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Dividends, earnings volatility and information

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Abstract

It is generally accepted that a firm's dividend policy can provide information about its future financial performance. Most studies link dividend policy with firm valuation; however, other signals involving dividend policy are also observed. The focus of this article is not to continue the examination of the return (valuation) information contained in dividend announcements, but rather to consider the information about risk that the announcements provide. We consider the ‘risk information hypothesis’, whereby management provides the market with new information about the risk of the firm's earnings variability through their dividend policy. The results of our study provide evidence that positive changes in dividends are associated with positive future changes in mean real Earnings Per Share (EPS). Furthermore, a significant increase in EPS variance (risk) after a dividend change is observed for all dividend change classifications except for dividend omissions. The strongest signal of future variance shifts is with dividend increases.

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