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**Article**

## Can liquidity explain dividends?

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## BANKING & FINANCE | LETTER

# Can liquidity explain dividends?

Xuan Vinh Vo<sup>1\*</sup>

**Abstract:** Vietnam is an interesting case to study firm behavior because it is an example of a successful transitional economy. In the last few years, the government is building a supportive environment to promote business activities. Therefore, it is crucial to investigate whether corporate managers utilize dividend payout policy as a corporate financial management tool to address information asymmetries in such an environment. However, in the context of emerging markets, this topic is still under-explored even though firms in emerging markets are of lower disclosure quality. This paper investigates how corporate dividend decision is associated with liquidity, a measure of information asymmetries using a data sample of listed firms in Vietnam, an emerging market. Specifically, we utilize a dataset of firms listed on the Ho Chi Minh City stock exchange (HOSE) from 2007 to 2015. We find a negative relation between stock market liquidity and dividend payout in Vietnamese firms. The finding confirms that corporate managers in Vietnam tend to compensate for less liquidity with more dividend payout. The paper also suggests that dividends could be a substitute for stock liquidity.

**Subjects:** Mathematical Finance; Quantitative Finance; Statistics for Business, Finance & Economics; Corporate Finance; Financial Management

**Keywords:** Supporting government; information asymmetries; dividend payouts; stock market liquidity; Vietnam

**Subjects:** G10; G30; G35

### 1. Introduction

Vietnam is an interesting case to study firm behavior because it is an example of a successful transitional economy. However, Vietnam is facing various challenges which need constant policy reforms (Bui et al., 2018; Nguyen, Ho et al., 2018). In the last few years, the government is building

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#### PUBLIC INTEREST STATEMENT

In this paper, we analyze whether corporate managers utilize dividend payout policy as a corporate financial management tool to address information asymmetries. However, in the context of emerging markets, this topic is still under-explored even though firms in emerging markets are of lower disclosure quality. This paper explores how corporate dividend decision is associated with liquidity, a measure of information asymmetries using a data sample of listed firms in Vietnam, an emerging market. We find that corporate managers in Vietnam tend to compensate for less liquidity with more dividend payout. This finding also suggests that dividends could be a substitute for stock liquidity.

a supportive environment to promote business activities. The current research is looking at the business aspect (ie. firm level) of the results of the supporting government policies that the Vietnamese government follows. Particularly, the Vietnamese government has aimed to support firms and business activities with various supporting policies and constant reforms (Nguyen, Vo et al., 2018). The supporting government philosophy results in various policy reforms which create a strong business environment. As a result, there is an increasing number of new firms entering the business world. In such an environment, it is interesting to investigate firm behavior and how firms can utilize different policies to promote business performance.

In this paper, we consider the aspect of supporting the government in promoting the business environment at firm level by analyzing how firms use management techniques to reduce asymmetry in Vietnam. The role of supporting government philosophy by the Vietnamese government in firm behavior has been widely discussed in previous research, especially from the perspective of government ownership in firms (Vo, 2018a, 2018b, 2019b, 2019c). Corporate dividend payout as a signal to reduce corporate information asymmetries is an important topic that continues to generate many conflicting arguments among financial researchers. According to the seminar work of Miller and Modigliani (1961), the dividend is irrelevant to firm value. However, this argument is only valid in a perfect world without market frictions. In the real world, information asymmetries do exist, and corporate managers are considered to know more than outside investors. Signaling is a conduit for transmitting firm information to the markets, and dividends are viewed as an important signal about firm prospects to outside investors (Peterson, 1996). Even though dividends' signaling role in reducing information asymmetries has strong theoretical support, empirical studies provide mixed results. For example, Li and Zhao (2008) state that firms with greater information asymmetries are less likely to pay, initiate or increase dividends. Brav et al. (2005) conduct a survey of the US managers and find that dividend is not a channel to reduce information asymmetries.

Information asymmetry is often associated with a transitional economy. To be aware of this problem, the Vietnamese government conducts several policy reforms supporting government philosophy to reduce information asymmetry for a better business environment. This paper concerns the two closely linked concepts relating to information asymmetries. First, we address whether corporate managers use dividend policy to address a high degree of information asymmetries, which is reflected by low liquidity. Specifically, the current study investigates the link between stock market liquidity and dividend payout policy in Vietnam. We utilize a dataset of firms listed on the Ho Chi Minh City Stock Exchange covering the period from 2007 to 2015.

Liquidity is an important reflection of information asymmetries in the stock market, where higher liquidity is associated with lower information asymmetries (Dang et al., 2019; Diamond & Verrecchia, 1991). Liquidity is also referred to as an indirect measure of information asymmetries (Affleck-Graves et al., 2002). Welker (1995) and Attig et al. (2006) states that increased quality disclosure reduces information asymmetry and increases liquidity. In addition, liquidity is related to firm value (J. Batten & Vo, 2019).

Most previous studies investigating dividend policy as a tool to deal with information asymmetries provide conflicting results. Moreover, these studies tend to utilize advanced country data and context of which findings are not always possible to generalize into the context of emerging markets due to differences in institutional background and level of development. This motivates a natural question of whether the dividend is a useful tool to reduce information asymmetries in emerging markets. In lieu of the current literature on this topic, further study is clearly important to provide a better understanding of dividend policy, a critical corporate financial management tool.

Vietnam is an emerging market economy and also a successful transitional economy which builds a supporting government philosophy<sup>1</sup> that offers an interesting context to study information

asymmetries in firms. Previous studies also highlight the importance of information asymmetries reflected by liquidity. Of particular note is the liquidity characteristics where higher liquidity is associated with higher returns (J.A. Batten & Vo, 2014), while it is naturally reasonable that stocks with lower liquidity should be sold at a lower valuation. This study also has strong implications for the government in building a supporting government in order to promote business activities.

The study is important due to several reasons. Most importantly, liquidity is a reflection of firm information asymmetries, and dividend policy is a tool to convey signaling information to reduce information asymmetries. The literature remains inconclusive about the link between firm stock market liquidity and dividend payout. Further, this issue is still under-explored in the context of emerging markets, even though corporate managers behave differently in these markets due to lower institutional standards.

The traditional clientele transaction cost or liquidity hypothesis suggests a negative link between liquidity and payout. This is grounded on the pioneering work concerning dividend policy of Miller and Modigliani (1961), which postulates that dividend is irrelevant in a frictionless world. This work relies on the assumption that the wealth is unchanged whether the shareholders receive a dollar of dividend or sell a dollar's worth of their investment. In the real world, investors face transaction costs, and firms with less liquid stocks tend to pay more dividends. Further, dividend helps investors to avoid trading cost when liquidity is low (Banerjee et al., 2007). This argument is also supported by Dong et al. (2005), which assert that retail investors partly want dividends due to the lower cost of cash dividends compared to the transaction cost when selling stock. A recent study by Lai et al. (2020) further reports that the negative link between stock market liquidity and the dividend is more pronounced in countries with sound political institutions.

Another school of thought suggests a positive link between liquidity and dividend payout. This is referred to as the informational effect of stock liquidity on payout policy in the context of an emerging market (Jiang et al., 2017). This argument relies on the assumption that firms with more liquidity stock are more transparent in their corporate policy. In turn, higher transparency is associated with informed trading makes the cost of expropriated retained earnings increase (Li & Zhao, 2008). Hence, firms with liquid stock tend to pay more dividends. This positive effect is reportedly more pronounced in an opaque environment and severe conflict of interest between controlling shareholders and minority investors (Jiang et al., 2017).

Using the data of listed firms in the Vietnam stock market, our paper reports a negative link between stock liquidity and dividend payout in the context of an emerging market and transitional economy with the supporting government philosophy. The result from this paper contradicts previous findings in studies using a data sample of other emerging markets. Specifically, our result contradicts the finding of Jiang et al. (2017) using the data of China. Our finding supports the importance of further studies using the context of emerging markets to enrich the literature on the link between stock market behavior and corporate policy.

The remainder of the paper is organized as follows. Section 2 presents the data, model, and estimation techniques. Section 3 shows and discusses our econometric results. Finally, section 4 provides some concluding remarks.

## **2. Data and research methodology**

### **2.1. Data**

It is commonly viewed that the quality of corporate disclosure in Vietnamese firms is at a lower standard than in developed economies. To deal with this problem, we employ data of publicly traded firms that exhibit a lower degree of information asymmetries. Specifically, we use a dataset of listed companies on the Ho Chi Minh City stock exchange (HOSE), covering the period from 2007 to 2015. The Ho Chi Minh City stock exchange is the largest and oldest bourse in Vietnam (Vo,

2015, 2016a, 2016b, 2016c, 2017a, 2017b, 2019a; Vo & Phan, 2019). Our data includes 287 firms which comprises most of the firms listed on the Ho Chi Minh City stock exchange over the period 2007–2015. Since the number of delisted firms are very small, we do not include delisted firms in our sample to maintain consistency.

## 2.2. Model

The main purpose of this paper is to investigate whether corporate managers utilize dividend policy to deal with the problem of information asymmetries. Information asymmetries in this paper being measured by the stock market liquidity, where lower liquidity is a reflection of higher information asymmetries. Particularly, we use the following baseline regression model:

$$DIV_{i,t} = \alpha_{i,t} + \beta_1 * SML_{i,t} + \beta_2 * I_{i,t} + \varepsilon_{i,t} \quad (1)$$

where DIV is the dividend payout proxies (CDE and CDY). SML is the stock market liquidity indicators (LIQ1, LIQ2, and LIQ3). *I* is a set of control variables, including leverage ratio (LEV), firm size (SIZE), profitability (ROA), and Tobin's Q (Q). The definition of variables is detailed as follows.

### 2.2.1. Dividend payout measures

We use two proxies for dividend payouts to ensure the robustness of the estimation results. The first measure is the cash dividend yield, which is calculated as the dividend per share divided by the adjusted stock price (CDY). The second one is the cash dividend to earning, which is the cash dividend per share, divided by earnings per share (CDE). We use the total cash dividend distributed in the financial year in the calculation.

### 2.2.2. Measuring liquidity

We also utilize several liquidity indicators to ensure the robustness of the results. The following indicators are employed in the analysis.

Trading volume (LIQ1): Campbell et al. (1993) claim that the trading volume is a signal for the high frequency of demand. Hence, trading volume is an indicator that measures the stock market liquidity (i.e., the stock traded frequently has high liquidity).

$$LIQ1 = \frac{TradedShares_{i,t}}{N}$$

where *TradedShares<sub>i,t</sub>* is the trading volume for firm *i* in year *t*, and *N* is the total trading days in one year.

Trading turnover (LIQ2): Following Muñoz (2013), we calculate the turnover liquidity measure as follows:

$$LIQ2_{it} = \frac{TradedShare_t}{N \times TotalShares}$$

where *TotalShare* is the number of shares outstanding, and *N* is the number of trading days in a year.

LIQ3: Following Lo and Wang (2000), we also include the following measure of liquidity:

$$LIQ3_{it} = \frac{TradedShare_t}{TotalShare}$$

### 2.2.3. Control variables

We use a number of control variables that potentially affect dividend payout, which is the firm size (SIZE), which is the logarithm of total assets; profitability (ROA), which is the net income divided by total assets; and growth opportunities (Q), which is defined as the sum of the market value of

equity and liabilities scaled by total assets; leverage ratio (LEV) which is total liabilities divided by total assets.

### 2.3. Estimation techniques

Since our payout policy is ranging between 0 and 1, we use the Maximum Likelihood (Newton-Raphson/Marquardt steps) regression estimator to estimate the model. In order to ensure the robustness of the estimation, we report both normal and logistic estimation results.

## 3. Results and discussion of results

### 3.1. Summary statistics

Summary statistics are reported in Table 1, which allows us to have an overall observation of the data.

This table presents the descriptive statistics of the main variables. The sample covers the data of firms listed on the HOSE from 2007 to 2015. Dependent variables are cash dividend yield (CDY) and cash dividend to earning (CDE). Three liquidity variables (LIQ1, LIQ2, and LIQ3) are calculated as in the previous section. Four control variables are firm size (SIZE), profitability (ROA), growth opportunities (Q), and leverage ratio (LEV).

### 3.2. Correlation matrix

We examine how variables are correlated, and the results are presented in Table 2. A glance at the table, we observe that the two dependent variables (CDY and CDE) and all liquidity variables (LIQ1, LIQ2, and LIQ3) are negatively correlated. The negative correlation between liquidity indicators and dividend payout variables denotes that firms with less liquid stock tend to pay more dividends throughout the sample period of 2007–2015. This reflects that corporate investors attempt to use the dividend to reduce corporate information asymmetries.

This table presents the correlation matrix of variables. The sample covers the data of listed firms on the HOSE from 2007 to 2015. Dependent variables are cash dividend yield (CDY) and cash dividend to earning (CDE). Three liquidity measures include LIQ1, LIQ2, and LIQ3. Four control variables are firm size (SIZE), profitability (ROA), growth opportunities (Q), and leverage ratio (LEV).

### 3.3. Regression results

Using the econometric method discussed previously, Tables 3 and 4 presents regression results relating to the dividend payouts effects of stock market liquidity.

**Table 1. Summary statistics**

Variables	Obs.	Mean	Max	Min	Std. Dev.
CDE	1493	0.3615	1.0000	0.0000	0.2930
CDY	1493	0.0613	0.7822	0.0000	0.0648
LIQ1	1493	10.5316	16.3073	4.5556	1.9605
LIQ2	1493	0.0039	0.0732	0.0000	0.0058
LIQ3	1493	0.9252	18.0774	0.0004	1.4236
SIZE	1493	11.6832	14.1258	9.9457	0.6333
ROA	1493	0.0746	0.7837	-0.6455	0.0845
Q	1493	1.1070	7.2524	0.0481	0.8875
LEV	1493	0.4749	0.9706	0.0140	0.2100

**Table 2. Pearson correlation matrix**

	CDEPS								
CDYIELD	LIQ1	LIQ2	LIQ3	SIZE	ROA	Q	LEV		
<i>CDEPS</i>	1								
<i>CDYIELD</i>	0.689	1							
<i>LIQ1</i>	-0.117	-0.202	1						
<i>LIQ2</i>	-0.150	-0.184	0.587	1					
<i>LIQ3</i>	-0.157	-0.177	0.576	0.985	1				
<i>SIZE</i>	0.002	-0.111	0.419	-0.037	-0.042	1			
<i>ROA</i>	0.219	0.338	-0.076	-0.120	-0.127	0.348	1		
<i>Q</i>	-0.049	-0.128	-0.062	-0.025	-0.042	0.096	0.115	1	
<i>LEV</i>	-0.088	-0.038	0.060	-0.018	-0.023	-0.108	-0.426	-0.072	1

Overall, we find a consistently negative and significant coefficient for all liquidity measures in explaining dividend payout. This highlights that dividends could be a substitute for liquidity. It is important to interpret this finding from the corporate management lens. Our finding also suggests that corporate managers tend to follow the market signal to make dividend decisions in order to compensate for a lower level of liquidity or a higher degree of information asymmetries. In other words, we find evidence that corporate managers could use dividends as a signal of the firm's future earnings prospect, thereby reducing information asymmetries. This finding is largely in line with the results using advanced country data confirming that managers of firms with high market friction (high information asymmetries or low liquidity) pay dividends to improve the firm's market valuation.

There are two important caveats arising from the results of our paper. Firstly, we confirm that dividend is a substitute for stock liquidity, which is consistent with the findings reported in several previous studies (Banerjee et al., 2007; Michaely & Qian, 2017). Secondly, we postulate that the link between stock liquidity and dividend payout is not uniform across emerging economies. Particularly, our finding contradicts the outcome of Jiang et al. (2017) employing the sample of Chinese listed firms from 2000–2014. This finding again substantiates the importance of further research on this topic since studies using different country data provide conflicting results.

Table 4 reports the estimation with the logistic approach. Overall, the results in this table are similar to those reported in Table 3. We confirm a negative and significant link between stock market liquidity and dividend policy.

Our finding of a negative link between dividend liquidity and dividend policy is interesting because of several reasons. First, this finding contradicts the finding of the prior study of Jiang et al. (2017) using the context of China. Secondly, even though Vietnam does not have a strong institutional environment as in advanced countries, the result is consistent with the substitution evidence between liquidity and dividends reported in studies of advanced countries such as Banerjee et al. (2007).

Tables 3 and 4 also report some important findings regarding the other factors affecting dividend payout. We only briefly report here for brevity. We find that large firms and firms with more investment opportunities pay fewer dividends. This is consistent with the notion that Vietnamese firms tend to follow the pecking order theory. In addition, we consistently find that dividend payout is positively correlated with firm earnings.



**Table 3. This table reports the regression results of stock liquidity on dividend payout using the maximum likelihood estimation—censored normal (TOBIT) approach (Newton-Raphson/Marquardt steps). The dependent variables are cash dividend yield (CDY) and cash dividend to earning (CDE). The key explanatory variables are three stock market liquidity measures, as discussed in the previous section. Four control variables are firm size (SIZE), profitability (ROA), growth opportunities (Q), and leverage ratio (LEV). The sample comprises the data of listed firms on the HOSE from 2007 to 2015. \*, \*\*, \*\*\* denote significance at the 10%, 5% and 1% levels respectively**

Variables	The dependent variable is CDE		The dependent variable is CDY	
C	0.378* [0.194]	0.580*** [0.188]	0.275 *** [0.039]	0.324 *** [0.037]
LIQ1	-0.021 *** [0.006]		-0.005 *** [0.001]	
LIQ2		-8.531 *** [1.751]		-2.277 *** [0.356]
LIQ3				
SIZE	0.0039 [0.019]	-0.029 * [0.016]	-0.019 *** [0.004]	-0.026 *** [0.003]
ROA	1.459 *** [0.150]	1.494 *** [0.147]	0.499 *** [0.030]	0.506 *** [0.029]
LEV	0.073 [0.052]	0.056 [0.052]	0.056 *** [0.010]	0.051 *** [0.010]
Q	-0.038 *** [0.011]	-0.035 *** [0.011]	-0.016 *** [0.002]	-0.015 *** [0.002]
Obs	1495	1495	1617	1617
Sample (adjusted)	2007–2015	2007–2015	2007–2015	2007–2015

**Table 4.** This table details the regression results of stock liquidity on dividend payout using the maximum likelihood estimation—censored logistic approach (Newton-Raphson/Marquardt steps). The dependent variables are cash dividend yield (CDY) and cash dividend to earning (CDE). The key explanatory variables are three stock market liquidity measures discussed in the previous section. Four control variables are firm size (SIZE), profitability (ROA), growth opportunities (Q), and leverage ratio (LEV). The sample comprises the data of listed firms on the HOSE from 2007 to 2015. \*, \*\*, \*\*\* denote significance at the 10%, 5% and 1% levels respectively

Variables	The dependent variable is CDE			The dependent variable is CDY		
C	0.434** [0.202]	0.668*** [0.194]	0.674*** [0.194]	0.263*** [0.035]	0.314*** [0.034]	0.314*** [0.034]
LIQ1	-0.023*** [0.006]			-0.005*** 0.001		
LIQ2		-8.830*** [1.818]			-2.028*** [0.332]	
LIQ3			-0.039*** [0.008]			-0.008*** [0.001]
SIZE	0.0005 [0.020]	-0.037** [0.017]	-0.037** [0.017]	-0.017*** [0.003]	-0.025*** [0.003]	-0.025*** [0.003]
ROA	1.482*** [0.157]	1.506*** [0.155]	1.491*** [0.155]	0.450*** [0.029]	0.459*** [0.029]	0.459*** [0.029]
LEV	0.089 [0.055]	0.067 [0.055]	0.063 [0.055]	0.047*** [0.010]	0.044*** [0.009]	0.043*** [0.009]
Q	-0.038*** [0.011]	-0.035*** [0.011]	-0.036*** [0.011]	-0.016*** [0.002]	-0.015*** [0.002]	-0.015*** [0.002]
Obs	1495	1495	1495	1617	1617	1617
Sample (adjusted)	2007–2015	2007–2015	2007–2015	2007–2015	2007–2015	2007–2015

#### 4. Conclusion

Vietnam is an emerging market and a successful transitional economy where the Vietnamese government constantly conducts policy reforms to promote a strong business environment. Therefore, the term “supporting government” is introduced as a philosophy since the Vietnamese government wants to set policies to promote its citizens’ business environment and social welfare. In this paper, we examine the business environment aspect which the supporting government aims to build and promote.

Reducing information asymmetry is an important goal of the supporting government. Dividend policy is an important governance tool to reduce information asymmetry (Attig et al. 2016), and the link between stock market liquidity (as a reflection of information asymmetries in stock markets) in determining firm dividend payout is an interesting topic in finance. Even though it is an interesting topic, that remains inconclusive. Further, this topic is still under-explored in the current literature, especially in the context of emerging markets. In this paper, we analyze this link in the context of Vietnam, an emerging market, to fill that gap.

We find that stock market liquidity is negatively associated with dividend payout in Vietnamese listed firms. To this end, this finding suggests that dividends could be a substitute for liquidity. This finding could be intuitively interpreted that corporate managers could use dividend policy to compensate for higher information asymmetries or to reduce information asymmetries. In addition, this study postulates that the link between stock market liquidity and dividend payout is not uniform across markets.

This study has important implications for investors and corporate managers in emerging markets. Particularly, we find that corporate managers in emerging markets tend to use dividend policy as an important management tool to reduce information asymmetries between inside corporate managers and outside investors. The ability to substitute dividends for liquidity gives corporate managers more flexibility in improving market valuation and the ability of a firm to raise funds. This is even more important in emerging markets like Vietnam, where most investors in stock markets are individual investors who lack firm information due to the lower quality of disclosure. Further, the substitution is more pronounced in low liquidity markets because investors are uncertain about the large executive transaction.

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#### Note

1. The government aims to provide supporting policies <http://lapphap.vn/Pages/tintuc/tinchitiet.aspx?tintucid=210253>.

#### Disclosure statement

No potential conflict of interest was reported by the author(s).

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