

INVESTORS' PREFERENCES FOR CASH DIVIDENDS: THE ROLE OF SELF-CONTROL AND DEMOGRAPHICS

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Received: May 05, 2024

Revised: June 09, 2024

Accepted: June 17, 2024

Published: June 30, 2024

ABSTRACT

This study examines the impact of an important emotional bias i.e. self-control and various demographic factors such as age, sex, marital status, academic qualification on investors' preferences for cash dividends. The data required was gathered through questionnaires from 201 investors of the Pakistan Stock Exchange (PSX). Results of the study reveal that investors with low self-control tend to favor cash dividends more strongly than those investors having more resistance to temptation. Likewise, male investors exhibited a higher level of preference for cash dividends compared to their female counterparts. Investors holding a PhD showed significantly lower preferences for cash dividends as compared to those with secondary education. Married investors displayed slightly lower preferences for cash dividends compared to single investors. The observed preferences between younger and older investors was not significantly different.

Keywords: Cash payouts, self-control, preferences, PSX, demographics.

1. INTRODUCTION

Traditional finance (neoclassical finance theory) is grounded in three important principles i.e. utility theory (Neumann & Morgenstern, 1944), the efficient market hypothesis (Fama, 1970), and principles of arbitrage in explaining the behavior of economic agents. Under classical paradigm agents are assumed to be fully informed and rational (Simon, 1959), their aim is to maximize utility and adapt to new market information (Becker, 1962). According to the neoclassical theory, the arbitrage process prevents noise traders' transactions. However, real market behavior often deviates from traditional model due to bounded rationality and other behavioral factors (Almansour et al., 2023; Almansour, Elkrgli & Almansour, 2023). Such behavior results in various market anomalies, such as idiosyncratic trading patterns, average cross-sectional returns (Nigam et al., 2018). Researchers

are exploring these anomalies from different behavioral perspectives.

Kahneman and Tversky (1979), under the lens of the prospect theory challenges the first founding principle (utility theory) of traditional approach. The theory suggests that investors when faced with sure gains and sure losses deviate from the principle of expected utility theory and make irrational decisions. Literature also suggests that decision-making under risk is not necessarily rational due to different anomalies (Chang, 2008; Shapira & Venezia, 2001). Behavioral economists question the assumption of human rationality and argue that many inconsistencies in standard finance can only be addressed through the perspective of behavioral finance (Tversky & Kahneman, 1974; Thaler, 1990, 1999). Efficient Market Hypothesis suggests market rationality but acknowledges the presence of noise traders (irrational investors) in the market. These

traders can cause market disruptions due to suboptimal decisions influenced by limited information, emotions, and biases (Friedman, 1956). While noise traders may create arbitrage opportunities for rational investors, the limits to arbitrage highlighted by Shleifer and Vishny (1997) suggest that such opportunities are not always risk-free or profitable.

Standard finance often overlooks human emotions, cognition, and behavior (Statman, 1995), but behavioral finance focuses on investors' cognitive psychology. Behavioral biases, such as mental accounting and self-control, play a significant role in investor decision-making (Kahneman & Tversky, 1982; Thaler & Shefrin, 1984).

Evidence from laboratory and field studies shows that individuals often deviate from standard decision-making preferences (Shapira & Venezia, 2001). Policymakers need to be aware of such deviations to tailor effective strategies and policies. In line with dividend clientele effect, demographic factors, such as age do play a role in determining investors' preferences.

To devise effective dividend policies, companies must understand investors' preferences and their demographic attributes. For instance, a mature company having stable cash flows and limited growth opportunities might appeal an investors' clientele as per their behavioral inclinations and demographic elements. Likewise, a company having more opportunities for growth might attract investors as per their tendencies and demographic factors. Such tailored made dividend policies can attract cheaper capital, reduce the cost of equity, and potentially improve the company's market performance.

While extensive research has focused on identifying the optimal dividend policy to maximize firm value, this study shifts the focus to understand what causes investors to prefer cash dividends? Is it something to do with investors self-control and demographics?

We explore the behavioral dimensions of investors' cash dividend preferences, providing insights into how various investors with varying behavioral inclinations and demographics respond to various dividend payout policies. Understanding human emotions and attitudes is crucial in finance. Behavioral economists have linked investors' preferences for cash dividend with behavioral biases, suggesting that consuming dividends serve as a self-control mechanism to preserve capital. Self-control,

broadly defined as the ability to control impulses (Metcalf & Mischel, 1999), plays a crucial role in guiding human choices. People with higher self-control can better resist temptation and recognize the long-term costs of failing to resist temptation (Flynn, 1985; Wolfe & Johnson, 1995; Romal & Kaplan, 1995). The central question this study addresses is how self-control of investors and their demographic factors, such as investor's age, academic qualification, gender, and marital status (dichotomous variables), influence individual investors' preferences for cash dividends.

This paper is structured into five sections. First section explores background of the study, research question, and objectives. Second section discuss existing literature, theoretical framework and hypotheses. Section III covers the data handling and econometric model employed. Section IV focuses on data analysis, while Section V addresses the conclusions and implications of the research.

2. Literature and Hypothesis

According to Bozos et al., (2011) researchers have spent decades to unravel the motives of firms to pay, and investors to receive dividends. According to Lintner (1956) managers would only increase or initiate dividends when they have confidence in the firm's future projections. Managers often view high dividend payments as a fiduciary duty, resulting in a belief that payout should follow a smooth function of earnings, known as dividend smoothing. Dividend irrelevance (Miller & Modigliani, 1961) argue that payout policy has no impact on share price, cost of capital, investors required rate of return and hence, value of the firm. Miller and Modigliani (1961) suggest that value of the firm depends on the profitability and riskiness of firms' assets only. Under frictionless assumptions, investors can devise their homemade dividend policy by selling their shares to convert their capital gain into cash and those who don't desire may reinvest their cash dividends for future capital gains. such circumstances make firm's dividend policy irrelevant. Black and Scholes (1973) further support this irrelevance, showing no difference between high-yield and low-yield stocks. Subsequent empirical literature (Adesola & Okwong, 2009; Denis & Osobov, 2008; Adefila et al., 2004) support irrelevance.

However, literature suggest positive relationship between payout and stock prices (Bhattacharya, 1979;). Other empirical studies (Hussainey & Mgbame, 2010; Baker, Powell, & Veit, 2002; Myers & Frank, 2004; Dong, Robinson & Veld, 2005) reports that investors are more inclined to cash dividends than capital gains. Similarly, Nissim and Ziv (2001); Bajaj and Vijn (1990); Brown (1978); Pettit (1972); Ball and Brown (1968) reports that the stock prices respond positively when firm announces dividends and negatively to dividend cuts. The theory of choice suggests that different investors have different predilections for various distributions. Like for small distributions, investors prefer dividend payments; while for large distributions they prefer open market repurchases; and for largest distributions, tender offers are preferred (Brennan & Thakor, 1990). Despite tax disadvantage, retail investors tend to invest in high dividend-paying firms (Brav et al., 2005; Jain, 2007; Collins & Kemsley, 2000). These empirical studies confirm that investors have likings for cash dividends as compared to capital gains.

According to Khan et al., (2022), dividend policy has been examined from one extreme i.e. irrelevance to relevance in terms of bird in hand, clientele effect, information content, life cycle theory, and catering theory. In view of many inconsistencies regarding dividend payout policy, Black (1976) summarizes the dividend question in traditional finance as a puzzle with several pieces that simply cannot be fit together.

The question regarding investors inclination to cash dividends or capital gains may reflect investors choices about short and long term. However, knowing the reason for that is of fundamental importance to firms. The assumptions of traditional finance for instance, perfect human rationality and

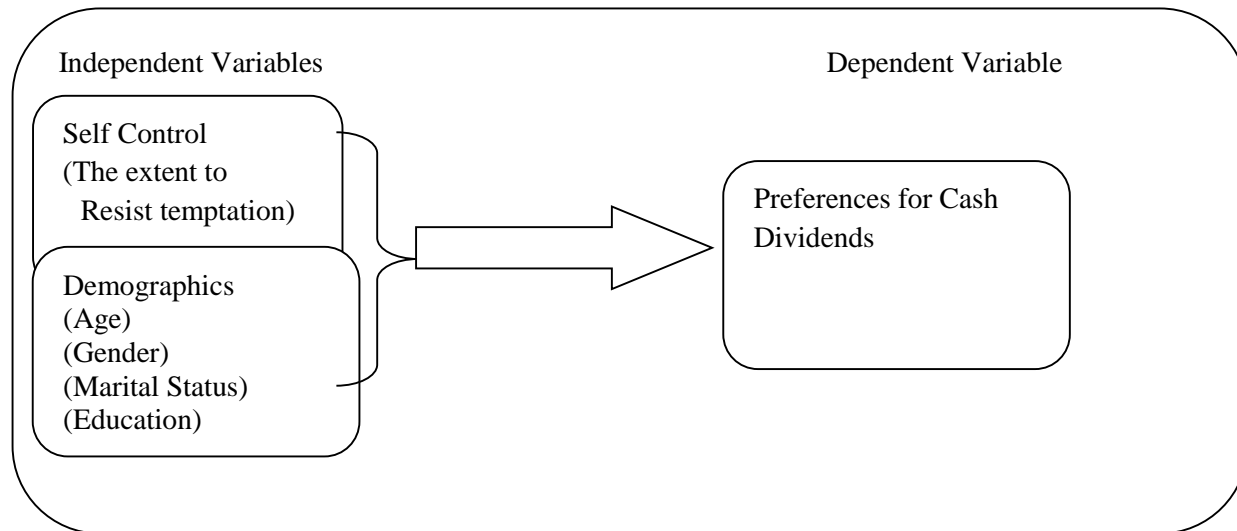
utility maximization, are facing serious challenges from behavioral finance. Behavioral finance assumes economic agents as normal having different emotional and psychological biases, which may potentially impact their decision making (Baker & Nofsinger, 2002). That is why, research focus is shifting to explore behavioral dimensions of the dividend issue. Miller and Scholes (1982) report that the dividend yield-return effects initiate from sources other than tax differentials, linking these effects to human behavioral biases. Prior literature (Acquisti, 2004; Kalenscher & Pennartz, 2007; Thaler & Shefrin, 1981, 1983) suggests that self-control and the craving for instant gratification has an important role in decision-making. Self-control model describes elderly investors exhibit a strong preference for cash dividends while younger investors preferring lower payout (Shefrin & Statman, 1984). Mental accounting, loss aversion, and self-control are proposed solutions for the dividend puzzle (Prast, 2004; Feng & Seasholeles, 2007).

Despite these insights, the question of why investors prefer dividends and what are its repercussion for firms remains unresolved, highlighting a gap in our understanding of corporate dividend policy.

In the light of the aforementioned, this study posits the following hypotheses:

- H1: A lack of self-control leads investors to favor cash dividends.
- H2: Gender influences investors' preference for cash dividends.
- H3: Educational level impacts investors' inclination towards cash dividends.
- H4: Marital status affects investors' preference for cash dividends.
- H5: Age determines investors' preference for cash dividends

The schematic diagram of this study is given as follows:



3. Methods

3.1. Sampling and Data collection:

This study utilizes cross-sectional data gathered through questionnaires circulated to retail investors registered with the Pakistan Stock Exchange (PSX). The objective is to scrutinize the microeconomic behaviors and demographic characteristics that influence individual investor decisions within the framework of PSX. The PSX was chosen as the data collection venue based on its convenience and accessibility. The emphasis on individual investors is deliberate, given the pronounced behavioral tendencies observed within this group in the Pakistani financial context. A notable proportion of individual investors in Pakistan operate without the guidance of professional financial advisors. Conversely, institutional investors often rely on expert financial counsel, thereby reducing their susceptibility to behavioral biases. Furthermore, when institutional investors act as agents for other investors, their decisions typically mirror the preferences of their principals rather than their own. This distinction underscores the decision to focus solely on individual investors in this study.

3.2. Measurement of variables:

Various researchers have formulated and employed distinct self-control scales, tailored to the specific context of their research inquiries. For instance, the self-control scale introduced by Brandon, Oescher, and Loftin (1990) predominantly focuses on health

behavior management. Notably, over a quarter of the items in this scale pertain to eating habits. Given its health-centric orientation, this particular scale cannot be deemed a comprehensive measure of self-control. Gottfredson and Hirschi (1990) posit that the latent construct of self-control comprises six behavioral dimensions:

1. Tendency to prioritize for immediate gratification (impulsivity).
2. Strong inclination toward straightforward tasks.
3. Preference for risk-seeking endeavors.
4. Low self-control manifests as a heightened preference for physical exertion over cognitive effort.
5. Quickness to anger.
6. Self-interested orientation.

Drawing on these dimensions, Grasmick et al. (1993) devised a 24 items scale of self-control to empirically test the theory of crime proposed by Gottfredson and Hirschi (1990). Nevertheless, we opt for a more comprehensive scale devised by Tangney, Baumeister, and Boone (2004) due to its broad applicability and widespread adoption in academic research. The Tangney et al. scale comprises 36 items, each rated on a five-point Likert scale ranging from "strongly disagree" (1) to "strongly agree" (5). Moreover, we include 12 structured questions to gauge investors' preferences for cash dividends and four questions pertaining to demographic variables: gender, marital status, age, and educational

attainment. Respondents were assured of the voluntary and confidential nature of the survey to ensure ethical consideration prior to its administration. Out of the 500 questionnaires distributed, only 201 were returned, resulting in a response rate of approximately 40.2%. Among the 201 respondents, 173 (86%) were male and 27 (14%)

were female. Data was analyzed using SPSS-29. To account for the impact of demographic qualitative variables such as age, gender, academic qualification, and marital status on investors' preferences, four dichotomous dummies were incorporated into our analytical model.

Investors' Gender	Marital Status	Age	Academic Qualification
Dsex = 1 Male 0 Female	Dmar = 1 Married 0 Unmarried	AgI = 1 for ≤ 25 years 0 other wise AgII = 1 less than 40 years 0 other wise AgIII = 1 for ≤ 50 years 0 other wise AgIV = 1 for ≥ 50 years 0 other wise	AqI = 1 secondary 0 otherwise AqII = 1 graduation 0 otherwise AqIII = 1 post-graduate 0 otherwise AqIV = 1 MS/MPhil 0 otherwise AqV = 1 Ph.D. 0 otherwise

3.3. Econometric Model:

This study employs the following regression equation for hypotheses estimation:

$$PDIV_i = \beta_0 + \beta_1 SCL_i + \beta_2 Dsex_i + \beta_3 Dmar_i + \beta_4 AgI_i + \beta_5 AgII_i + \beta_6 AgIII_i + \beta_7 AgIV_i + \beta_8 AqI_i + \beta_9 AqII_i + \beta_{10} AqIII_i + \beta_{11} AqIV_i + \beta_{12} AqV_i + et_i$$

In the regression model, *PDIV* represents the investors' preference level for cash dividends, while *SCL* stands for their level of self-control. The model also incorporates several dummy variables to account for the qualitative aspects of the investors. Specifically, *Dsex* is the dummy variable used for male investors, and *Dmar* is employed for wedded investors. For age categories, *AgII* serves as the dummy for investors aged less than 40 years, *AgIII* for those aged less than 50 years, and *AgIV* for investors aged 50 years and above. *AgI* acts as the reference dummy for age. In terms of educational levels, *AqII* is the dummy for graduate-level

investors, *AqIII* for postgraduate-level investors, *AqIV* for those with an MS/MPhil degree, and *AqV* for investors with a PhD. *AqI* serves as the reference dummy for educational level.

4. Results:

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4.1. Diagnostic Tests:

The collected data for the study was examined for multi-collinearity and heteroskedasticity using VIF and Breusch-Pagan-Godfrey and White tests respectively. VIF was found to be less than 5 indicating no significant issue of multi-collinearity among explanatory variables. Likewise, the tests for heteroskedasticity yielded insignificant results, as illustrated in Table 1. Given that the data is homoscedastic, we can proceed with estimating our model.

Table 1

White Test for Heteroskedasticity:			
F-statistic	0.900	Prob. F (35,165)	0.633
Obs*R-squared	32.21	Prob. Chi-Square (35)	0.604
Scaled explained SS	21.25	Prob. Chi-Square (35)	0.968

Table 3

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4.2. Summary statistics:

Table 2 presents the summary statistics e.g. sample mean, median, maximum, minimum values, and standard deviation, for the *PDIV* and *SCL* under. Both the mean and median measures for both investors' preferences for cash dividends (*PDIV*) and their level of self-control (*SCL*) suggest that, on average, respondents exhibited a somewhat neutral stance when inquired about their preference for cash dividends and their level of self-control. This was assessed on a 5-points likert scale ranging from “strongly disagree” (1) to “strongly agree” (5). The

nearly equal values mean and median values for both *PDIV* and *SCL* indicate that the investors in our sample displayed typical behavior regarding their likings for cash dividends and level of self-control. The maximum value indicates that the highest response from the respondents was “agree” (4) when questioned about both *PDIV* and *SCL*. Conversely, the minimum value reveals that the lowest response from the respondents was “disagree” (2) on the same 5-point Likert scale

Table : 2 Summary Statistics for the Data

Variables	Mean	Median	Max	Min	Std.Dev
<i>PDIV</i>	03.940	02.920	03.850	02.080	0.350
<i>SCL</i>	02.070	02.880	03.880	01.940	0.310

4.3. Regression results:

A linear regression model was employed to analyze the data. Regression results are presented in Table 3. The results as per Table 3 show a significant negative relation between *PDIV* and *SCL*. This suggests that a higher level of self-control is associated with a reduced preference for cash dividends, and conversely, a lower level of self-control is linked with a higher preference for cash dividends. This finding is consistent with the perspectives of Shefrin and Statman (1984) and Black (1990). Investors with lower self-control might favor cash dividends as a protective measure to safeguard their principal from excessive consumption. This may also be attributed to risk aversion and seeking immediate gratification. The same results are also consistent with the bird in hand theory.

Male respondents exhibited a significantly stronger preference for cash dividends as compared to their female counterparts. This trend could be attributed to

the cultural norms in Pakistan, where males often bear the primary responsibility for meeting domestic expenses such as rent, utilities, children's education fees, and other miscellaneous costs.

Investors with a Ph.D. demonstrated lower preference for cash dividends compared to those with a only secondary level of education. One potential explanation is that Ph.D. holders are often part-time investors and may meet their cash needs or consumption needs through other financial resources, thus not relying solely on cash dividends for their consumption. No significant differences were observed in the preferences for cash dividends among investors with other educational levels compared to those with a secondary education.

The preference for cash dividends among married investors was insignificantly lower than among unmarried investors. Contrarily, no notable difference was found in the preferences between

investors of younger and older age. This result contradicts the findings of Shefrin and Statman (1984), whose research indicated that older investors typically exhibit a higher preference for cash dividends as they are retirees with no labor income and, therefore, rely on cash dividends for their income.

The R-squared value reveals that the all-independent variables account for 18.2% of the variance in *PDIV* (preferences for cash dividends). Additionally, the F-value indicates that the model is statistically significant

Table : 3

Variable	Coefficient	Std. Error	t-Statistic	Prob.
<i>C</i>	2.77	0.30	9.19	0.00
<i>SCL</i> (Self-control)	-0.03	0.00	-5.71	0.00
<i>Dsex</i> (Gender dummy)	0.23	0.07	3.09	0.00
<i>Dmar</i> (Marital status dummy)	-0.03	0.10	-0.27	0.78
<i>AgII</i> (dummy for age group of 40 years or less)	0.07	0.11	0.59	0.55
<i>AgIII</i> (dummy for age group of 50 years or less)	0.20	0.14	1.40	0.16
<i>AgIV</i> (dummy for age group of 50 years or above)	0.16	0.16	1.03	0.31
<i>AqII</i> (Dummy for graduation/equivalent)	0.19	0.12	1.59	0.11
<i>AqIII</i> (Dummy for post-graduation/equivalent)	0.16	0.11	1.43	0.16
<i>AqIV</i> (Dummy for MS/MPhil/equivalent)	-0.02	0.10	-0.24	0.81
<i>AqV</i> (Dummy for Ph.D/equivalent)	-0.03	0.01	-3.30	0.00
R Square	0.18			
F-statistic	1.89			0.049

Dependent variable: *PDIV* (Preferences for cash dividends)

5. Important Conclusions and Results' Implications

Human beings have emotions and cognitive processes, which significantly influence their decision-making. Therefore, it is unrealistic to always expect people to act perfectly rational. Stock market investors have no exception (Statman, 1995). It is therefore suspected that they may take decisions based on their behavioral tendencies rather than rationality. Prospect theory also advocates that investors may deviate from standard utility theory when faced with sure gains/losses and probable gains/losses.

In this study we examined the impact of self-control and demographic factors on investors' preferences for cash dividends. Primary data through questionnaires were gathered from 201 investors of the Pakistan Stock Exchange (PSX). The findings of this study suggest that investors with an emotional self-control bias tend to have stronger preferences for cash dividends. This is in line with Shefrin's (2000, p.30) argument that investors value cash dividends

more due to self-control issues. The rationale for this could be either investors discount future capital gains due to risk or due to time value of money. But our findings show that preference for cash dividends arises simply from investors inability to resist temptation for immediate gains.

Cash dividends in Pakistan are subjected to higher taxes than future capital gains. Thus, technically capital gains are advantageous (to cash dividends). This tax advantage should offset the downside potential of capital gains in terms of time value of money. Despite of the aforementioned, investors with low level of self-control in our sample exhibited higher preferences for cash dividends. It can be argued that bird in hand theory (Gordon & Lintner, 1963) in traditional finance is a consequence of human emotional propensities related to self-control. Hence, it can be expected that firms that pay cash dividends are more likely to attract investors with low level of self-control, potentially at lower cost. Such investors would value these dividend-paying firms more than those firms who don't pay

dividends. The underlying logic for such behavior of investors might be that while all investors are concerned about the firm's cash flows from investment activities, many will focus on their own cash flows, i.e., cash dividends.

This current study does some limitations. Although, there is a possibility that investors do not derive immediate pleasure or satisfaction from cash dividends, but their immediate consumption needs compel them to prefer cash dividends. Therefore, this study should have accounted for such immediate needs of investors for cash, but we could not account for such immediate consumption needs of investors. Another limitation is the lack of consideration for the socio-economic status of the investors. As a future research direction, researchers should overcome such limitations for a better and comprehensive understanding of the dividend dilemma.

The findings of this study offer several practical and theoretical implications. This study can assist companies in understanding how different investors respond to cash dividends. Consequently, companies can tailor their dividend policy to align with investor preferences, thereby attracting a clientele of investors based on their dividend attitudes. A growing firm with intentions to retain earnings instead of distributing could appeal investors interested in the growth of their funds (capital gains) without a preference for cash dividends. Conversely, a mature and stable firm with surplus free cash and no/limited growth opportunities could appeal to investors interested in cash dividends. Such a clientele-based dividend policy can attract cheaper capital for the company and potentially reduce the cost of equity.

Similarly, this study lays the foundation for researchers to explore the dividend policy question from behavioral perspectives. Given that the results indicate investors with self-control bias strongly prefer firms that provide cash dividends. However, it is also likely that other investors with different cognitive and emotional biases would show different dividend policy preferences. Therefore, a theory based on behavioral dividend clientele can be developed and categorized.

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