveys (Lintner (1956), Brav et al. (2005), Baker, Powell and Veit (2001)). Those results are also supported by Allen and Michaely (2002) who showed a great stability of dividend payment during the years 1972-1998.

- Positioning Stock repurchase / Dividend:

Our study helps to understand share repurchase reality as a mean of pay out.

A majority of respondent (40% of the themes on "Positioning Stock repurchase / dividend") do not consider stock repurchases as a mean of pay out. Stock repurchase is only used for relution or stock price management. Most of those respondents understand that repurchase can be a mean of pay out, but they do not want to use it like that.

For the others, (43% of that category), pay out policy involves two parts:

- First, an ordinary dividend smoothed and stable
- Then, shares repurchase program or a special dividend to pay out extra cash. This pay out is unstable.

First, those results lighten a difference between USA and France. Brav et al (2005) found managers do not consider dividend and share repurchase as substitutes, but they do consider repurchase as a mean of pay out. This might be linked to the fact that share repurchase has been allowed for a long time in USA whereas it is only allowed since 1998 in France. In consequence American point of view might comes to France one day.

Second, our results (for those managers who consider repurchase as a mean of pay out) echoe those from Guay and Harford (2000) and Jagannathan et al (2000) that showed that repurchase is used to pay non recurrent cash.

***Existence of a conflicting agency relation***

Five respondents showed that they were conscious of the existence of an agency relation between shareholders and managers. They mentioned that if this relation is conflicting, shareholders ask for pay out to avoid letting free cash in the firm. Those results fit agency theory which conclude to the influence of conflicting agency relation on pay out policies.

## 3.3. Elements external to the firm

Our study shows that managers also take into account elements from outside the firm when they decide pay out policies. Those elements collected 20% of themes from our category "explanatory factors" (183 themes).

What is said or done outside the firm influences pay out. The main influence comes from financial markets (65% of themes from « External influence » or 119 themes) and then from competitors (14%, or 26 themes).

***Financial markets' influence***

This influence materializes mainly through analysts and portfolio managers' opinions (23 themes). Press and foreign markets also influence firms in their pay out policies.

Those actors create a kind of "market opinion", which is listened at very carefully by firm managers. Those actors judge firms, but above all they raise rules that have to be followed. Respondents mentioned (17 themes) the strong markets' influence on good corporate governance principles, information and transparence requirements, accepted level of risk….

More precisely, several points of influence concerning pay out policies comes out of our study:

- Dividend culture:

There is a strong dividend culture on markets. It is good to pay dividends and firms must do it. Some interviewees think markets would not understand that repurchases take the place of dividends. At the end of the interviews, I asked some respondents if they could imagine a substitution of dividends by share repurchases. The following verbatim shows we are far from it in France:

Respondent n°7: "Where I am very surprised, it's because it didn't come to us, or I am wide of the mark, or the company for which I work is totally wide of the mark, but this issue of pay out policy with dividend and share repurchase has not come to us at all."

- Shares repurchase fashion:

3 respondents out of 12 mentioned that share repurchases is a fashion that has to be followed. Besides, most respondents think a share repurchase program has to be voted even if it is not planned to implement it. Not having such a program can be bad for the firm's image on markets.

Respondent n°5: "There was a little fashion effect in stock repurchase and at a time share repurchase was a way to be in good books, it was very in fashion, all companies at the forefront were doing it. So, we thought about the issue and we said after all why not us."

- Yield share and Growth share:

Markets distinguish Yield shares and Growth shares. Firms with high yield, called "yield shares" pay out big money. Firms with high growth, called "growth shares" have a good growth of their stock price. This distinction influences firms at the time of their pay out decision. If a firm is ranked in yield shares, the dividend paid out is very important and pay out policy will be looked at very carefully. Whereas, growth shares thanks to their stock price potential don't have pay out obligations.

***Competitors influence***

Six respondents mentioned their main competitors as a model for their pay out policies. The influence of the sector obtained ambiguous support from the literature. In our study, concerning pay out, firms try to be the less distinguishable from their competitors they can.

Respondent n°8: "We look at what our friends are doing, […], we look at each others and we check that we are not disconnecting us from what the market is doing."

Respondent n°9: "And, of course, we also look at what our big competitors are doing, to avoid, if there are differences, to have arbitrages against us."

## 3.4. Factors explaining choice between dividend and share repurchase.

As seen before, some respondents assimilate repurchases to pay out. The study of those interviews has permitted to find out a few explanatory factors of the choice made between the two means of pay out. As said previously, this choice is done mainly between special dividends and repurchases.
The main determinant of that choice is the difference in the shape of the two tools (61% of themes from category "Explanatory factors of choice between dividend and repurchase" or 20 themes). The way the cash is received is different. Some respondents have the feeling that share repurchase does not pay out every shareholders. Even more, they feel they pay only the leaving shareholders. Some others have a different feeling about that. They think share repurchase lets more freedom to shareholders to choose or not to receive cash.

The flexibility of share repurchase compared to ordinary dividend is also a mentioned argument. This might influence the choice between the tools (21% of themes of the category, 7 themes). Respondents talked very little about the fact that signals sent by each tool or taxes are different. This is yet something important in theory.

The flexibility of share repurchase has been underlined by Allen and Michaely (2002) : in the USA during 1972-1988 period, stocks repurchases were much more volatile than dividends. Guay and Harford (2000) and Jagannathan et al (2000) also insisted on the flexibility and less restricting aspect of shares repurchase.
Other studies based on surveys also contradict influence of taxes on choice between dividend and shares repurchases. (Brav et al. (2005) and Baker, Powell and Veit (2003))

**Conclusion**

This paper does not intend to resolve the complexity of pay out policy issues. It makes the assumption that the dividend puzzle is still not resolved, because of a lack of explanatory variables. To move forward in its resolution and find new theories or links between variables, a better knowledge of the reality of pay out policies is necessary. To reach that aim, we proceeded to a qualitative survey of dividend and share repurchase decision-makers.
The results of this study are limited statistically by the size of our sample. However this research enables to point out and stress the main variables that interfere in pay out decision in France. It is only the beginning of a larger research; it lightens potential variables that need to be studied.

So what are the contributions of this paper?
First, it shows pay out decision is the result of a consensus between various elements: financial capacity of the firm, external influences, and shareholding pressure.
It supports elements from the literature: influence of financial variables, signal function of pay out or smoothing of dividend policy. It introduces new elements that may lead to interesting questioning: existence of pay out culture in firms, influence of managers' characteristics or competitors' behavior.

This paper also underlines divergences with the literature. Those differences might be linked to the French cultural context, but they might also question the validity of some theories.

For example, the role of share repurchase is questioned. We show in this paper that stock repurchase is not fully considered as pay out neither by firms, nor by markets. This point might be even more striking among all listed firms because we studied big companies that tend to repurchase more. Share repurchase can be used as pay out, but it is more often used as relution tool. It also seems important to note the difference between the vote of a repurchase program and its implementation. Voting a program does not mean the firm is going to repurchase. Is all this a cultural difference or a backward state?

Secondly, this paper contradicts the literature that emphasizes the role of taxes in pay out decisions. Our results show that shareholders' tax is not a meaningful variable, at the firm level.

Last, we found that majority shareholders have a strong influence on pay out. It may be linked to French and European specificity of firms' capital holding. [3]

Managers' and main shareholders' power on pay out decision leads to question the necessity for pay out. Are pay out policies decided in the firm's interest, in shareholders'one or in the private interest of some influent people? Isn't it done to the detriment of minority shareholders or stakeholders? This reinforces the idea to lighten pay out mechanisms by a deeper study on corporate governance systems of the firm.

The ramification of our study could then take the way of understanding effect of governance variables on shape of pay out policies. It seems essential to check the efficiency of corporate governance structure to monitor firms' decision: do corporate governance mechanisms permit monitoring on pay out policies? Is pay out policy a mean of governance?

[3] See Correia da Siva et al. (2004) for a cross cultural survey on differences between shareholding structures.

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