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Local peer influence on dividend payout decisions

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ABSTRACT

Using a large sample of US-listed firms, we examine how firms' dividend payout decisions are influenced by the dividend policies of their local peers. We find that the decisions to increase and decrease dividends are both influenced by the payout choices of firms headquartered in the same locality. We show that local peer effects are driven by the desire to compete for local dividend clineteles, with local peer effects proving more pronounced in geographies with greater retail investors clienteles, institutional-tax clienteles, and agency-cost clienteles. In contrast to dividends, share repurchases are not influenced by local peer repurchase decisions. Our findings prove robust to various sampling methods, peer portfolios, model specifications, and estimation techniques.

1. Introduction

Since the seminal work of Miller and Modigliani (1961), the relevance of firms' corporate payout policies has received extensive theoretical and empirical attention (e.g., Benartzi et al. 1997, Allen et al. 2000, Fama and French 2001, DeAngelo and DeAngelo 2006, Becker et al. 2011, John et al. 2011, Golubov et al. 2020, Michaely et al. 2021). In recent developments, the literature has revealed that firms' dividend payout decisions are in fact highly dependent on the dividend decisions of their industry counterparts (Adhikari and Agrawal 2018, Grennan 2019). However, this advancement has largely overlooked the role of local peer effects on firms' payout decisions. This omission is surprising given the known existence of local interactions and knowledge spillovers amongst neighboring firms (e.g., Greenstone et al. 2010, Davis et al. 2014). Moreover, empirical evidence has shown that other corporate financial decisions (e.g., Dougal et al. 2015, Li and Wang 2022), CEO compensation packages (e.g., Francis et al. 2016, Yonker 2017), and stock returns (e.g., Pirinsky and Wang 2006, Parsons et al. 2020) all display geographic intradependencies. Thus, to address this gap in the literature, we examine whether the dividend payout decisions of firms are influenced by the payout decisions of their local peers.

In examining this research question, our paper enhances the expanding body of literature concerning the significance of local peer influence on firms' corporate decisions, including firms' investment decisions (Dougal et al. 2015, Grieser et al. 2022), earnings forecasts announcements (Matsumoto et al., 2022) and corporate social responsibility expenditures (Li and Wang, 2022). In our pursuit, we test the importance of local peers and postulate that local peer behavior is particularly relevant for firms' dividend payout decisions due to firms' competition for local dividend clienteles. More specifically, it is well documented that both retail and institutional investors – with heterogeneous preferences for dividends – hold a disproportionate amount of their portfolios in local firms (Coval and Moskowitz 1999, Grinblatt and Keloharju 2001, Ivković and Weisbenner 2005) and that managers frequently cater for local dividend clienteles when deciding their dividend payout policies (Becker et al., 2011), especially in high agency cost environments (John et al. 2011, Golubov et al. 2020). Consequently, failing to maintain dividend parity with local peers will likely result in the transmission of negative information to local dividend clienteles, prompting adverse market and/or managerial consequences such as possible negative price reactions (e.g., Michaely et al. 1995, Benartzi et al. 1997), potential declines in clientele ownership (e.g., Parrino et al. 2003), or even an increased risk of CEO dismissal (e.g., Schaeck et al. 2012). Thus, we hypothesize that firms' dividend decisions are positively influenced by the dividend decisions of thier local peers and that these peer effects are more pronounced in locations with stronger local dividend clienteles.

To test this conjecture, we use a large sample of US public firms consisting of 71,993 firm-year observations for the period covering 1980–2018. For our point of departure, we begin by identifying geographic and industry peer reference groups. Specifically, we partition firms according to their geographic location using the Combined Statistical Area (CSA) of each firm's headquarters and their industry affiliation, defined by Fama and French 12 industry classification. Unlike the works of Adhikari and Agrawal (2018) and Grennan (2019), our industry classification is intentionally broad as we seek to minimize

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the chance that our local portfolios pick up any endogenous interactions via industry linkages. Accordingly, our local peer reference groups are formed by those firms operating in the same local CSA but in a different industry. In our empirical approach, we examine the effects of local peer behavior on a firm's decision to increase or decrease dividends, as previous literature has shown that these decisions are not symmetrically determined by the same factors (e.g., Lintner 1956, Leary and Michaely 2011, Grennan 2019).

One of the main empirical challenges in estimating local peer effects derives from a specific form of endogeneity known as the reflection problem (Manski, 1993). In its simplest sense, if the dividend decisions of firms are influenced by their local counterparts, then firm i's dividend decision is a function of local firm k's and vice versa. Accordingly, the challenge persists as one must determine if the average behavior in a group influences the behavior of the firms who compose said group (Grennan, 2019). To address the well-known reflection problem and to identify the causal effect of local peer behavior on a firm's propensity to either increase or decrease dividend payments, we employ an instrumental variable approach. Pioneered by Leary and Roberts (2014), we instrument the endogenous peer dividend decision variable with a measure of local peer idiosyncratic equity shock derived from the residuals of an augmented asset pricing model. The instrumental variable approach suffices the validity conditions required for our identification strategy (which we discuss in Section 4.2) and has equally been externally validated by a plethora of recent peer effect studies, such as, Adhikari and Agrawal (2018), Silva (2019), Gyimah et al. (2020), Seo (2021), Matsumoto et al. (2022) and Hsu et al. (2023).

Our baseline results show that the dividend payout decisions of firms are influenced by the dividend decisions of their local peers. Specifically, we find that a one standard deviation increase in the fraction of local peers increasing (decreasing) their dividend payments increases the probability that a firm in the same locality increases (decreases) dividend payments by 10.1% (4.9%) on average, all else equal. As a reference for economic significance, we note that Li and Wang (2022) find that a one-standard-deviation increase in corporate social responsibility among local peers results in a 9.9% increase in a firm's own corporate social responsibility, while Matsumoto et al. (2022) reports that a one standard deviation increase in the fraction of locals peers forecasting earnings is associated with a 4.3% increase in the likelihood that a firm forecasts. To shed further light on the economic significance of local peer effects, we extend our baseline results and compare the influence of local peers to industry peers. By instrumenting both local and industry peer effects, we find the economic magnitude of local peers effects to be comparable to that of industry peer effects. Specifically, our joint instrument analysis shows that local peer influence yields significant estimates of 9.4% and 4.7% for dividend increases and dividend decreases, respectively, while industry peer effects yield estimates of 12.3% and 5.1% for the same set of dividend decisions. Thus, our work complements the recent literature on industry peer effects (e.g., Adhikari and Agrawal (2018) and Grennan (2019)) by showing that local peers play an equally important role in determining firms' dividend payout decisions. Given the economic significance of our local peer effect estimates, we further demonstrate their statistical robustness via an extensive range of tests, including a placebo test, two peer proximity-based tests, an alternative instrumental variable approach, various model specifications, multiple sub-sample tests, and different standard error assumptions.

With our baseline results firmly established, we exploit the cross-sectional heterogeneity of our sample and test the local dividend clientele mechanisms underpinning local peer effects. The theoretical and empirical literature has attributed various characteristics to the dividend clientele explanation of corporate payout theory, such as investor age (Becker et al., 2011), investor income (Baker and Wurgler, 2004b), investor tax-status (Allen et al. 2000, Desai and Jin 2011), the degree of asymmetric information between firms and investors (John et al., 2011), and the quality of governance mechanisms (John et al. 2015, Golubov et al. 2020). Accordingly, we leverage the established dividend clinetele literature and test how the demands and preferences of three prominent local dividend clineteles, namely, local retail investor clienteles, local institutional tax clienteles, and local agency-cost clienteles, impact the degree of local peer influence on firms' dividend payout decisions. In doing so, our tests help to bridge the traditional dividend clientele literature (e.g., Allen et al. 2000, Becker et al. 2011) with the recent dividend peer effect literature (e.g., Adhikari and Agrawal 2018, Grennan 2019).

Consistent with our primary conjecture, we find that the demands and preferences of local dividend clienteles impact the degree of local peer influence on firms' dividend payout decisions. Specifically, by employing local proxies for retail investor age and income, as well as bank monitoring and analyst coverage, we demonstrate that local peer effects on firms' dividend increases and decreases are more pronounced in areas with larger local retail investor and agency-cost dividend clienteles. In contrast, we find local peer effects to be insignificant in regions with younger and wealthier local retail investors and in localities with substantial bank presence and analyst coverage. Most interestingly, the cross-sectional tests for local institutional tax clienteles reveal that firms respond asymmetrically to the presence of more sophisticated local dividend clienteles, with local peer influence strongly manifesting itself for dividend increases (decreases) in geographies where the presence of local institutional tax clienteles are high (lower). Taken together, our analysis reveals that the demands and preferences of local dividend clineteles not only impact dividend payouts directly (e.g., Becker et al. 2011, Golubov et al. 2020), but also indirectly via the local peer effect channel, as firms' imitate the dividend payout decisions of their local peers to cater to the demands of different local dividend clienteles and to maintain local payout market reputation.

In the final part of the paper, we conduct a series of additional empirical tests to further strengthen and consolidate our understanding of local peer effects on firms' payout decisions. First, we use a selection of subsample windows to examine how local peer influence on firms' dividend payout decisions has changed over time. Consistent with the disappearing and reappearing dividend arguments of Michaely et al. (2021), we find local peer effects to be economically and statistically significant for dividend decreases throughout the 1980s and 1990s, while for dividend increases, we report an increasing and positive trend for the statistical and economic importance of local peer influence, with local peers proving most influential in more recent years, during 2010–2018. Second, we test if a firm's dividend decision is influenced by the opposing dividend decisions of its local peers. In line with theoretical herding models of firm behavior (e.g., Scharfstein et al. 1990), we find that firms are less likely to increase (decrease) dividends when their local counterparts are decreasing (increasing) their dividend payments. These results support our main findings and reinforce the notion that firms largely imitate their local peers to maintain competitive parity. Third, we examine whether local peer effects are also important for firms' share repurchases. Consistent with the work of Grennan (2019), we find no evidence to suggest that local peer behavior statistically influences firms' share repurchase decisions, confirming the fact that dividends and share repurchases are not determined by the same factors and thus should not be considered as perfectly interchangeable payout methods. As a final complement of tests, we adopt alternative local peer portfolio definitions and examine the sensitivity of our results to alternative samples by omitting firms headquartered in prominent CSAs. In both tests, our results remain empirically robust.

Our work makes several important contributions to the literature. To our knowledge, this is the first paper that identifies the causal effect of local peer behavior on dividend payout decisions. In doing so, our paper bridges the gap and contributes to two important bodies of literature: (i) the recent dividends peer effects literature and (ii) the dividend clientele literature. Specifically, our paper complements the recent dividend peer effects studies of Adhikari and Agrawal (2018) and Grennan (2019), by showing that the dividend payout decisions of firms are not only influenced by their industry counterparts but also by their local peers. Moreover, by extensively documenting the importance of local dividend clienteles, we enrich the clientele literature by showing that firms not only respond directly to the pressures of local retail and institutional investors (e.g., Becker et al. 2011, Golubov et al. 2020), but also indirectly via the local peer effect channel, as they desire to compete for local dividend clineteles and maintain their local payout market reputation.

More broadly, our work contributes to the important and fastly growing literature on peer effects on other corporate financial policies, such as firms' capital structure (Leary and Roberts, 2014), investment (Foucault and Fresard, 2014), trade credit (Gyimah et al., 2020), and disclose decisions (Seo, 2021), which have predominately restricted a firm's peer reference group to its industry counterparts. We conjecture, that a firm's financial decisions are likely to be influenced not only by the behavior of its industry peers, but also by their local peers due to the vast number of interactions that occur at the local geographic level (e.g., Glaeser et al. 2001, Pirinsky and Wang 2006, Davis et al. 2014, Dougal et al. 2015). Accordingly, the evidence put forward in this paper surfaces a potential new line of inquiry, as the influence of local peers may also be present for a number of equally salient corporate financial decisions, such as firms' capital structure and trade credit decisions.

The remainder of the paper is structured as follows. Section 2 provides an overview of the related literature. Section 3 details the data and local peer definition employed in our paper. Section 4 lays out our empirical methodology, explains the construction and validity of our instrumental variable approach, and reports the sample summary statistics. Section 5 presents our main empirical results. Section 6 examines the cross-sectional heterogeneity in our main findings subject to local dividend clienteles. Section 7 provides further empirical insights and robustness tests and Section 8 concludes.

2. Related literature

Why do firms pay dividends and what factors influence firms' dividend payout decisions? Ever since the work of Miller and Modigliani (1961), these questions have puzzled financial economists and continue to attract significant attention (e.g., Benartzi et al. 1997, Allen et al. 2000, Fama and French 2001, DeAngelo and DeAngelo 2006, Becker et al. 2011, John et al. 2011, Golubov et al. 2020, Michaely et al. 2021). Finance scholars have traditionally attributed firms' dividend payouts to the desire to communicate important information to shareholders (Miller and Rock 1985, Benartzi et al. 1997), the need to cater to the preferences and demands of distinct dividend clienteles (Baker and Wurgler 2004b, Becker et al. 2011), or as a mechanism to alleviate excess cash flow concerns (Fama and French 2001, DeAngelo and DeAngelo 2006). More recently, an important contribution to this debate has emerged with the works of Adhikari and Agrawal (2018) and Grennan (2019) showing that firms' dividend payout decisions are in fact significantly influenced by the decisions of their industry peers. Specifically, Adhikari and Agrawal (2018) find firms that face more intense product market competition are more likely to imitate the payout decisions of their industry peers while Grennan (2019) shows that financially constrained firms are often pressured into increasing their dividend payouts by the strategic dividend increases of their cash-abundant competitors. However, despite such important developments, evidence on whether local peers also play a pivotal role in influencing firms' payout decisions remains surprisingly scarce.

Drawing from dividend catering and dividend clientele theories, we postulate and test that local peer behavior is particularly relevant for firms' corporate payout decisions due to firms' competition for local dividend clienteles. From the catering perspective, Baker and Wurgler (2004b) advances that managers actively observe valuation differences between firms that pay dividends and those that do not, and managers cater to investors by initiating dividends when investors place a premium on dividend payers, and by omitting dividends when investors prefer nonpaying firms. Li and Lie (2006) extend this argument to the intensive margin of dividends by showing that managers also cater to the dividend premiums placed on dividend increases and dividend decreases. In terms of local dividend clienteles, the empirical literature has widely shown that the portfolios of both retail and institutional investors are characterized by local biases resulting in geographically segmented investor markets (e.g., Coval and Moskowitz 1999, Grinblatt and Keloharju 2001, Ivković and Weisbenner 2005) and both sets of investors display heterogeneous preferences for dividends. For example, Graham and Kumar (2006) documents that retail investors' stock holdings reflect a dividend preference that increases with age and decreases with income, while Brav and Heaton (1998) argue that legislative constraints – such as the prudent man rule – limit institutional investors' ability to invest in low-paying dividend stocks. Given local investor biases and age-based preferences for dividends, Becker et al. (2011) show that firms headquartered in locations with a higher fraction of senior citizens are more likely to pay dividends, initiate dividends, and have higher dividend yields. Put simply, the empirical evidence demonstrates that local clientele preferences induce geographically varying demand for dividends that is catered for and reflected in firms' payout decisions.

In addition to the above demands and preferences of local investor clienteles, an established literature has also documented firms' active catering towards investors' tax-based preferences. Theoretical models have argued that high-quality firms are more likely to pay dividends to attract the monitoring capabilities of tax-advantaged institutional investors (e.g., Allen et al. 2000). In line with the tax clientele hypothesis, Grinstein and Michaely (2005) and Dahlquist et al. (2014) report that institutional investors, on average, prefer and hold more dividend-paying stocks. Desai and Jin (2011) further support this argument but highlight that institutional investors serving dividend-averse clienteles tend to hold stocks with lower dividend yields. Moreover, by exploiting the 2003 Jobs and Growth Tax Relief Reconciliation Act (JGTRRA), Kawano (2014) shows that decreases in dividend tax rates result in investor clienteles actively adjusting their portfolios towards higher dividend-paying stocks. Chetty and Saez (2005) further report that post-JGTRRA a large number of firms initiated or increased regular dividend payments to cater to the preference changes of their tax-sensitive dividend clienteles. Accordingly, the composition and tax-based preferences of local investors is also likely to induce geographically varying demand for dividends and competition among local firms.

A further motivation for the existence of local peer effects in firms' dividend payout decisions relates to the agency-cost argument for local dividend clienteles. Agency-cost theories (e.g., Easterbrook 1984, Jensen 1986) have long advocated that in environments characterized by high levels of asymmetric information between managers and shareholders, dividends serve as an important mechanism to discipline managers and to limit the misappropriation of funds. For example, in their agency model of dividend clienteles, Allen et al. (2000) predicts that firms with more severe agency problems are more likely to pay dividends to attract institutional investors. In line with these predictions, John et al. (2011) shows empirically that firms in remote locations of the US (i.e., in locations where asymmetric information and monitoring costs are arguably higher) regularly cater to the agency-cost concerns of distant clienteles by committing to higher dividend payments. John et al. (2015) and Crane et al. (2016) further show that US firms with weak governance structures pre-commit themselves to paying higher dividends. Finally, using a global sample of mergers and acquisitions, the recent work of Golubov et al. (2020) document that acquiring firms located in countries with weaker governance regimes actively increase dividends post-acquisition to cater to the agency-cost preferences of their newly acquired dividend clientele.

Bridging together the dividend peer effects and local dividend clientele literature, our study investigates for the first time the existence of local peer effects in firms' dividend payout decisions and examines whether such effects are connected to local dividend clientele pressures. Specifically, in what follows, we focus on the demands and preferences of three prominent dividend clinetele groups, namely, (i) local retail investor clienteles - proxied by local age and income considerations - (ii) local institutional tax clienteles - proxied by local institutional investors' presence and their tax sensitivity - and (iii) local agency-cost clienteles - proxied by the degree of external monitoring faced by firms, namely, the number of financial institutions and the degree of analyst coverage in the local area. In doing so, our paper not only seeks to establish the existence of local peer effects in firms' dividend payout decisions, but endeavors to identify the underlying mechanisms attributed to local dividend clienteles.

3. Data and local peer portfolio definition

3.1. Data

To conduct our analysis we draw from a number of datasets. For our main sample, we obtain firm-level financial data from Compustat and stock price information from CRSP, covering the period 1980–2018. We select this start date to avoid the prior period surrounding President R. Nixon's 1971 dividend freeze (Baker and Wurgler, 2004b). We obtain CSAs delineations from the US Census Bureau and further supplement our design with CSA demographic data from the US Census Bureau, CSA income data from the Bureau of Economic Analysis, firm-level institutional ownership data from Thompson Reuters (13f), Blouin et al. (2017) institutional investor classifications,[1] bank branch network data from the FDIC, and analyst coverage data from Institutional Brokers' Estimate System (IBES). As it is standard in the literature, we apply several filters to our final dataset. First, we exclude financial firms and utility firms, because these industries are highly regulated. Next, we drop observations with missing data for the variables employed in the regressions and omit firm-year observations with fewer than three local peers. Finally, to reduce the effects of outliers, we winsorize all continuous variables at the top and bottom 1%. The final sample includes firms in the intersection of these databases, consisting of 73,977 firm–year observations for 8581 unique firms in 74 different CSAs. All variable names, definitions, and sources can be found in Appendix Table A.1.

3.2. Local peer portfolios

Before proceeding to our empirical design, it is important that we outline the definition and rationale behind our local peer portfolios. Consistent with the corporate finance literature, we adopt the headquarters of firms as our point of economic analysis. Accordingly, we begin by defining a firm's local geographical area as the CSA of its headquarters.[2] Despite the fact that large firms often operate across multiple counties or even states, empirical research has confirmed that industry interactions (e.g., Dougal et al. 2015), information asymmetries (e.g., John et al. 2011), and most importantly for our paper, dividend clienteles (e.g., Coval and Moskowitz 1999, Ivković and Weisbenner 2005, Becker et al. 2011) primarily occur with respect to firms' headquarters.[3]

As defined by the Office of Management and Budget (OMB), CSAs are "groupings of adjacent metropolitan and/or micropolitan statistical areas that have social and economic ties as measured by commuting to work". More specifically, CSAs "can be characterized as representing larger regions that reflect wider-ranging social and economic interactions, such as wholesaling, commodity distribution, and weekend recreation activities". Both segments of the definition are important as we endeavor to investigate the effect of local peer influence as a response to local dividend clienteles. More precisely, we want to identify firms that share geographical areas in which local investors are likely to display significant biases towards as a result of employment, social and/or retail interactions. Accordingly, because such economic and social activities are likely to span across geographical areas, we focus our analysis on CSAs rather than individual cities, counties, or even micropolitan (μSA) or metropolitan (MSA) statistical areas[4]

Given our local definition, we assign all firms into their relevant Fama–French 12 industry category and construct our local peer portfolios, where, for each firm, the local peer portfolio represents all non-industry peers headquartered within the same CSA. Unlike the studies of Adhikari and Agrawal (2018) and Grennan (2019) who focus on industry peer effects and adopt finer industry classifications, we deliberately opt for a broad industry classification as we attempt to minimize any potential endogenous industry interactions or influence spillovers that would likely arise from a more acute industry definition. Accordingly, by adopting a broad industry classification, our local peer portfolios allow us to confidently isolate the role of local peer influence on firms' dividend decisions. Nonetheless, in additional tests, we repeat our analysis using alternative industry classifications, including Fama–French 17 and 48 industries, the text-based industry measure developed by Hoberg and Phillips (2016), and two-digit and three-digit SIC codes. Our findings are empirically robust.

4. Empirical methodology

4.1. Econometric model

To test whether the dividend decisions of local peers influence a firm's propensity to either increase or decrease dividend payouts, we estimate the following model:

$$Dividend\ Decision_{i,j,a,t} = \alpha + \beta Local\ Peer\ Decision_{-i,-j,a,t} + \lambda' Controls + \omega_i + \mu_t + \upsilon_{i,j,a,t} \quad (1)$$

where the dependent variable, $Dividend\ Decision_{i,j,a,t}$, represents the dividend decision of firm i in CSA a and industry j in year t. In the main specifications, similar to Grennan (2019), $Dividend\ Decision_{i,j,a,t}$, is a vector of dummy variables denoting dividend increases or dividend decreases. Our main variable of interest, $Local\ Peer\ Decision_{-i,-j,a,t}$, is the equally-weighted average dividend decision of all non-industry peer firms in CSA a, naturally excluding firm $i's$ own dividend decision.[5] Our primary objective is to examine the degree in which local peers' average dividend decision influences firm $i's$ own dividend decision. We expect, however, the OLS estimate of $Local\ Peer\ Decision_{-i,-j,a,t}$ to be biased due to a specific form of endogeneity, known as the reflection problem (Manski, 1993). To deal with this endogeneity problem, we employ an instrumental variable approach that allows us to truly identify the causal effect of local peer influence on firms' own dividend

[1] We thank Brian Bushee for making this classification data available on his personal website.

[2] A complete list of all CSAs used in our empirical analysis can be found in Internet Appendix Table 1.

[3] Following Dougal et al. (2015), we test whether headquarter changes impact the degree of local peer influence by interacting local peer effects with a post-headquarter change indicator variable. Consistent with findings of Dougal et al. (2015), we find headquarter changes to have an insignificant incremental effect on local peer effects. The results are reported Internet Appendix Table 2.

[4] Other studies focused on local peer effects have also adopted larger geographical areas, such as economic areas (e.g., Dougal et al. 2015) and census regions (e.g., Li and Wang 2022).

[5] Following Leary and Roberts (2014), we employ the contemporaneous values of this variable, as firms in competitive environments are more likely to imitate current peer dividend decisions thus allowing one to identity more cleanly the existence of peer influence. Nevertheless, our results remain robust to alternative lagged specifications.

decisions. More specifically, in line with previous studies, we use an indicator of peers' idiosyncratic equity shocks as an instrument for $Local\ Peer\ Decision_{-i,-j,a,t}$. The specific details of our identification strategy are provided in Section 4.2.

The variable $Controls$ denotes a series of firm-specific ($X_{i,j,a,t-1}$) and peer control variables ($\bar{X}_{-i,-j,i,t-1}$, $\bar{Y}_{-i,j,t}$, $\bar{X}_{-i,j,t-1}$). Specifically, the vector $X_{i,j,a,t-1}$ contains a set of control variables that account for the impact of firm-specific factors on dividend decisions, including a firm's size, age, profitability, investment, market-to-book ratio, leverage, tangibility of assets, R&D expenditure, retained earnings, and institutional ownership.[6] In our empirical analysis we also include the firm-specific measure of our instrument, idiosyncratic equity shock, to ensure the unbiased and consistent estimation of our main variable of interest (Von Hinke et al., 2019).

In addition to firm-specific characteristics, we also control for potential contextual effects by including the vector $\bar{X}_{-i,-j,i,t-1}$ of local peer firm average characteristics. Furthermore, given the recent studies of Adhikari and Agrawal (2018) and Grennan (2019), we control for potential industry peer and contextual effects by including the terms $\bar{Y}_{-i,j,t}$ and $\bar{X}_{-i,j,t-1}$, respectively, where $\bar{Y}_{-i,j,t}$ is the equally weighted average dividend decision of all firms in industry j, except firm i in year t, and $\bar{X}_{-i,j,t-1}$ is a vector of industry peer average characteristics. We include firm (ω_i) and year (μ_t) fixed effects to account for unobserved effects and common correlated factors that may influence or indeed cause coinciding dividend decisions. Finally, $\upsilon_{i,j,a,t}$ denotes the firm-specific error term, which is assumed to be correlated within the firm and heteroscedastic. Subsequently, all reported standard errors are robust to heteroskedasticity and are clustered at the firm level to allow for within dependence (Petersen, 2009).

4.2. Identification strategy

4.2.1. Identification problem and instrument construction

While the notion of local peer effects is relatively straightforward to contextualize, in practice, the identification of the true causal effect is notoriously challenging due to a specific form of endogeneity, known as the reflection problem (Manski, 1993). More specifically, if the dividend decisions of firms in a given CSA are truly influenced by their local peers, then firm $i's$ outcome is a function of firm $k's$ and vice versa. Equally, firms may simultaneously, yet independently, make the same dividend decisions in response to a local common shock. Given this, a clear endogeneity issue exists, and the OLS estimator of β in Eq. (1) will undoubtedly be biased. In order to address this endogeneity problem, empirical peer effect studies require an instrument variable approach, where one must identify an instrument able to capture variation in ex-ante peer characteristics that both predates the decision variable and is not affected by common shocks (Angrist and Pischke, 2009).

In this paper, we propose a 2SLS estimation approach similar to the studies of Leary and Roberts (2014), Adhikari and Agrawal (2018), Grennan (2019), Gyimah et al. (2020), Seo (2021), Matsumoto et al. (2022), and Hsu et al. (2023). Following these works, we instrument the potential endogenous regressor, $Local\ Peer\ Decision_{-i,-j,a,t}$, with a measure of peer idiosyncratic equity shock which is strongly correlated with $Local\ Peer\ Decision_{-i,-j,a,t}$, but has no direct effect on our dependent variable, $Dividend\ Decision_{i,j,a,t}$. To construct our instrument, we use a traditional asset pricing model to separate idiosyncratic firm-level shocks from other common shocks occurring at the market, industry, and local levels. Specifically, we estimate the following augmented asset pricing model:

$$R^{j,a}_{i,t} = \alpha^{j,a}_{i,t} + \beta^{M}_{t}(RM_t - RF_t) + \beta^{j}_{i,t}(\bar{R}^{j}_{-i,t} - RF_t) + \beta^{a}_{i,t}(\bar{R}^{a}_{-i,t} - RF_t) + \eta^{j,a}_{i,t} \quad (2)$$

where $R^{j,a}_{i,t}$ is the return of firm i in local CSA a and industry j in month t. $(RM_t - RF_t)$ is the excess return on the market, defined as the difference between the market return at time t (RM_t) and the risk-free rate (RF_t). Similarly, $(\bar{R}^{j}_{-i,t} - RF_t)$ is the excess return on an equal-weighted industry portfolio, excluding firm i's return, and $(\bar{R}^{a}_{-i,t} - RF_t)$ is the excess return on an equal-weighted CSA portfolio, excluding firm i's return. We estimate Eq. (2) for each firm on a rolling annual basis using historical monthly returns data from the CRSP database. Each regression requires at least 24 months of historical data and uses up to 60 months of data in the estimation. For example, in order to obtain the idiosyncratic returns for Intel Corporation from January 2010 to December 2010, we first estimate Eq. (2) using monthly returns from January 2005 to December 2009. Then using the estimated coefficients from Eq. (2) and the monthly factor returns from January 2010 to December 2010, we compute the expected and idiosyncratic returns as follows:

$$Expected\ Return^{j,a}_{i,t} \equiv \hat{R}^{j,a}_{i,t} = \hat{\alpha}^{j,a}_{i,t} + \hat{\beta}^{M}_{t}(RM_t - RF_t) + \hat{\beta}^{j}_{i,t}(\bar{R}^{j}_{-i,t} - RF_t) + \hat{\beta}^{a}_{i,t}(\bar{R}^{a}_{-i,t} - RF_t) \quad (3)$$

$$Idiosyncratic\ Return^{\,j,a}_{\,i,t} \equiv \hat{\eta}^{j,a}_{i,t} = R^{j,a}_{i,t} - \hat{R}^{j,a}_{i,t} \quad (4)$$

To obtain expected and idiosyncratic returns for Intel Corporation in 2011, we repeat the same process by updating the estimation sample from January 2006 to December 2010 and use the estimated parameters for 2011 returns. Following this process, for each firm, we construct firm-specific annual measures of idiosyncratic equity shock by taking the geometric average of the monthly idiosyncratic returns generated from Eq. (4). To construct our instrument for $Local^{-j,a}_{-i,t}$, we take, for firm i, the equally weighted average all non-industry peer firms idiosyncratic equity shocks in the respective CSA, naturally excluding firm $i's$ own idiosyncratic equity shock. In doing so, our approach adopts an instrumental variable that is free of market, industry, and local common factors. Thus, our instrument and identification strategy allows us to cleanly disentangle such common shocks from local peer effects and enables us to estimate the causal relationship between local peer behavior and firms' dividend decisions.[7]

Table 1 presents the summary statistics for the estimated factor regressions used to construct our instrument. The average (median) number of months per rolling regression over the year is 55 (60). On average, the factor regressions load positively across market, local, and industry betas, whose factor loadings sum closely to one. Industry beta reports the largest loadings in absolute terms, however, the magnitude of local beta implies that local loadings explain a sizeable element of systematic variation in the stock returns. The R-squared is consistent with prior studies, such as Leary and Roberts (2014), with an average (median) of 0.207 (0.185). The average and expected return is 0.14 and 0.15, respectively, and the average idiosyncratic return is −0.001.

[6] The choice of our control variables is guided by the recent peer effects literature (e.g., Adhikari and Agrawal 2018, Grennan 2019). The precise definition of the variables used in our analysis is provided in the Appendix Table A.1.

[7] More comprehensively, it is important to note that whilst firms headquartered in the same locality could independently and simultaneously make the same dividend decision in response to a shared exposure in a common local shock, our empirical approach alleviates this concern. Specifically, our instrumental variable (i.e., local peer idiosyncratic shock) strategy enables us to purge any potential variation in local peer dividend decisions that arise as a response to shared exposure, thus leaving only variation in the dividend decision itself. This approach has been widely advocated by the corporate finance peer effects literature and has been adopted to disentangle confounding factors from peer effects in a range of empirical settings, from confounding local factors in geographic peer effects on earnings forecasts (Matsumoto et al., 2022) to confounding industry factors in industry peer effects on firms' leverage (Leary and Roberts, 2014), dividend (Grennan, 2019), and trade credit decisions (Gyimah et al., 2020), to name but a few.

Table 1
Factor regression summary.

Panel A: Regression Statistics	Mean	Median	SD
$\hat{\alpha}_{i,t}$	0.006	0.006	0.022
$\hat{\beta}^M_{i,t}$	0.071	0.179	1.301
$\hat{\beta}^j_{i,t}$	0.729	0.620	1.457
$\hat{\beta}^a_{i,t}$	0.214	0.106	1.365
Adjusted R^2	0.207	0.185	0.164
Obs. per Regression	55	60	10

Panel B: Return Statistics	Mean	Median	S.D.
Avg. Monthly Return	0.014	0.000	0.202
Expected Monthly Return	0.015	0.014	0.093
Idiosyncratic Monthly Return	−0.001	−0.009	0.176

The sample consists of monthly returns for all nonfinancial, nonutility firms in annual Compustat merged with monthly CRSP between 1980 and 2018. The table presents mean factor loadings and adjusted R2s from the following regression:

$$R^{j,a}_{i,t} = \alpha^{j,a}_{i,t} + \beta^M_t(RM_t - RF_t) + \beta^j_{i,t}(\bar{R}^j_{-i,t} - RF_t) + \beta^a_{i,t}(\bar{R}^a_{-i,t} - RF_t) + \eta^{j,a}_{i,t}$$

where $R^{j,a}_{i,t}$ is the return of firm i in local CSA a and industry j in month t. $(RM_t - RF_t)$ is the excess return on the market. $(\bar{R}^j_{-i,t} - RF_t)$ is the excess return on an equal-weighted industry portfolio excluding firm i's return. $(\bar{R}^a_{-i,t} - RF_t)$ is the excess return on an equal-weighted CSA portfolio excluding firm i's return. Industries are defined by Fama and French's 1997 12 industry classification. Following Leary and Roberts (2014), the regression is estimated for each firm on a rolling annual basis using historical monthly returns data from the CRSP database. Each regression requires at least 24 months of historical data and uses up to 60 months of data in the estimation. Expected returns are computed using the estimated factor loadings and realized factor returns 1 year forward. Idiosyncratic returns are computed as the difference between realized and expected returns.

4.2.2. Instrument validity

The conclusions drawn from this paper are largely dependent on the validity of our instrument, local peer idiosyncratic equity shock, and its ability to satisfy two important conditions, namely, the relevance criterion (i.e., to be strongly correlated with our endogenous local peer dividends variable) and the exclusion restriction (i.e., not to have a direct effect on the dependent variable). Ultimately, it is key for the reader to appreciate the empirical qualities of our instrument in order to accept the inferences made in this study.

We begin by discussing the relevance criterion. There is a well-established literature that documents the relationship between stock returns, shocks, and dividend payout decisions (e.g., Campbell and Shiller 1988, Grullon et al. 2002, Hoberg and Prabhala 2009). Evidence as far back as Lintner (1956) can be suggested to identify the negative association between performance shocks, firms' exposure to risk and dividends, with managers proving reluctant to increase dividends they may ultimately have to reverse. Similar anecdotal evidence from Brav et al. (2005) finds that such conservatism still proves profound 50 years later. In addition to such evidence, Hail et al. (2014) shows that information shocks also impact corporate payout decisions, with firms less likely to pay or increase dividends after a positive information shock between managers and investors. Finally, as highlighted by Adhikari and Agrawal (2018), our instrument of idiosyncratic equity shock is a strong predictor of future performance and cash flow, which are equally well-known core determinants of firms' dividend payout decisions (e.g., Fama and French 2001, DeAngelo et al. 1996). Thus, the relevance condition of our instrumental variable is supported from a theoretical perspective. From an empirical standpoint, our instrument consistently passes the Kleibergen and Paap (2006) weak instrument F-test in our forthcoming 2SLS estimations, thus further supporting the relevance of our approach.

Next, we consider the exclusion restriction. As documented by Leary and Roberts (2014), the augmented asset pricing model employed to construct our instrument descends from a well-established literature (e.g., Fama and French 1993) and the empirical approach is well known for its ability to decompose stock returns and purge common shocks from firm-specific shocks. Specifically, the inclusion of market and industry-specific factors alleviates a vast amount of known variance in stock returns and removes common market and industry-specific shocks from firm-specific stock returns. Moreover, in our empirical design, we further supplement our approach by including local geographical factors to further purge regional common shocks known to cause local share co-movements (e.g., Bernile et al. 2015). Thus, we are confident that the residuals obtained from our empirical approach are purely firm-specific and do not detail common market, industry and/or local factors.

To further provide empirical support for our design, we follow the likes of Leary and Roberts (2014) and Guryan et al. (2009) and test the validity of our instrument by examining its sensitivity to both contemporary and lagged firm-specific controls. In the Internet Appendix, Table 3, we illustrate that firm-specific variables are scarcely correlated with our measure of local peer idiosyncratic equity shock, thus illustrating that firm-specific factors provide little prediction of our peer-level instrument.[8] Furthermore, in our main empirical specification, we further mute any concerns regarding our instrument and its ability to satisfy the exclusion restriction by estimating a specification fully populated with firm-specific variables and contextual variables along with firm- and year-fixed effects.

Finally, to further buttress our claim that the instrument employed in this study is indeed valid, we stress the vast use of our adopted identification strategy and its considerable growth in popularity in recent years. Specifically, since the initial work of Leary and Roberts (2014), the identification of peer effects has received considerable attention, not only have peer idiosyncratic shocks been employed to disentangle the effects of peer influence on firms' dividend decisions (e.g., Adhikari and Agrawal 2018, Grennan 2019) but more widely, the approach has been adopted to investigate the existence of peer influence on a number of equally salient corporate decisions, including corporate disclosure decisions (Seo, 2021), earning announcements (Matsumoto et al., 2022) and trade credit decisions (Gyimah et al., 2020). Taken together, we are confident that the identification strategy and instrument employed in this study is valid and thus pivotal for our examination of local peer influence on firms' dividend payout decisions.

4.3. Descriptive statistics

Table 2 presents the descriptive statistics of our final sample of 73,977 firm-year observations. Panel A details the distribution of firms across peer portfolios. Panel B details descriptive statistics of all firm-specific and peer variables and Panel C reports the correlations between all firm-specific and peer dividend decisions. The final sample consists of 8581 unique firms across a total of 74 CSA areas and 10 Fama and French Industries. In a typical year, the average firm in the sample has 86 local peers, that is, firms that share the same CSA but operate in different Fama and French industries.[9] Roughly speaking, around 35% of firm-year observations pay cash dividends with dividend increases (decreases) occurring 27% (9%) of the time. In contrast, around 39% of firm-year observations repurchase shares with repurchase increases (decreases) occurring 25% (22%) of the time. The average firm-specific idiosyncratic equity shock is equal to −0.002 and has a standard deviation of 4.6%, consistent with Adhikari and Agrawal (2018). Similarly, the peer averages for local peers are similar to firm-specific values but typically have lower standard deviations. In Panel C we show all

[8] For example, when employing contemporaneous independent variables, in Internet Appendix Table 3, we find only firm-specific Age significantly determines peer idiosyncratic equity shock at the 5% significance level.

[9] A complete list of all CSAs and the distribution of firms can be found in Internet Appendix Table 1.

Table 2
Summary statistics.

Panel A: Peer Group Portfolios	Mean	SD	Min	Median	Max
Firms per year	1,973	367	1,085	1,925	2,584
Total number of CSAs	74				
Total number of Industries	10				
Firms per CSA-year	109	94	4	83	347
Non-Industry firms per CSA-year	86	79	3	63	343
Firms per Industry-year	289	156	15	282	750

Panel B: Summary Statistics	Firm-Specific Factors			Local Peer firm averages			Industry Peer firm averages		
	Mean	SD	Median	Mean	SD	Median	Mean	SD	Median
Payout Characteristics									
Div. Payer	0.353	0.478	0.000	0.335	0.182	0.299	0.331	0.178	0.314
Div. Increase	0.273	0.446	0.000	0.258	0.156	0.229	0.254	0.143	0.234
Div. Decrease	0.088	0.283	0.000	0.086	0.070	0.072	0.086	0.053	0.079
Repurchaser	0.392	0.490	0.000	0.389	0.155	0.357	0.388	0.137	0.354
Rep. Increase	0.249	0.433	0.000	0.242	0.112	0.222	0.241	0.086	0.217
Rep. Decrease	0.224	0.417	0.000	0.218	0.080	0.198	0.218	0.105	0.200
Controls:									
Profitability	0.062	0.236	0.113	0.046	0.092	0.076	0.044	0.080	0.053
Investment	0.061	0.065	0.040	0.060	0.030	0.055	0.059	0.024	0.056
Market-to-book	1.655	1.606	1.139	1.682	0.611	1.493	1.691	0.506	1.623
Leverage	0.227	0.217	0.190	0.231	0.065	0.237	0.234	0.064	0.234
Size	1.031	2.017	0.917	0.846	0.879	0.726	0.887	0.895	0.844
Age	2.731	0.708	2.708	2.700	0.297	2.702	2.703	0.303	2.659
Tangibility	0.274	0.221	0.215	0.274	0.123	0.276	0.270	0.092	0.259
R&D/Sales	0.235	1.573	0.002	0.248	0.549	0.045	0.287	0.504	0.083
RE/BE	−0.492	6.539	0.419	−0.659	1.262	−0.299	−0.653	1.540	−0.398
Institutional Ownership	0.423	0.313	0.384	0.420	0.175	0.382	0.423	0.166	0.371
Idios. Equity Shock	−0.002	0.046	−0.003	−0.002	0.004	−0.002	−0.002	0.009	−0.003

Panel C: Correlations Matrix	(1)	(2)	(3)	(4)	(5)	(6)
(1). Div. Increase	1.000					
(2). Local Peer Div. Increase	0.301	1.000				
(3). Industry Peer Div. Increase	0.382	0.590	1.000			
(4). Div. Decrease	−0.207	−0.042	−0.016	1.000		
(5). Local Peer Div. Decrease	−0.036	−0.136	−0.143	0.382	1.000	
(6). Industry Peer Div. Decrease	−0.014	−0.137	−0.041	0.437	0.830	1.000

This table presents peer group portfolio statistics, variable summary statistics, and a correlation matrix of the core variables used in our main analyses. The sample consists of all non-financial, non-utility firms in the annual Compustat database between 1980 and 2018 with nonmissing data for all analysis variables (see Appendix Table A.1 for variable definitions). The final sample consists of 73,977 firm-year observations. Panel A reports the means, standard deviations (SD), minimums (Min), medians, and maximums (Max) for our peer group portfolios. Panel B reports means, standard deviations (SD), and medians for firm and peer group variables. Panel C reports the correlations between firms' dividend increase and dividend decrease and the respective local and industry peer firm averages. Firm-specific factors denote variables corresponding to firm i's value in year t. Local peer firm averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the observation of firm i. Industry peer firm averages denote variables constructed as the average of all firms within an industry-year combination, excluding the observation of firm i. Industries are defined by Fama and French's 1997 12 industry classification.

peer average dividend decisions to be correlated as expected, with, for example, local peer dividend increase being positively correlated to firm-specific dividend increases and negatively correlated with the opposing measure of local peer dividend decrease.

5. Empirical results

5.1. Baseline results

In Table 3 we report the 2SLS estimates of local peer influence on dividend increases and dividend decreases. To facilitate the interpretation of the results, all coefficients in Table 3 have been scaled by the corresponding variable's standard deviation. In columns (1) and (4) we report the estimates of a restricted specification of Eq. (1), which only control for firm and year fixed effects, in columns (2) and (5) we augment our specification to account for well-established firm-level characteristics that affect the dividend decisions of firms, and finally, in columns (3) and (6) we report the estimates for the fully unrestricted specification of Eq. (1), including local peer firm averages and industry peer firm averages that are also likely to affect a firm's dividend decisions.

Our results show that local peer effects are robust across all specifications and support the hypothesis that the decisions taken by firms to increase and decrease dividend payments are positively influenced by the respective decisions of their local peers, complementing the recent studies of Adhikari and Agrawal (2018) and Grennan (2019) who both document the importance of industry peer influence on firms' corporate payout decisions. More precisely, the results from the full model specification reported in columns (3) and (6) of Table 3 show that a one standard deviation increase in the fraction of local peer firms' increasing (decreasing) dividend payments increases the probability that a firm will increase (decrease) dividend payments by 10.1% (4.9%) on average, all else equal. Interestingly, unlike (Grennan, 2019) who only provides support for the manifestation of industry peer effects on dividend increases, our baseline estimates reveal that local peers are statistically significant for dividend increases and dividend decreases. Moreover, in terms of economic magnitude, the influence of local peer behavior on dividend payout decisions is comparable to other known local peer effects, such as the work of Li and Wang (2022) who finds that a one-standard-deviation increase in CSR among local peers results in a 9.9% increase in a firm's own CSR and Matsumoto et al. (2022) who shows that a one-standard-deviation increase in

Table 3
Baseline results: Dividend increase and dividend decrease.

	Dividend increase			Dividend decrease		
	(1)	(2)	(3)	(4)	(5)	(6)
Peer Firm Averages:						
Local Peer avg. Increase	0.099***	0.090***	0.101***			
	(2.827)	(2.599)	(2.680)			
Local Peer avg. Decrease				0.052***	0.050***	0.049***
				(3.253)	(3.113)	(2.873)
Firm-Specific Factors:						
Profitability		0.021***	0.022***		−0.014***	−0.015***
		(6.895)	(7.101)		(−6.704)	(−7.049)
Investment		0.008***	0.008***		−0.001	−0.000
		(2.875)	(2.806)		(−0.243)	(−0.052)
Market-to-book		0.019***	0.019***		−0.004***	−0.004**
		(6.957)	(7.125)		(−2.593)	(−2.168)
Leverage		−0.045***	−0.045***		0.004	0.003
		(−11.927)	(−11.932)		(1.432)	(1.084)
Size		0.101***	0.100***		0.020***	0.022***
		(9.498)	(9.327)		(3.000)	(3.138)
Age		0.067***	0.061***		0.013**	0.015**
		(7.656)	(6.752)		(2.221)	(2.553)
Tangibility		−0.030***	−0.027***		0.012**	0.012***
		(−4.267)	(−3.876)		(2.574)	(2.577)
R&D/Sales		0.004***	0.003***		−0.002***	−0.002***
		(4.093)	(3.479)		(−5.146)	(−4.908)
RE/BE		0.001	0.002		0.001	0.001
		(1.297)	(1.443)		(1.362)	(1.422)
Institutional Ownership		0.006	0.006		−0.000	−0.001
		(1.099)	(1.051)		(−0.122)	(−0.168)
Idios. Equity Shock		0.008***	0.008***		−0.011***	−0.011***
		(6.891)	(6.687)		(−11.300)	(−11.151)
Kleibergen-Paap F-stat	146.3	144.6	129.3	216.9	213.7	182.9
First Stage Instrument	0.042***	0.042***	0.039***	−0.081***	−0.081***	−0.076***
First Stage t-statistic	(20.745)	(20.653)	(20.012)	(−23.339)	(−23.206)	(−21.448)
Localpeer averages	No	No	Yes	No	No	Yes
Industry peer averages	No	No	Yes	No	No	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118

The sample consists of all nonfinancial, nonutility firms in the annual Compustat database between 1980 and 2018 with nonmissing data for all analysis variables (see Appendix Table A.1 for variable definitions). The table presents the two-stage least squares (2SLS) estimates of Eq. (1) for both Dividend Increases and Dividend Decreases. The dependent variable is indicated at the top of each column. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decisions are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

the fraction of locals peers forecasting earnings is associated with a 4.3% increase in the likelihood that a firm forecasts. In terms of diagnostics, the Kleibergen and Paap (2006) F-statistic from the first stage of the IV regression is 129.3 and 182.9 for dividend increases and dividend decreases, respectively. This, and our instrument, local peer idiosyncratic equity shock, are both highly significant across all specifications. In addition, the results for the control variables are relatively consistent in terms of their magnitude and significance levels across the different specifications and are consistent with those in the prior literature. For instance, both profitability and idiosyncratic firm-specific shocks predict dividend increases (decreases) positively (negatively), consistent with, Benartzi et al. (1997) and Fama and French (2001), and Adhikari and Agrawal (2018) and Grennan (2019), respectively.

To shed light on the economic magnitude of local peer effects compared to industry peer effects, in Table 4 we re-estimate the specifications reported in Table 3 and instrument both local and industry peer effects. In Panel A, we report the results using Fama and French's (1997) 12 industry classification. In Panel B, we report additional estimates using 3-digit SIC Industry definitions consistent with Adhikari and Agrawal (2018) and Grennan (2019). Our analysis demonstrates that although industry peers exert the largest influence across all specifications, the impact of local peer effects is both substantial in magnitude and comparable to industry peer effects. For example, in column (6) of Panel A, we show that a one standard deviation increase in the fraction of local peers decreasing dividends influences a firms propensity to reduce dividends by 4.7%, while industry peers yield an effect of 4.9%. Therefore, the results reported in Table 4 further underscore the economic significance of local peer effects and highlight the incremental influence local peers exert on top of the already well-documented industry peer effects.

5.2. Robustness tests

As discussed in Section 4.2, to address the reflection problem and to ensure that the observed relationship between a firm's dividend decision and the dividend decisions of its local peers is indeed causal, we employ instrumental variable approach based on Leary and Roberts (2014). Whilst the use of peer idiosyncratic equity shocks as an instrument has many advantages, including being free of common market,

Table 4
Local peer effects and industry peer effects.

Panel A: Fama and French 12 Industry Classification

	Dividend increase			Dividend decrease		
	(1)	(2)	(3)	(4)	(5)	(6)
Local Peer avg. Increase	0.087**	0.082**	0.094**			
	(2.517)	(2.372)	(2.508)			
Industry Peer avg. Increase	0.134***	0.116***	0.123***			
	(4.991)	(4.364)	(3.226)			
Local Peer avg. Decrease				0.049***	0.047***	0.047***
				(3.024)	(2.893)	(2.725)
Industry Peer avg. Decrease				0.059***	0.056***	0.051***
				(4.555)	(4.363)	(3.649)
Kleibergen-Paap F-stat	74.86	73.83	65.68	105.0	103.1	87.85
Instrumental Variables						
Local Peer avg. Idios. Equity Shock	0.042***	0.042***	0.039***	−0.081***	−0.080***	−0.076***
	(20.832)	(20.697)	(20.151)	(−23.112)	(−22.946)	(−21.332)
Industry Peer avg. Idios. Equity Shock	0.064***	0.064***	0.046***	−0.119***	−0.119***	−0.111***
	(47.689)	(47.675)	(41.985)	(−42.171)	(−42.123)	(−40.591)
Firm Controls	No	Yes	Yes	No	Yes	Yes
Localpeer averages	No	No	Yes	No	No	Yes
Industry peer averages	No	No	Yes	No	No	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118

Panel B: Three Digit Standard Industry Classification

	Dividend increase			Dividend decrease		
	(1)	(2)	(3)	(4)	(5)	(6)
Local Peer avg. Increase	0.099***	0.093***	0.120***			
	(3.029)	(2.898)	(3.150)			
Industry Peer avg. Increase	0.144***	0.124***	0.151***			
	(4.246)	(3.663)	(3.351)			
Local Peer avg. Decrease				0.048***	0.049***	0.051***
				(2.956)	(3.001)	(2.958)
Industry Peer avg. Decrease				0.086***	0.073***	0.071***
				(5.973)	(5.105)	(4.627)
Kleibergen-Paap F-stat	108.8	102.9	55.27	144.4	146.6	128.5
Instrumental Variables						
Local Peer avg. Idios. Equity Shock	0.046***	0.046***	0.040***	−0.084***	−0.084***	−0.079***
	(24.023)	(23.831)	(21.620)	(−24.463)	(−24.309)	(−22.530)
Industry Peer avg. Idios. Equity Shock	0.043***	0.042***	0.033***	−0.090***	−0.089***	−0.085***
	(18.640)	(18.169)	(14.615)	(−24.906)	(−24.452)	(−22.946)
Firm Controls	No	Yes	Yes	No	Yes	Yes
Localpeer averages	No	No	Yes	No	No	Yes
Industry peer averages	No	No	Yes	No	No	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for both Dividend Increases and Dividend Decreases instrumenting both local and industry peer effects. Panel A reports the results using Fama and French's 1997 12 industry classification. Panel A reports the results using Three Digit Standard Industry Classification. The dependent variable is indicated at the top of each column. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Firm-Specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local and industry peer averages of the respective dividend decision are instrumented by the one-period lagged local and industry peer firm average equity shocks. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

industry, and local shocks, one may still argue the possibility that our instrumental variable is correlated with some omitted local common factors, thus threatening our identification strategy. To strengthen the casual claim of our paper, in this section we perform a series of additional robustness tests to alleviate such concerns. First, we administer a placebo test using local pseudo-peers to demonstrate that our local peer effects are not the result of unobservable common factors. Second, we implement two geographical proximity-based tests to further rule out the possibility that latent local common factors are determining our main findings. Third, following the works of Bustamante and Frésard (2020) and Song and Wang (2024), we employ an alternative instrumental variable approach based on a peers of peers identification strategy and instrument our local peer variable with the dividend decisions of non-local industry peers. In doing so, we demonstrate that our main findings are robust to an alternative instrument that is, by design, exogenous to local common factors. Fourth, we explicitly control for local demographic, economic, and institutional characteristics to mute any remaining concerns associated with the omission of local common factors. Finally, to further buttress the validity of our baseline results, we conduct a series of additional robustness tests including diverse model specifications, various standard errors assumptions, and alternative instrumental variable combinations.

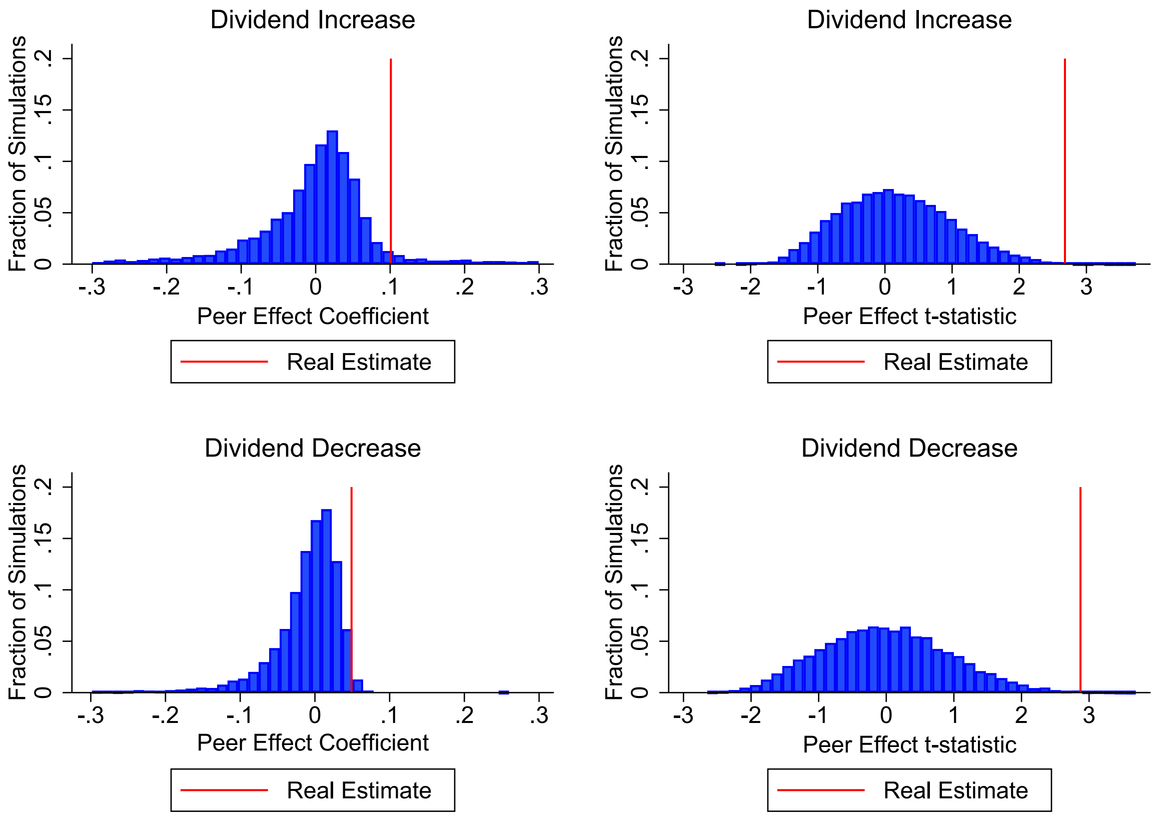

Fig. 1. Distribution of Local Peer Effect Placebo Estimates.
The figure presents the distribution of coefficient estimates and the associated t-statistics from the local peer placebo test formally reported in Table 5. To conduct the test, each firm is allocated a placebo CSA headquarter which is then drawn, at random, from a random normal distribution. Following this, all local endogenous and contextual variables are recalculated using the portfolios of non-industry placebo CSA peers while industry peer portfolios remain unchanged. Local non-industry placebo CSA peer variables are constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer average variables are constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's (1997) 12 industry classification. To administer the test, we re-run the baseline specification (Eq. (1)) for both dividend increase and dividend decrease using the placebo endogenous and contextual variables based on firms' placebo CSA location. This process is repeated for 10,000 runs. All coefficients have been scaled by the corresponding variable's standard deviation. The red lines indicate the location of the real (non-placebo) estimates formally reported in column 3 and column 6 of Table 3. To ease presentation, coefficient estimates have been truncated at −0.3 and +0.3 and t-statistics have been truncated at −3 and +3.

5.2.1. Placebo test

As a first step to alleviate potential identification concerns, we administer a placebo test to verify that the evidence of local peer influence is not driven by some unobservable common factor attributable to our use of local peer portfolios. The test design is devised around the random allocation of local peer groups, where, if some latent local factor is indeed present, the misspecification of local peers should not matter for the overall effect. To conduct our test, we begin by reallocating firms into random CSA locations. Specifically, each firm is drawn at random and allocated into one of 74 pseudo-CSA locations. Thereafter, we recalculate all local endogenous and contextual variables using the pseudo portfolios of non-industry pseudo-CSA peers and estimate Eq. (1). We repeat this process for 10,000 runs. In columns (1) and (7) of Table 5, we report the mean estimates of these peer effects and in Fig. 1 we document the corresponding coefficients and t-statistic distributions from the 10,000 estimates. We observe that local pseudo-peers have an insignificant effect on both dividend increases and dividend decreases, thus reassuring that our measure of local peers is an appropriate and relevant reference group for firms' dividend payout decisions.

5.2.2. Geographical proximity test: Close vs distant peers

One limitation of the randomized placebo test is that it does not fully rule out the possibility that latent common factors are responsible for the correlation observed between firms' dividend decisions at the local level, as one would naturally expect that the dividend policies of firms are less correlated with the dividend policies of randomly assigned and geographically heterogeneous peers. To sharpen our claim and to more directly rule out the threat of broad local confounds, we adopt a more targeted approach and conduct two tests based on the geographical proximity of a firm's local peers. For our first test, we expand the geographical region of a firm's local peer network to the state level and construct two alternative peer measures: one local peer measure based on non-industry firms located in the same state within a 50-mile radius, and a counterfactual measure, based on non-industry firms' located in the same state but headquartered greater than 50 miles away. If broad state-level factors are indeed responsible for our baseline results, the estimates obtained from our two measures should be indifferent. The results from these tests are reported in Table 5, specifically in columns (2) and (3) for dividend increases, and columns (8) and (9) for dividend decreases. We show that firms' dividend decisions are significantly influenced by the decisions of their local peers within a 50-mile radius while the dividend decisions of distant peers (i.e., firms headquartered outside the 50-mile radius) prove insignificant for both dividend increases and dividend decreases.[10] These results underscore the importance of geographical proximity and ease concerns associated with broad common factors.

[10] In unreported results, we repeat this test using 40-mile and 60-mile radiuses. Our findings remain empirically robust.

Table 5
Robustness tests.

	Dividend increase						Dividend decrease					
	Placebo test (1)	≤ 50 Miles (2)	50 > Miles (3)	Inverse distance weights (4)	Alternative instrument (5)	Local controls (6)	Placebo test (7)	≤ 50 Miles (8)	50> Miles (9)	Inverse distance weights (10)	Alternative instrument (11)	Local controls (12)
Local Peer avg. Increase	−0.001	0.102***	0.041	0.170***	0.196***	0.100***						
	(0.188)	(3.117)	(1.235)	(3.580)	(8.408)	(2.576)						
Local Peer avg. Decrease							0.014	0.053***	0.076	0.062**	0.108***	0.045**
							(0.032)	(3.151)	(0.979)	(2.149)	(11.532)	(2.567)
Local Seniors						0.524						0.179
						(0.616)						(0.305)
Local Population Growth						−0.003						0.015
						(−0.055)						(0.372)
Local Income						0.320***						0.078
						(3.706)						(1.308)
Local Income Growth						−0.038						−0.168
						(−0.276)						(−1.310)
Local Number of Firms						0.018						0.006
						(0.720)						(0.358)
Local Bank Presence						0.012						−0.009
						(1.424)						(−1.356)
Kleibergen-Paap F-stat	28.40	151.80	98.73	61.25	1023.80	126.21	95.20	149.01	7.25	82.48	1374.7	174.43
First stage instrument	0.010***	0.040***	0.039***	0.027***	0.431***	0.038***	−0.035***	−0.067***	−0.016***	−0.042***	0.323***	−0.074***
First stage t-stat	(4.137)	(12.321)	(9.936)	(7.826)	(51.028)	(11.234)	(−9.222)	(−12.207)	(−2.693)	(−9.078)	(45.788)	(−13.207)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118	63,118	63,118	63,118	63,118	63,118	63,118

The table presents two-stage least squares (2SLS) baseline and placebo estimates of Eq. (1) for Dividend Increases and Dividend Decreases. Columns (1) and (7) report the mean coefficient and t-statistic from our placebo test based on 10,000 pseudo estimates of Eq. (1). Columns (2) and (8) report the estimates for local peers headquartered in the same state within a 50 mile radius and Columns (3) and (9) report the estimates for local peers headquartered in the same state but located more than 50 miles away. Columns (4) and (10) report the estimates of local peer effects, where local peer portfolios are constructed using the inverse distance weights. Columns (5) and (11) report the estimates from an alternative instrumental variable based on a peers of peers identification approach, where local peer dividend decisions are instrumented by the decisions of their non-local industry peers. Columns (6) and (12) report the estimates of local peer effects after controlling for local demographic, economic, and institutional factors (see Appendix Table A.1 for variable definitions). Industry peer average variables are constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm controls denote variables corresponding to firm i's value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

5.2.3. Geographical proximity test: Distance weighted peer decisions

For our second proximity-based test, we construct an alternative local peer measure that incorporates asymmetric weights derived from the geographical proximity of peers to more acutely examine the importance of peer locality and to strengthen the causal credibility of our baseline results. Specifically, we calculate, for each firm, the geographical distance between its headquarters and the headquarters of its respective local peers and use inverse distance weights attributable to peer proximity to reconstruct our endogenous and contextual local peer measures. The results are reported in columns (4) and (10) of Table 5. The test show that after accounting for the within-CSA proximity of local peers, the influence of local peer dividend decisions is economically more meaningful. For example, in column (4) of Table 5, we find that a one standard deviation increase in the fraction of local peer firms' increasing dividend payments increases the probability that a firm will increase dividend payments by 17% compared to our baseline estimate of 10.1%. Taken together, both proximity-based tests help solidify the causal support for local peer effects and alleviate concerns attributable to broad local common factors.

5.2.4. Alternative instrument: Peers of peers approach

To further mitigate the potential concern that latent local common factors might be influencing our baseline results via correlation with our instrumental variable, we follow the likes of Bramoullé et al. (2009), Bustamante and Frésard (2020) and Song and Wang (2024) and employ an alternative instrumental variable approach based on a peers of peers identification strategy.[11] Specifically, building on the well-established evidence of industry peer effects on firms dividend decisions (e.g., Adhikari and Agrawal (2018) and Grennan (2019)), whereby the dividend policies of our local peers are correlated with the dividend decisions of their industry counterparts, we use the fraction of dividend increases (dividend decreases) of non-local industry peers to instrument the dividend increases (dividend decreases) of a firm's local peers. By adopting this peers of peers identification approach, we test the reliability of our paper's identification strategy by comparing our baseline results against the estimates obtained from an alternative instrumental variable, one that is correlated with the dividend decisions of firms' local peers, via the industry peer effects channel, but exogenous to latent local common factors. In columns (5) and (11) of Table 5, we demonstrate that our baseline findings are robust to the use of this alternative (non-local) peers of peers instrumental variable, and thus mute concerns related to the validity of our primary identification strategy.

5.2.5. Controlling for observed local common factors

In a final attempt to mitigate potential identification threats, we directly control for a wide range of local common factors that are likely to simultaneously affect local firms' dividend decisions. Specifically, we proxy for local demographic, economic, and institutional characteristics by including six additional control variables in our baseline specification, namely, local senior percentage, local population growth, local income (per capita), local income growth, local number of firms, and the presence of local banks. Consistent with prior tests, in columns (6) and (12) of Table 5 we continue to observe the positive and significant influence of local peers on firms' dividend payout decisions. Thus, ruling out the notion that our results are influenced by local demographic, economic, and/or institutional factors.

Overall, the results in Table 5 reinforce our paper's primary finding that the dividend payout decisions of firms are influenced by the dividend decisions of their local peers. Moreover, what is reassuring is our estimates remain relatively stable across all our robustness tests. For

[11] We thank the anonymous referee for this valuable suggestion.

instance, the significant coefficient estimates of local dividend increases and local dividend decreases range from 0.100 to 0.196 and 0.045 to 0.108, respectively. The stability of these estimates suggests that any potential bias arising from omitted variables or latent local common factors is likely to be low (Oster, 2019) and does not pose a serious threat to our identification of local peer effects. However, that being said, while the documented tests are reassuring, we remain mindful and acknowledge that, like any other peer effects study, completely ruling out all latent factor explanations is a close to impossible task.

5.2.6. Additional robustness tests

To further confirm the validity of our baseline results, we report additional robustness tests in the Internet Appendix of the paper. Specifically, in Internet Appendix Table 4 we examine the stability of our results to alternative model specifications and alternative controls, including CSA-fixed effects and Industry-fixed effects. In Internet Appendix Table 5, we follow Grennan (2019) and apply a minimum cut-off of at least a 1% change to define dividend increases and dividend decreases. In Internet Appendix Table 6, we test and compare various clustered standard errors, including CSA, industry, and firm-year robust standard errors. Moreover, in the spirit of Staiger and Stock (1997) and Stock and Yogo (2005), the recent work of Lee et al. (2022) shows how the use of weak single instrumental variables in just-identified cases can result in misleading second-stage inference issues. Accordingly, to illustrate the statistical validity of our baseline results, we further report in Internet Appendix Table 6 the Lee et al. (2022) tF adjusted second-stage t-statistic for all standard-error clusters.[12] In all of the defined tests, our results remain economically and statistically robust.

6. Do local dividend clienteles matter?

In this Section, we examine the mechanisms underpinning our main findings by analyzing the degree to which local peer influence is driven by the demands and preferences of local dividend clienteles. As reviewed in Section 2, the literature has documented that both retail and institutional investors hold a disproportionate amount of their portfolios in local firms (e.g., Coval and Moskowitz 1999, Ivković and Weisbenner 2005) and managers frequently tailor dividend payouts to cater to the demands and preferences of different local dividend clienteles (e.g., Becker et al. 2011, John et al. 2011). To investigate the underlying mechanisms, we focus on the demands and preferences of three prominent local dividend clinetele groups, namely, local retail investor clienteles, local institutional tax clienteles, and local agency-cost clienteles, and test whether firms located in areas with a greater local dividend clientele presence are more likely to be influenced by the dividend decisions of their local peers. It is important to underscore that the heterogeneity tests presented in this section not only shed light on the underlying mechanisms of our main findings but further support the causal inferences of our results because identifying an omitted variable that biases our results equally across all the local dividend clientele dimensions discussed in this section is extremely difficult.

6.1. Local retail investor clienteles

We begin our cross-sectional tests by investigating how the demands and preferences of local retail investor clienteles impact our main findings. Theories associated with life-cycle consumption patterns (e.g., Miller and Modigliani 1961, Shefrin and Thaler 1988), self-control considerations (Thaler and Shefrin, 1981), and mental accounting practices (Shefrin and Statman, 1984) ally with the notion that older investors and investors with a greater need for cash income display stronger preferences towards high dividend-yielding stocks. Moreover, empirical studies document that retail investors' stock holdings reflect a dividend preference that increases with age and decreases with income (Graham and Kumar, 2006). As a result, Becker et al. (2011) confirms that firms located in geographies with a higher proportion of senior citizens face higher dividend demand and are more likely to pay dividends, initiate dividends, and exert higher dividend yields. Accordingly, we hypothesize that firms located in areas with a higher fraction of senior citizens and a greater representation of lower-income investors are more likely to imitate and maintain parity with the dividend payout decisions of their local peers in order to compete for local retail investor clienteles.

To test this conjecture, we collect CSA demographic data from the US Census Bureau and personal income data from the Bureau of Economic Analysis and construct two indicator variables to reflect the demands and preferences of local retail investors. Specifically, following Becker et al. (2011) the first indicator, *local seniors*, reflects the proportion of the local population equal to or over the age of 65, and the second, *local income*, reflects the average CSA income per capita. To test the importance of local retail investor clienteles, we partition our sample into high and low levels of local retail investor demand based on the sample median of local seniors and local income and estimate our baseline model for these two sub-samples. In Table 6, we show the degree of peer influence is positively associated with local retail investors' age and negatively associated with local retail investors' income. Specifically, we find that dividend decisions of local peers have a positive and significant influence on both dividend increases and dividend decreases for firms located in CSAs with a higher fraction of senior citizens and a greater representation of lower-income investors. In contrast, we find both local peer dividend increases and dividend decreases to be statistically insignificant in the sub-sample of firms located in CSAs with younger and wealthier local retail investor clienteles.[13] These results support our conjecture that managers are more concerned about the dividend decisions of their local peers when the level of local retail investor clientele is higher. Moreover, these findings complement the works of Graham and Kumar (2006) and Becker et al. (2011) by showing that the positive (negative) association between dividend preferences and retail investors' age (income) extends beyond investors' portfolio preferences to local peer effects and the degree of payout competition amongst local firms, as firms' imitate the dividend decisions of their local peers to cater for the demands and preferences of local retail investors.

6.2. Local institutional tax clienteles

We next examine whether the presence of local institutional tax clienteles influences the effect of local peer behavior on firms' dividend payout decisions. The extant literature has widely documented the dividend-favoring demands and preferences of institutional investors. For instance, Allen et al. (2000) argues that high-quality firms often pay dividends to cater to the relative dividend tax advantages of institutional investors in order to attract their monitoring capabilities. Moreover, empirical studies have shown that tax-advantaged institutional investors are more likely to hold dividend-paying stocks (e.g., Grinstein and Michaely 2005, Dahlquist et al. 2014), while dividend cuts and dividend omissions are often met by large declines in institutional ownership (Parrino et al., 2003). Therefore, we argue that in areas with a greater presence of local institutional tax clienteles, firms are more likely to imitate the dividend payout decisions of their local peers to compete for institutional shareholders' monitoring capabilities and to avoid institutional exoduses.

[12] We thank the anonymous referee for this valuable suggestion.

[13] In additional unreported tests, we follow Pirinsky and Wang (2006) and adopt a more acute measure of local investor income using exclusively the income from dividends, interest, and rents to proxy for local investor income. Our results prove robust to the alternative measure. These results are available upon request.

Table 6
Cross-sectional analysis: Local retail investor clienteles.

	Local seniors				Local income			
	Dividend increase		Dividend decrease		Dividend increase		Dividend decrease	
	High (1)	Low (2)	High (3)	Low (4)	High (5)	Low (6)	High (7)	Low (8)
Local Peer avg. Increase	0.141***	0.036			0.016	0.123***		
	(2.707)	(0.537)			(0.160)	(2.720)		
Local Peer avg. Decrease			0.056***	0.015			0.064	0.043**
			(2.802)	(0.349)			(0.682)	(2.214)
Kleibergen-Paap F-stat	77.26	46.70	112.2	46.59	106.32	82.066	17.866	125.589
First stage instrument	0.043***	0.030***	−0.095***	−0.045***	0.027***	0.039***	−0.036***	−0.085***
First stage t-stat	(14.786)	(11.986)	(−17.368)	(−10.099)	(13.163)	(13.646)	(−9.308)	(−16.223)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mechanism Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	28,152	34,358	28,152	34,358	29,379	33,257	29,379	33,257

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases partitioned for high and low levels of Local Seniors and Local Income (see Appendix Table A.1 for variable definitions). High (Low) denotes CSA-year observations with above (below) the medium-year value of Local Seniors and Local Income. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

To quantify the presence of local institutional tax clienteles, we construct two local indicator variables based on the market-weighted average of shares held by institutional investors in each CSA. As a broad measure, we follow the likes of Ayers et al. (2003), Dhaliwal et al. (2003), and Dai et al. (2008) and assume that, relative to retail investors, all institutional investors have a dividend tax advantage and are thus classified as tax-insensitive. Accordingly, the first indicator variable, *local institutional investor presence*, is constructed using shares held by all institutional investors. As a second, more acute measure of local institutional tax clienteles, we follow Golubov et al. (2020) and take advantage of the novel tax sensitivity classification proposed by Blouin et al. (2017) where institutions are hand-classified as tax-sensitive and tax-insensitive based on their end-of-year trading and portfolio characteristics. Accordingly, our second measure, *local institutional tax-insensitive presence*, is constructed using exclusively the shares of Blouin et al. (2017) tax-insensitive institutional investors.

In line with the previous set of tests, we partition our sample into high and low levels of local institutional investor presence and local institutional tax-insensitive presence and estimate our baseline model for these two sub-samples. In Table 7 we report our findings. Interestingly, across both indicators, we document evidence to suggest that firms respond asymmetrically to the presence of local institutional tax clienteles, with local peer influence strongly manifesting itself for dividend increases (decreases) when the presence of institutional tax clienteles in the local CSA is high (low). Concretely, in the first partition test, our results show that a one standard deviation increase in the fraction of local peer firms' increasing (decreasing) dividend payments in high (low) areas of local institutional tax clienteles increases the probability that a firm will increase (decrease) dividend payments by between 12.7% (4.4%), on average, all else equal. Moreover, in the second partition test, where we employ a more acute measure of tax sensitivity, we obtain consistent results in terms of statistical and economic significance, with local peer dividend decisions being most influential for dividend increase (decrease) in areas with high (low) levels of local institutional tax clienteles. Taken together, these findings make an important contribution to the literature and complement the works of Short et al. (2002), Parrino et al. (2003), and Grinstein and Michaely (2005), among others, as not only do the demands and preferences of institutional investors force dividends up directly from within the firm but, we show they also cause upward pressure on local firms indirectly through local peer influence.

6.3. Local agency-cost clienteles

As a final set of cross-sectional tests, we examine how the demands and preferences of local agency-cost clienteles impact our main results. The extant literature has argued that in opaque environments with pervasive information asymmetries, regular dividend payments can play an important role in mitigating manager-shareholder agency conflicts by reducing the amount of corporate funds available for misappropriation and firms regularly commit to paying higher dividends to cater to the agency concerns of dividend clienteles (e.g., Jensen and Meckling 1976, Easterbrook 1984, Allen et al. 2000, John et al. 2011, 2015, Golubov et al. 2020). Complementary to the disciplining function of dividends, the corporate governance literature has also stressed the importance of financial institutions and financial analysts in alleviating manager-shareholder agency conflicts via the external monitoring channel. For example, the external monitoring by financial institutions and/or financial analysts has been shown to influence various aspects of firms' decision-making including, the intensity of over-investment (Chen et al., 2017), the likelihood of committing corporate fraud (Hagendorff et al., 2022), the propensity to emit toxic pollutants (Jing et al., 2022), and the probability of engaging in value-destroying activities along with CEO compensation packages (Chen et al., 2015). Thus, in the absence of strong external monitoring devices in local areas, we hypothesize that firms are more likely to imitate and

Table 7
Cross-sectional analysis: Local institutional tax clienteles.

	Local institutional investor presence				Local institutional tax-insensitive presence			
	Dividend increase		Dividend decrease		Dividend increase		Dividend decrease	
	High (1)	Low (2)	High (3)	Low (4)	High (5)	Low (6)	High (7)	Low (8)
Local Peer avg. Increase	0.127**	0.095			0.120**	0.096*		
	(2.110)	(1.504)			(2.084)	(1.843)		
Local Peer avg. Decrease			0.036	0.044**			0.021	0.056**
			(1.453)	(2.426)			(0.881)	(2.567)
Kleibergen-Paap F-stat	45.56	62.64	78.06	134.10	49.85	104.20	79.08	125.60
First stage instrument	0.037***	0.035***	−0.081***	−0.084***	0.036***	0.044***	−0.080***	−0.082***
First stage t-stat	(11.873)	(13.567)	(−14.085)	(−17.952)	(11.528)	(17.496)	(−13.594)	(−17.631)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mechanism Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	28,751	32,818	28,751	32,818	25,611	36,107	25,611	36,107

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases partitioned for high and low levels of Local Institutional Investor Presence and Local Institutional Tax-insensitive Presence (see Appendix Table A.1 for variable definitions). High (Low) denotes CSA-year observations with above (below) the medium-year value of Local Institutional Investor Presence and Local Institutional Tax-insensitive Presence. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

maintain parity with the dividend payout decisions of their local peers in order to satisfy the disciplinary demands and agency-cost concerns of local dividend clientele.

To measure the degree of external monitoring in local areas, we collect data from the FDIC Summary of Deposits and IBES and construct two local partition variables. First, to proxy for the monitoring expertise of banks, we follow Hagendorff et al. (2022) and measure the degree of *local bank presence* by exploiting the density of local bank branches in each CSA. Second, motivated by the works of Chen et al. (2015, 2017), and Jing et al. (2022), we use *local analyst coverage*, defined as the average number of analysts covering firms headquartered in each CSA, to proxy for the degree of financial analyst monitoring. In Table 8 we partition our sample into subsamples with high and low values of local bank monitoring and local analyst coverage and repeat our baseline estimates. In line with our conjecture, we find that in localities with lower levels of external monitoring from banks and financial analysts local peer behavior proves economically and statistically significant, with firms more likely to imitate the dividend increases and dividend decreases of their local peers in order to maintain parity and cater for the agency concerns of local dividend clienteles. On the contrary, when local monitoring is high, peer influence proves statistically insignificant suggesting a potential substitution effect between the quality of local monitoring mechanisms and the degree of local peer imitation.

7. Further considerations

Up to this point, we have robustly established the existence of local peer influence on firms' dividend increases and dividend decreases and the importance of the local dividend clinetele mechanism. In this section, we introduce a final series of empirical tests designed to further unravel and identify the extent of local peer influence on firms' payout decisions and to reinforce the robustness of our main findings.

7.1. Trends in local peer influence

To deepen our understanding of local peer effects, we first explore how local peer influence on firms' dividend payout decisions has changed over time. Over the past three decades, the intertemporal patterns of aggregate dividend payouts have received substantial interest and scrutiny. For example, the seminal study of Fama and French (2001) documents the drastic decline in dividend-paying firms from the 1970s through to the late 1990s, with studies attributing the disappearing dividends phenomenon to the substitution of dividends for share repurchases (Grullon and Michaely 2002, Grullon et al. 2011), clientele catering (Baker and Wurgler 2004a, Jiang et al. 2013, Kulchania 2013), and changes in corporate risk (Hoberg and Prabhala, 2009). However, more recently, Michaely et al. (2021) has shown that since the turn of the century, decreases in earnings volatility and changes in the proclivity of firms have resulted in the reappearance of dividend payouts.

To complement the above studies, we explore whether the trends in local peer influence on dividend payout decisions are consistent with the intertemporal patterns observed at the aggregate level. To do so, we estimate our main regressions across four sub-samples, namely: 1980 to 1990, 1990 to 2000, 2000 to 2010, and 2010 to 2018. The results of our estimates are detailed in Table 9. Interestingly, we document an increasing and positive trend for the statistical and economic importance of local peer influence on dividend increases, with firms largely

Table 8
Cross-sectional analysis: Local agency-cost clienteles.

	Local bank presence				Local analyst coverage			
	Dividend increase		Dividend decrease		Dividend increase		Dividend decrease	
	High (1)	Low (2)	High (3)	Low (4)	High (5)	Low (6)	High (7)	Low (8)
Local Peer avg. Increase	−0.056	0.110**			0.049	0.114**		
	(−0.467)	(2.367)			(0.701)	(2.304)		
Local Peer avg. Decrease			0.060	0.046**			0.074	0.043**
			(0.956)	(2.420)			(1.554)	(2.174)
Kleibergen-Paap F-stat	241.7	83.11	150.6	141.9	500.9	74.78	249.3	130.9
First stage instrument	0.038***	0.036***	−0.043***	−0.077***	0.042***	0.034***	−0.049***	−0.074***
First stage t-stat	(17.469)	(14.073)	(−9.695)	(−16.690)	(19.494)	(13.366)	(−11.998)	(−16.147)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mechanism Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	22,063	40,627	22,063	40,627	22,171	40,388	22,171	40,388

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases partitioned for high and low levels of Local Bank Monitoring and Local Analyst Coverage (see Appendix Table A.1 for variable definitions). High (Low) denotes CSA-year observations with above (below) the medium-year value of Local Bank Monitoring and Local Analyst Coverage. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

imitating their local counterparts in the period covering 2010–2018. In contrast, we find evidence to suggest that local peers influenced dividend decreases throughout the 1980s and the 1990s, and local peer behavior has resurfaced in importance again more recently in the period covering 2010 to 2018. Taken together, our sub-sample estimates are consistent with the disappearing and reappearing dividend debate of Michaely et al. (2021) and supplement the literature by suggesting that local peer influence may have been partially responsible for the drastic decline of dividend payouts in the 1980s and 1990s and their return post-millennium.

7.2. The effect of opposite local peer payout decisions

Thus far, our empirical analysis has revealed how firms' dividend choices are positively influenced by the same dividend decisions of their local peers. However, it is unclear, a priori, how the opposing dividend decisions of local peers will influence a firm's decision to either increase dividends or decrease dividends, if at all. Theoretical models provide mixed evidence on this question. For example, given the signaling effects of dividends and investors' aversion to unstable payouts, theoretical herding models (e.g., Scharfstein et al. 1990) would predict that managers will be less likely to decrease dividends when their local peers increase dividends, as they seek to avoid the adverse signaling effects to local dividend clienteles. Alternatively, models of strategic interaction (e.g., Basak and Makarov 2014) would predict a positive response, with strategic managers being more likely to exploit the dividend decreases of their local counterparts and increase dividends in order to benefit from the positive signaling effects.

To test these theoretical predictions, in this subsection, we analyze empirically whether a firm's decision to increase dividends or decrease dividends is influenced by the opposite dividend decision of their local peers. Table 10 reports our empirical results. In line with the herding models of firm behavior, we find that a firm's decision to increase dividends or decrease dividends is negatively influenced by the opposite dividend behavior of their local peers. Consistent with our baseline results, we find the dividend increases of local peers to be the most economically meaningful, with a one standard deviation increase in the fraction of local peer firms' increasing (decreasing) dividend payments reducing the likelihood that a firm will decrease (increase) dividend payments by 9.2% (5.2%) on average, all else equal. These set of results complement, and are consistent with, the survey conclusions of Brav et al. (2005), who argue that, with respect to payout policy, a firm's objective is not to deviate too far from its competitors.

7.3. Do local peers influence firms' share repurchase decisions?

Next, to further strengthen our understanding of local peer effects and how local peers influence the distribution of funds to shareholders, we examine whether the share repurchase decisions of firms are also subject to local peer effects. Its now widely acknowledged that share repurchases play a central role in the redistribution of funds to shareholders and the corporate payout literature has presented various explanations as to why firms choose to distribute funds in the form of dividends and/or share repurchases (e.g., Allen et al. 2000, Jagannathan et al. 2000, Grullon et al. 2002, Lee and Rui 2007, Jiang et al. 2013, Kulchania 2013). However, notwithstanding such vast attention, the literature remains largely divided over the comparative merits and interchangeability of both payout methods. For example, the substitution hypothesis advanced by Grullon et al. (2002) suggests that both dividends and share repurchases are interchangeable payout mechanisms with Grullon et al. (2011) arguing that the disappearing dividend phenomenon was almost entirely offset by share repurchases. Similarly, Jiang et al. (2013) and Kulchania (2013) show that firms regularly substitute dividends and share repurchases to actively cater to the payout preferences of different clienteles. Accordingly, in a world where share repurchases and dividends are perfect substitutes,

Table 9
Trends in local peer influence.

	Dividend increase				Dividend decrease			
	1980–1990 (1)	1990–2000 (2)	2000–2010 (3)	2010–2018 (4)	1980–1990 (5)	1990–2000 (6)	2000–2010 (7)	2010–2018 (8)
Local Peer avg. Increase	0.049	0.116*	0.171**	0.217**				
	(0.868)	(1.748)	(1.978)	(2.322)				
Local Peer avg. Decrease					0.058*	0.056**	0.039	0.080**
					(1.668)	(1.996)	(0.794)	(2.509)
Kleibergen-Paap F-stat	75.91	39.27	35.58	24.43	53.75	61.22	21.72	37.11
First Stage Instrument	0.073***	0.038***	0.027***	0.031***	−0.123***	−0.068***	−0.064***	−0.117***
First Stage t-statistic	(9.542)	(7.290)	(5.638)	(2.740)	(−9.144)	(−7.508)	(−6.560)	(−6.235)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	13,02	20,014	20,626	13,159	13,402	20,014	20,626	13,159

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases partitioned across time-specific subsamples. Columns (1) and (5) are estimates using subsamples of data from 1980 to 1990, columns (2) and (6) from 1990 to 2000, columns (3) and (7) from 2000 to 2010, and columns (4) and (8) from 2010 to 2018. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

Table 10
The effect of opposite local peer payout decisions.

	Dividend increase			Dividend decrease		
	(1)	(2)	(3)	(4)	(5)	(6)
Local Peer avg. Increase				−0.093***	−0.090***	−0.092***
				(−3.002)	(−2.899)	(−2.754)
Local Peer avg. Decrease	−0.052***	−0.048***	−0.052***			
	(−2.946)	(−2.720)	(−2.709)			
Kleibergen-Paap F-stat	216.9	213.7	182.9	146.3	144.6	129.3
First Stage Instrument	−0.081***	−0.081***	−0.076***	0.042***	0.042***	0.039***
First Stage t-statistic	(20.745)	(20.653)	(20.012)	(−23.339)	(−23.206)	(−21.448)
Firm Controls	No	Yes	Yes	No	Yes	Yes
Localpeer averages	No	No	Yes	No	No	Yes
Industry peer averages	No	No	Yes	No	No	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for both Dividend Increases and Dividend Decreases. The reported estimates examine the influence of opposite peer dividend decisions (see Appendix Table A.1 for variable definitions). The dependent variable is indicated at the top of each column. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denotes variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-Specific Factors denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local and industry peer firm average equity shocks. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

one would expect the existence of local peer effects on firms' share repurchase decisions to be consistent with the local peer influence observed in firms' dividend payout decisions. Alternatively, however, if these two policies are unrelated or imperfect substitutes, as argued by Allen et al. (2000), DeAngelo et al. (2000), Jagannathan et al. (2000), and Lee and Rui (2007), among others, there is no reason to believe, without further testing, that the existence of local peer effects on dividend payout decisions extends to firms' share repurchases.

The prior literature on industry peer effects and share repurchases also provides mixed evidence. While Grennan (2019) fails to find evidence of the existence of industry peer effects for share repurchase decisions, Adhikari and Agrawal (2018) show the importance of industry peers on firms' decision to repurchase shares, specifically for large and mature firms. Moreover, Massa et al. (2007) documents that firms mimic the share repurchase decisions of their industry peers and that these effects are stronger in industries with more strategic interactions.

Table 11
Share repurchase decisions.

	Share repurchase increase			Share repurchase decrease		
	(1)	(2)	(3)	(4)	(5)	(6)
Local Peer avg. Increase	0.049	0.041	0.051			
	(0.773)	(0.647)	(0.689)			
Local Peer avg. Decrease				−0.007	−0.004	−0.005
				(−0.139)	(−0.092)	(−0.101)
Kleibergen-Paap F-stat	26.92	26.20	20.96	48.51	46.47	40.54
First Stage Instrument	0.028***	0.028***	0.024***	−0.038***	−0.038***	−0.036***
First Stage t-statistic	(8.856)	(8.706)	(7.632)	(−11.417)	(−11.208)	(−10.547)
Firm Controls	No	Yes	Yes	No	Yes	Yes
Localpeer averages	No	No	Yes	No	No	Yes
Industry peer averages	No	No	Yes	No	No	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	63,118

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for both share repurchase increases and share repurchase decreases (see Appendix A.1 for variable definitions). All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Industries are defined by Fama and French's 1997 12 industry classification. Firm-specific controls denote variables corresponding to firm $i's$ value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer firm average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

To test whether local peer behavior matters for firms' repurchase decisions, in Table 11 we examine whether a firm's decision to increase or decrease share repurchases is influenced by the repurchase decisions of their local peers. Replicating the same specifications as our baseline estimates for dividend peer effects, we find no evidence to suggest that local peer behavior statistically influences firms' share repurchase decisions. In further unreported tests, we repeat our cross-sectional clientele tests in an attempt to isolate firms exposed to more intense clientele pressures, however, we continue to document no significant evidence of local peer effects on share repurchases.[14] Taken together, our results ally with the findings of Grennan (2019) as we document that share repurchase decisions are also not influenced by local peers, and more broadly, we contribute to the studies of Allen et al. (2000), DeAngelo et al. (2000), Jagannathan et al. (2000), and Lee and Rui (2007), among others, by demonstrating that dividends and share repurchase decisions are not determined by the same factors and therefore should not be considered equally interchangeable.

7.4. Industry peer definitions

As an additional test, we examine the robustness of our baseline results to alternative local peer portfolios by varying the type of industry classification. As stressed in Section 3, the industry definition used in our analysis, Fama and French 12 industries, is intentionally broad as we seek to isolate local peer effects and minimize any potential endogenous industry interactions or influence spillovers that would likely arise with more acute industry definitions. In Table 12, we relax this constraint and report a battery of results from alternative industry classifications. In columns (1) and (7), we report our baseline results from Table 3 for dividend increases and dividend decreases, respectively. In the following two columns, we use slightly broader industry definitions based on Fama and French 17 and Fama and French 48 industry classifications. In columns (4) and (10) and columns (5) and (11) we define industries more broadly by using two-digit SIC and using three-digit SIC, respectively. Lastly, in columns (6) and (12) we employ (Hoberg and Phillips, 2010) FIC 100 text-based industry classification. We find, with the exception of Hoberg and Phillips (2010) FIC 100 text-based industry classification, that the adoption of more acute industry classifications and therefore larger local peer portfolio sets, results in greater local peer influence on firms' dividend increases and dividend decreases. For instance, taking column (5) as an example, a one standard deviation increase in the fraction of local peer firms' increasing dividend payments increases the probability that a firm will increase dividend payments by 12.4%, on average, compared to our baseline result of 10.1%. These findings demonstrate the robustness of our baseline estimates are largely consistent with other local peer effect studies, such as Dougal et al. (2015) for firms' investment decisions and Matsumoto et al. (2022) for firms' earnings forecasts, and reinforce our decision to adopt broader industry classifications to minimize the effect of industry linkages and influence spillovers.

7.5. The effect of prominent CSA omissions

To conclude our further analysis, we consider the sensitivity of our results to alternative samples by omitting firms located in prominent CSAs. Whilst we have already established via our robustness tests in Section 5.2 that our results are not the by-product of some unobservable local common factor, prior to concluding we endeavor to mute any concerns that our primary results are driven by firms headquartered in prominent or outlying CSAs. In Table 13 we report our results. In columns (1)-(4) and columns (6)-(10) we omit, separately, firms residing in the four largest CSAs in our sample, namely, New York-Newark, Los Angeles-Long Beach, Boston-Worcester-Providence and San Jose-San Francisco-Oakland. In column (5) and column (6) we omit all CSAs with less than 5 local peers. Our results show that our initial findings of local peer influence are largely consistent across different samples. Moreover, the omission of the top and bottom tails of the CSA distribution in terms of resident firms illustrates that the findings put forward in this paper are not driven by firms located in specifically large or small local geographic areas.

[14] Results available upon request.

Table 12
Alternative industry definitions.

	Dividend increase						Dividend decrease					
	Baseline (1)	FF17 (2)	FF48 (3)	SIC2 (4)	SIC3 (5)	HP100 (6)	Baseline (7)	FF17 (8)	FF48 (9)	SIC2 (10)	SIC3 (11)	HP100 (12)
Local Peer avg. Increase	0.101***	0.136***	0.116***	0.120***	0.124***	0.092**						
	(2.680)	(2.859)	(2.868)	(2.912)	(2.991)	(2.222)						
Local Peer avg. Decrease							0.049***	0.061***	0.055***	0.052***	0.055***	0.043*
							(2.873)	(2.682)	(2.795)	(2.724)	(2.970)	(1.842)
Kleibergen-Paap F-stat	129.30	63.75	82.72	83.31	83.90	85.31	182.90	66.67	91.21	94.56	102.05	64.49
First stage instrument	0.039***	0.032***	0.034***	0.034***	0.033***	0.028***	−0.076***	−0.071***	−0.074***	−0.073***	−0.074***	−0.059***
First stage t-stat	(20.012)	(16.164)	(17.041)	(16.563)	(16.983)	(13.734)	(−21.448)	(−20.404)	(−20.743)	(−20.690)	(−20.789)	(−16.572)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,118	63,118	63,118	63,118	63,118	51,046	63,118	63,118	63,118	63,118	63,118	51,046

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases using alternative definitions of industry peers. The dependent variable along with the type of industry classification is indicated at the top of each column. Baseline reports the baseline results from Table 3 where the industry is defined as FF12, FF17, and FF48 denote Fama and French's 1997 17 and 48 industry classifications, respectively. SIC2 and SIC3 denote two and three-digit standard industry classifications, respectively. HP100 denotes Hoberg and Phillips (2016) text-based fixed industry classifications which cover from 1988–2018. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Firm-specific controls denote variables corresponding to firm i's value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer firm average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

Table 13
Excluding prominent combined statistical areas.

	Dividend increase					Dividend decrease				
	Omit New York -Newark (1)	Omit Los Angeles -Long Beach (2)	Omit Boston -Worcester -Providence (3)	Omit San Jose- -San Francisco -Oakland (4)	Omit Local CSA < 5 Peers (5)	Omit New York -Newark (6)	Omit Los Angeles -Long Beach (7)	Omit Boston -Worcester -Providence (8)	Omit San Jose -San Francisco -Oakland (9)	Omit Local CSA < 5 Peers (10)
Local Peer avg. Increase	0.103***	0.103***	0.101***	0.104***	0.098**					
	(2.922)	(2.854)	(2.797)	(2.768)	(2.471)					
Local Peer avg. Decrease						0.049***	0.050***	0.045***	0.047***	0.041**
						(3.124)	(3.100)	(2.734)	(2.760)	(2.393)
Kleibergen-Paap F-stat	352.2	366.1	367.7	341.4	354.1	408.8	435.6	408.3	398.6	455.5
First stage instrument	0.040***	0.039***	0.039***	0.038***	0.036***	−0.078***	−0.077***	−0.075***	−0.076***	−0.075***
First stage t-stat	(18.767)	(19.134)	(19.176)	(18.478)	(18.816)	(−20.219)	(−20.872)	(−20.207)	(−19.966)	(−21.341)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Localpeer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry peer averages	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	53,925	58,781	58,622	57,465	60,304	53,925	58,781	58,622	57,465	60,304

The table presents two-stage least squares (2SLS) estimates of Eq. (1) for Dividend Increases and Dividend Decreases omitting tail (largest and smallest) CSA(s) from the sample. The dependent variable along with the omitted CSA(s) are denoted at the top of each column. Columns (1) and (7) omit the CSA of New York - Newark. Columns (2) and (8) omit the CSA of Los Angeles-Long Beach. Columns (3) and (9) omit the CSA of Boston-Worcester-Providence. Columns (4) and (10) omit the CSA of San Jose-San Francisco-Oakland. Columns (5) and (10) omit CSA observations with less than 5 local non-industry peers. All coefficients have been scaled by the corresponding variable's standard deviation to ease interpretation. Local peer averages denote variables constructed as the average of all non-industry firms within the CSA-year combination of firm i, excluding the ith observation. Industry peer averages denote variables constructed as the average of all firms within an industry-year combination, excluding the ith observation. Firm-specific controls denote variables corresponding to firm i's value in year t. All independent variables, including the instrument but excluding the endogenous variables, are lagged 1 year relative to the dependent variable. In 2SLS estimates, local peer averages of the respective dividend decision are instrumented by the one-period lagged local peer firm average equity shock. The Kleibergen-Paap F-stat is the cluster-robust Kleibergen and Paap (2006) F-statistic for weak instruments. Standard errors are robust to heteroskedasticity and within firm dependence, and t-statistics are reported in parentheses. *, ** and *** indicate significance at the 10%, 5% and 1% levels, respectively.

8. Conclusion

This paper provides robust support for the existence of local peer effects in firms' dividend decisions. Using a large sample of US firms over the period 1980–2018, we find significant evidence that firms' decisions to increase and decrease dividend payments are highly dependent on the actions of their local peers. We show local peer effects are shaped by the demands and pressures of different local dividend clienteles, including local retail clienteles, local institutional tax clienteles, and local agency-cost clienteles. Thus, in line with the rivalry-based theory of imitation, our paper concludes that the demand for firms to imitate their local competitors' dividend decisions is stronger in environments with greater local dividend clienteles. In contrast to dividends, we find local peers do not influence firms' share repurchase decisions.

In summary, our paper bridges the gap and contributes to two important bodies of literature: (i) the recent dividends peer effects literature and (ii) the dividend clientele literature. Specifically, we complement the recent work of Adhikari and Agrawal (2018) and Grennan (2019), by showing that the dividend payout decisions of firms are not only influenced by their industry counterparts but also by their local peers. Moreover, by illustrating the importance of local clientele demand factors, we enrich the clientele literature by showing that firms not only respond directly to the pressures of local market investors (e.g., Allen et al. 2000, Becker et al. 2011, Golubov et al. 2020), but also to the dividend decisions of local market peers as they seek to maintain local reputation with local investor clienteles. Given the presence of such geographic intradependencies and the existence of local interactions and knowledge spillovers amongst neighboring firms, our results suggest that local peer effects are likely to be relevant not exclusively for firms' dividend decisions, but also for other important untested corporate policies such as firms' capital structure and trade credit decisions. Hence, our study holds significance for the expanding

Table A.1
Variable definitions.

Payout variables:	
Dividend Payer	An indicator variable that equals 1 if the firm pays a common dividend (**dvc**) in the fiscal year, and 0 otherwise. Source: Compustat
Dividend Increase	An indicator variable that equals 1 if the firm's common dividend (**dvc**) in fiscal year (t) is greater than the common dividend in the previous fiscal year (t_{-1}), and 0 otherwise. Source: Compustat
Dividend Decrease	An indicator variable that equals 1 if the firm's common dividend (**dvc**) in fiscal year (t) is less than the common dividend in the previous fiscal year (t_{-1}), and 0 otherwise. Source: Compustat
Repurchaser	An indicator variable that equals 1 if the firm repurchases shares (**prstkc**) in the fiscal year, and 0 otherwise. Source: Compustat
Repurchase Increase	An indicator variable that equals 1 if the firm's share repurchases (**prstkc**) in fiscal year (t) is greater than the share repurchases in the previous fiscal year (t_{-1}), and 0 otherwise. Source: Compustat
Repurchase Decrease	An indicator variable that equals 1 if the firm's share repurchases (**prstkc**) in fiscal year (t) is less than the share repurchases in the previous fiscal year (t_{-1}), and 0 otherwise. Source: Compustat
Firm-Specific Factors:	
Profitability	Operating income before depreciation (**oibdp**) divided by total assets (**at**). Source: Compustat
Investment	Capital expenditure (**capx**) divided by total assets (**at**). Source: Compustat
Market-to-book	Market value of assets (**prcc_f** · **csho**)+**dlc**+**dltt**+**pstkl**-**txditc**) dividend by total assets (**at**). Source: Compustat
Leverage	Debt in current liabilities (**dlc**) plus long term debt (**dltt**) divided by total assets (**at**). Source: Compustat
Size	The logarithm of total assets (**at**) in constant 2015 dollars (based on US GDP deflator from the Federal Reserve Economic Data. Source: Compustat
Age	The logarithm of the current fiscal year less the fiscal year of firm $i's$ first appearance in Compustat. Source: Compustat
Tangibility	The book value of all plant property and equipment (**ppent**) divided by total assets (**at**). Source: Compustat
R&D/Sales	R&D expenditure (**xrd**) divided by total sales revenue (**sale**). Source: Compustat
RE/BE	Retained earnings (**re**) divided by common equity (**ceq**). Source: Compustat
Institutional Ownership	The percentage of shares held by institutional investors (**instown_perc**). Source: 13(f) Thomson Reuters
Idiosyncratic Equity Shock	The arithmetic mean of residuals obtained from rolling monthly stock returns regressions. Source: CRSP
Local Variables:	
Local Analyst Coverage	The total number of analysts covering firms headquartered in the CSA divided by the total number of firms headquartered in the CSA. In our cross-sectional tests, the indicator is equal to 1 when the local analyst coverage for the CSA is above the sample median during the year, and 0 otherwise. Source: Compustat, IBES
Local Bank Presence	The number of bank branches divided by the total number of firms headquartered in the CSA. In our cross-sectional tests, the indicator is equal to 1 when the local bank monitoring for the CSA is above the sample median during the year, and 0 otherwise. Source: Compustat, FDIC
Local Income	The personal income of a given CSA divided by the resident population of the area. In our cross-sectional tests, the indicator is equal to 1 when Local Income for the CSA is above the sample median during the year, and 0 otherwise. Source: Bureau of Economic Analysis
Local Income Growth	The percentage change of Local Income. Source: Bureau of Economic Analysis
Local Institutional Investor Presence	The average percentage of shares held by institutional investors for each CSA-year defined as the market capitalization-weighted average of the percentage of shares held by institutional investors for all firms with headquarters residing in the given CSA. In our cross-sectional tests, the indicator is equal to 1 when the local institutional investor presence for the CSA is above the sample median during the year, and 0 otherwise. Source: Compustat, 13(f) Thomson Reuters
Local Institutional Tax-insensitive Presence	The average percentage of shares held by tax-insensitive institutional investors for each CSA-year defined as the market capitalization-weighted average of the percentage of shares held by tax-insensitive institutional investors as classified by Blouin et al. (2017) for all firms with headquarters residing in the given CSA. In our cross-sectional tests, the indicator is equal to 1 when the local institutional tax-insensitive presence for the CSA is above the sample median during the year, and 0 otherwise. Source: (Blouin et al., 2017), Compustat, 13(f) Thomson Reuters
Local Number of Firms	The natural logarithm of the number of firms headquartered in the CSA. Source: Compustat
Local Population Growth	The percentage change of the total resident population in the CSA. Source: Bureau of Economic Analysis
Local Seniors	The percentage of the local population equal to or over the age of 65. In our cross-sectional tests, the indicator is equal to 1 when Local Seniors for the CSA is above the sample median during the year, and 0 otherwise. Source: US Census Bureau

field of peer effects in corporate finance, which, with the exception of a few (e.g., Dougal et al. (2015) and Li and Wang (2022)), has vastly neglected the existence of multiple peer effects, in particular those arising from the interactions of firms in the same geographical areas.

CRediT authorship contribution statement

Joshua Cave: Writing – review & editing, Writing – original draft, Methodology, Formal analysis, Data curation, Conceptualization. **Sandra Lancheros:** Writing – review & editing, Writing – original draft, Methodology, Formal analysis, Data curation, Conceptualization.

Data availability

The authors do not have permission to share data.

Appendix A

See Table A.1.

Appendix B. Supplementary data

Supplementary material related to this article can be found online at https://doi.org/10.1016/j.jbankfin.2024.107206.

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