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**Interrelation between Payout and Financing Decisions: Evidence from Emerging Markets.**

There is no doubt that financing and payout decisions have some impact on the company’s efficiency and value. The search for target (optimal) levels of capital structure and payout determined the direction of academic research in corporate finance in past 50 years. The authors tried to find the factors that will help companies to achieve target levels of financing and payout.

This particular paper aims to investigate whether payout and financing decisions are jointly determined in the companies from developing countries. In the academic literature, authors mainly concentrate on how payout policy affects financing policy. Instead, we apply a model where payout and financing decisions are determined simultaneously. Such a model accounts for possible two-side interrelation and endogeneity. Besides, very little research was conducted on the sample of companies from emerging markets, and if it was, the result would be controversial: some authors did not find any proofs for the existence of such an interrelation, some of them found positive interrelation and some of them – negative. Therefore, we tried to enhance the existing literature on this topic in two ways: by applying simultaneous framework and by focusing on the companies from emerging countries.

We apply simple budget constraint equation, proposed by Lambrecht and Myers:

*ΔDebt + Net Income = CapEx + Payout*.

The logic behind this equation is simple: debt absorbs the changes in net income if the company needs to hold its investment and payout policies constant. However, sometimes companies do not have any opportunities to change their debt (for example, because they already have excessive debt), or the existed opportunities are not enough. In such cases, the company will have to change either investment policy or payout policy and to come to some trade-off. We assume that companies consider this budget constraint when making financing and payout decisions.

In the research, we test the following hypotheses:

1. There is a **negative interrelation** between payout and financing decisions in the companies from developing markets;
2. The negative interrelation between payout and financing decisions takes place in both **developing** and **developed countries**;
3. The specifications of payout and financing decisions **do not affect the sign** of interrelation.

We use simultaneous equations to capture such a trade-off and possible interrelation (one equation for payout decisions and one for the financing decisions). We test two specifications of financing decisions (total debt to total assets ratio and long-term debt to total assets ratio) and two specifications of payout decisions (total payout (the sum of dividend payout and repurchases) to total assets ratio and dividend payout to total assets ratio). We also use soma control variables like capital expenditures, cash holdings, Tobin’s Q, return on assets and return on sales.

The research was conducted on two samples: the first contained the US companies and the second – companies from nine developing countries. Two samples allowed us compare the results obtained from developed and developing markets. Based on these two samples we obtained some interesting and significant results.

Payout and financing decisions are really made simultaneously and are jointly determined. There is a negative interrelation between total payout and financing decisions and positive – between dividend payout and financing decisions in the US companies. We tend to think that this result can be explained by the fact that repurchases are now more popular type of payout than dividends in the US. The dividends in the US might be considered as a “minimum” payout level, which will be maintained by any means, including new debt issues. For instance, if the company faces a significant negative change in its net income, it can draw more debt to maintain a dividend payout on its minimum acceptable level. However, when there is a positive change in net income, the company can make a repurchase (which will be considered as an extra payout) and reduce its debt.

In the sample of companies from developing countries, we obtained different results. In most countries (except Russia and China), there is a negative interrelation between financing and payout decisions for all specifications. This result let us conclude that most developing countries follow the same patterns in making financing and payout decisions as the US companies. However, in Russia and China there is a positive interrelation, which means that they draw more debt to maintain competitive levels of payout to attract investors. The reason for such behavior is not obvious and needs further investigation.

To sum up, the main findings are the following:

1. There is a significant interrelation between financing and payout decisions in companies from both developed and developing countries:
2. The sign of this interrelation might be affected by the specification of the payout decisions (for the US companies) and by the company’s home country.