

ORIGINAL ARTICLE

## Use of Freed-Up Shares as Payment Method Influences the Economic Capacity of Minority Shareholders

### ABSTRACT

This study examines how the payment of dividends through freed-up shares by companies listed on the Bolsa de Valores de Lima (BVL) during the period 2009-2016 has negatively affected the economic capacity of minority shareholders. The dividend policy adopted by these companies has caused economic harm due to the distribution of freed-up shares instead of cash dividends. The shareholders' concern is justified as they expect a cash return on their investment, as dividends are considered their natural source of income. This provides them with immediate access to cash when needed, whereas receiving freed-up shares does not. To avoid further damage to the economic capacity of minority shareholders, the solution is to shift the dividend policy model from distributing freed-up shares to paying dividends in cash. The evidence gathered in this study provides information on the distribution of freed-up shares to shareholders, and the analysis conducted through indicators can be used as a model. Ultimately, the study concludes that the payment of dividends through freed-up shares has a negative impact on the economic capacity of minority shareholders.

**Keywords:** minority shareholders; economic capacity; dividends.

**Abdias Armando Torre Padilla**

atorrepadilla@gmail.com

ORCID: <https://orcid.org/0000-0003-0637-6992>

Universidad Nacional del Callao,  
Facultad de Ciencias Económicas,  
Callao, Perú

Submitted: 02/10/2021 - Accepted: 07/08/2021 - Published: 06/29/2023

## INTRODUCTION

The aim of this article is to illustrate how the distribution of dividends in the form of freed-up shares had a detrimental effect on the economic capacity of minority shareholders of companies listed on the Lima Stock Exchange from 2009-2016. Specifically, in the words of Bebczuc (2000), “stock dividends are essentially an illusion, as shareholders receive new shares but no cash” (p. 87).

To address the issue at hand, it is necessary to define the key terms related to the topic. The first term is economic capacity, which has various interpretations. For this study, the definition provided in the Glossary of Economic Terms by the Banco Central de Reserva del Perú (BCRP, n.d.) is adopted, which emphasizes the importance of keeping liquidity for minority shareholders to avoid economic problems. The second term is freed-up shares, which are defined as shares issued and distributed proportionally to the number of shares held by each owner (BCRP, n.d.). Dividends, the third term, are defined by Ross *et al.* (2014) as “payments made from a firm’s profits to its owners, either in the form of cash or shares” (p. 570). The fourth term is dividend policy, which “determines the division of profits between payments made to shareholders and profits to be reinvested in the company” (p. 745), as stated by Weston and Copeland (1997).

In the search for background information, it was discovered that there is limited international and national research on the impact of dividend policy on the economic capacity of minority shareholders, particularly in relation to the distribution of dividends in the form of freed-up shares. There are few studies with a financial perspective, while more information is available with a legal perspective. Most of the studies found, which are general references, were conducted outside of Peru, and therefore they are not directly relevant to Peru. Moreover, there was a lack of explanatory text available to aid in the analysis and understanding. As a result, this article was developed using the theoretical information obtained.

International background information comes from Pérez’s (2007) thesis on “Remuneración de Directorio y Gobierno Corporativo”, Gutiérrez and Sáez’s (2014) article on “La política de dividendos de las empresas con accionistas de control”, and Díaz’s (2009) thesis on “La Regulación de los Conflictos de Interés de los Directores como una Medida de Protección a los Accionistas Minoritarios en la Sociedad Anónima”. Local studies include Santos’s (2008) article on “La política de dividendos y la rentabilidad de los negocios”, and Ramos’s (2004) thesis on “Derechos corporativos individuales del accionista y el financiamiento del objeto social de la sociedad anónima”, among others.

In this context and lacking evidence, the research problem is formulated as follows: Does the payment of dividends through freed-up shares have a negative impact on the economic capacity of minority shareholders? The focus of the study is not on all shareholders who choose to receive dividends in freed-up shares, but specifically on minority shareholders who did not choose this method of payment but received freed-up shares nonetheless, resulting in a negative impact on their economic capacity. The study draws upon various prominent theories.

According to Gordon’s model (1956, cited by Mascareñas, 2020), if a company can provide shareholders with a return that exceeds their minimum required rate, it may be more beneficial to not pay dividends and instead increase shareholders’ wealth. On the other hand, if the return is lower than the minimum required rate, it would be ideal to distribute profits to shareholders.

Modigliani and Miller (1958), cited by Menéndez and Guerrero (1994), proposed that, under certain assumptions including perfect capital markets, dividend policy is irrelevant in determining the value of the firm. They argued that the distribution of dividends does not affect the value of the shares for their owners, who do not care whether they receive returns through dividends or capital gains.

The theory of the importance of dividends is credited to Gordon (1963) and Lintner (1969), as cited by Gitman (2000), who suggest that shareholders should prioritize current dividends. This is because there is a direct relationship between dividend policy and market value. Investors usually prefer less risky options such as current dividends or capital gains, as opposed to future dividends or capital gains.

In the theory of the clientele effect, Mascareñas (2020) explains that there are different classes of investors who, based on their various preferences and rational behavior, seek to maximize the return on their investments. Some prefer to receive liquid dividends, while others prefer capital gains.

## METHODS

The present research is an exploratory and correlational study with a non-experimental longitudinal design that aims to study the process of change over time and trends. The unit of analysis is the Lima Stock Exchange (BVL) while the population consists of 284 companies, from which a non-probabilistic sample of 12 companies was selected based on the researcher's criteria. The sample consists of 96 financial statements for the period 2009-2016. The data collection technique is document analysis while financial statements were collected from the BVL website. The data was processed in Excel by applying ratios, and the panel data technique was used to group the ratios and apply them in the multiple linear regression model (shown below), which was processed in the software EViews. The results were objectively analyzed by comparing them with the theoretical framework, leading to the development of conclusions and recommendations.

$$Y = C_0 + C_1 * X_1 + C_2 * X_2 + C_3 * X_3 + \varepsilon$$

Where Y = economic capacity of minority shareholders;  $X_1$  = dividends per share;  $X_2$  = retention ratio (rate);  $X_3$  = price-to-utility ratio;  $y$ ,  $\varepsilon$  = random error term

The indicators used for the demonstration are as follows:

**$X_1$ : Dividend per Share (DPA).** It determines the amount of dividend per share that is distributed to shareholders. It is calculated by applying:

$$= \frac{\text{dividend paid out}}{\text{number of shares}}$$

**$X_2$ : Retention Ratio.** It refers to the portion of a company's earnings that it retains after paying dividends to shareholders. It is calculated by applying:

$$= \frac{\text{withheld earnings}}{\text{net earnings}}$$

**$X_3$ : Price-to-Utility Ratio (P-U).** It measures how much the public is willing to invest based on the company's earnings expectations. It is calculated by applying:

$$= \frac{\text{market price per common share}}{\text{earnings per share (EPS)}}$$

**$Y_1$ : Minority Shareholder's Interest.** It determines the proportion of a company's capital held by minority shareholders. It is calculated by applying:

$$= \frac{\text{minority shareholder capital}}{\text{issued capital}}$$

**$Y_2$ : Dividend Payout Ratio.** It indicates the percentage of a company's earnings that is distributed to shareholders as dividends rather than being retained. It is calculated by applying:

$$= \frac{\text{dividends paid}}{\text{net earnings}}$$

## RESULTS

The results are presented below, starting with Table 1:

**Table 1***Result of equation estimated by EViews for hypothesis*

Dependent variable: Y				
Method: Panel Least Squares				
Date: 11/06/18 Time: 23:29				
Sample: 2009 2016				
Periods included: 8				
Cross-sections includes: 12				
Total panel (balanced) observations: 96				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.21156	0.003825	55.30312	0.0000
X1	-0.261812	0.011802	-22.1828	0.0000
X2	-0.24469	0.003463	-70.66823	0.0000
X3	0.004209	8.83E -05	47.66733	0.0000
R-squared	0.99561	Mean dependent var		0.180078
Adjusted R-squared	0.995467	S.D. dependent var		0.155247
S.E. of regression	0.010453	Akaike info criterion		-6.243148
Sum squared resid	0.010052	Schwarz criterion		-6.136301
Log likelihood	303.6711	Hannan-Quinn criter		-6.199959
F-statistic	6954.781	Durbin-Watson stat		2.026749
Prob(F-statistic)	0.000000			

*Note.:* Prepared by the author, 2023.

The multiple linear regression equation was derived from data presented in Table 1. The parameters and results of the equation are discussed below:

$$Y = 0.211560 - 0.261812 X_1 - 0.244690 X_2 + 0.004209 X_3 + \varepsilon$$

**C<sub>0</sub> = 0.2115:** The intercept (the constant) in the multiple linear regression equation shows that if X<sub>1</sub>, X<sub>2</sub>, and X<sub>3</sub> had been all zero during the sample period, the observed average economic power of minority shareholders would have been 21.15%.

**X<sub>1</sub> = -0.2618:** This means that, while keeping the expected economic influence of minority shareholders unchanged, there was an average decrease of around -26.18% in the observed economic impact for minority shareholders for every reduction in dividend payment per share.

**X<sub>2</sub> = -0.244690:** This means that, while keeping the expected economic influence of minority shareholders unchanged, there was an average decrease of around -24.46% in the observed

economic impact for minority shareholders for every decrease in retained earnings.

**X<sub>3</sub> = 0.004209:** This means that, while keeping the expected economic influence of minority shareholders unchanged, there was an average decrease of around 0.42% for every increase in the price-earnings ratio.

**ε** = It encompasses all factors that are excluded from the proposed methodology and which could result in certain peripheral effects that may not be apparent in the behavior of the variables.

**R<sup>2</sup> Adjusted = 0.9954:** The obtained confidence level of 99.54% suggests that the three explanatory variables are the cause of the adverse impact on the economic capability of minority shareholders. This indicates a high level of statistical correlation, which is considered highly favorable.

**The Prob. (F-statistic) = 0.00:** This indicates that the probability of rejecting the hypothesis is 0%, which is considered highly favorable.

**Durbin-Watson statistic = 2.02679:** This indicates that there is no autocorrelation present in the residuals between the sub-variables (X1, X2, and X3) and their general variable Y when the model is adjusted.

## DISCUSSION

There is agreement with Bebczuc (2000) in acknowledging that distributing profits through freed-up shares is equivalent to distributing merely documents, and not actual money. This practice has clearly affected the economic capability of minority shareholders, as they have been deprived of cash and income. The reduction of their income alone is sufficient to demonstrate its effect and create vulnerability for minority shareholders. With regards to Gordon's (1963) and Lintner's (1963) theory on the significance of dividends, the theory is founded on the economic principle that receiving money today is better than receiving it tomorrow. However, this principle applies mainly to majority shareholders, whereas the opposite is true for minority shareholders who receive only stock dividends.

## CONCLUSION

- It has been established that the practice of paying dividends through freed-up shares has a detrimental effect on the economic capability of minority shareholders in companies listed on the Lima Stock Exchange.
- Furthermore, it has been determined that there is ample evidence supporting the fact that the combination of explanatory variables, namely the dividend per share ratio, earnings retention ratio, and price-earnings ratio is suitable in explaining the adverse impact on the economic capability of minority shareholders in companies listed on the Lima Stock Exchange during the period from 2009 to 2016.
- The findings of this study may prompt changes in legislation and regulations pertaining to the Securities Market Act. It is recommended that this law be revised in order to regulate the dividend payment system adopted by

companies listed on the Lima Stock Exchange. This can be achieved by stipulating that a minimum percentage of dividends to be distributed to shareholders must be guaranteed by the Securities Market Act. This percentage can be set at 30%, as is already the case in Chile, Colombia, Brazil, and Venezuela. With this amendment, investors will be assured of receiving at least 30% of dividends in cash, thus avoiding any negative impact on the economic capability of minority shareholders who wish to benefit from their investment in cash. The inclusion of such a clause can enhance transparency and safeguard minority shareholders. Better-informed investors will be able to choose how they prefer to receive their profits when purchasing shares: in cash or in freed-up shares. Ultimately, this amendment will have a socio-economic impact, and its effects will be reflected in the improvement of the economic capability of minority shareholders.

## REFERENCES

- Banco Central de Reserva del Perú (BCRP). (s.f.). Glosario de términos económicos. <https://www.bcrp.gob.pe/publicaciones/glosario/c.html>
- Bebczuk, R. (2000). *Información Asimétrica en Mercados Financieros. Introducción y Aplicaciones*. Editorial Cambridge, University Press.
- Díaz, R. (2009). *La Regulación de los Conflictos de Interés de los Directores como una Medida de Protección a los Accionistas Minoritarios en la Sociedad Anónima* [Tesis de Magíster, Universidad de Chile].
- Gitman, J. (2000). *Principios de Administración Financiera*. Pearson Educación.
- Gutiérrez, M. and Sáez, M. (2014). La política de dividendos de las empresas con accionistas de control. *INDRET. Revista para el análisis del Derecho*. N° 3, julio 2014. ISSN 1698-739X [https://indret.com/wp-content/themes/indret/pdf/1067\\_es.pdf](https://indret.com/wp-content/themes/indret/pdf/1067_es.pdf)
- Mascareñas, J. (2020). Política de Dividendos. *Monoграфías de Juan Mascareñas sobre Finanzas Corporativas*. N°31. ISSN: 1988-1878. <http://www.juanmascarenas.eu/monograf.htm>

- Menéndez, C. and Guerrero, S. (1994). La controversia sobre la Política de Dividendos: Revisión y Síntesis. *Revista Española de Financiación y Contabilidad*. Volumen XXIV, N° 80, julio-septiembre 1994, pp. 793-816.
- Pérez, C. (2007). *Remuneración de Directorio y Gobierno Corporativo*. [Tesis de Magíster, Pontificia Universidad Católica de Chile].
- Ramos, C. (2004). *Derechos corporativos individuales del accionista y el financiamiento del objeto social de la sociedad anónima* [Tesis de Maestría, Universidad Nacional Mayor de San Marcos].
- Ross, S., Westwerfield, R. and Jordan, B. (2014). *Fundamentos de Finanzas Corporativas*. Décima edición. Mc Graw Hill.
- Santos, N. (2008). La política de dividendos y la rentabilidad de los negocios. *Industrial Data Revista de Investigación*, 11(1), 29-36.
- Weston, F. y Copeland, T. (1997). *Finanzas en Administración* (9ª ed.). Volumen II. Editorial Mc Graw Hill.

### **Competing interests**

The author declares that there is no conflict of interest.

### **Authors' Contribution**

Abdias Armando Torre Padilla (lead author): Conceptualization, data curation, formal analysis, research, methodology, project administration, validation, visualization, writing (original, revision and edition).