

# Direct Investing: The Role of Stock Purchase Plans

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## Abstract

Direct stock purchase plans (DSPPs) represent an innovative financial service that provides individual investors with a cost effective and easy way to become stockholders. We survey managers of 267 U.S. companies with DSPPs to determine their *reasons* for establishing such plans, the *factors* contributing to their success in attracting investors, and their *views* about the future of DSPPs. The results show that companies offer DSPPs for both economic and relationship-related reasons. The major factors contributing to a plan's success are low cost combined with ease and convenience but promotional restrictions limit the ability of firms to attract investors. In the future, companies are likely to adopt DSPPs if they want to add small investors to the shareholder base. © 2002 Academy of Financial Services. All rights reserved.

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## 1. Introduction

Direct investing—purchasing stock in a company without a broker—has grown dramatically in the United States since the mid-1990s for several reasons. First, in December 1994, the Securities and Exchange Commission (1994) streamlined the procedures for establishing

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direct stock purchase plans (DSPPs). This resulted in more companies choosing to offer direct access to their stocks, which widened the reach of direct investing. Such plans allow one-time or periodic stock purchases without a broker and are typically linked with a firm's dividend reinvestment plan (DRIP), which lets existing shareholders collect dividends in shares instead of cash.

Second, cost-conscious individual investors have further propelled the growth of DSPPs (Cintron, 1999). For many individual investors, even online discount brokers are too expensive, especially when building a portfolio at several hundred dollars at a time. DSPPs provide a cost effective way for individual investors to acquire shares by sidestepping brokers' commissions. Investors can now acquire stocks directly from hundreds of companies and avoid the middleman. Offered by only 30 companies in 1994, DSPPs are now available from 570 corporations and some 300 foreign ones offering American depository receipts (Mcnamee, 1999).

Third, the proliferation of websites devoted to DSPPs and DRIPs has made direct investing easier for investors while reducing plan costs for corporations (Mcnamee, 1999). The sites range from transaction-based, such as Netstock Direct ([www.netstockdirect.com](http://www.netstockdirect.com)), which provides electronic prospectuses, online enrollment, and other services, to the purely informational, such as DRIP Investor ([www.dripinvestor.com](http://www.dripinvestor.com)) and DRIP Central ([www.dripcentral.com](http://www.dripcentral.com)). Some websites, such as First Share ([www.firstshare.com](http://www.firstshare.com)), can link up an individual who needs an initial share with someone who has a share to sell. Another relatively cheap way to buy such stock is through the National Association of Investors Corp.'s (NAIC) Low-Cost Investment Plan ([www.better-investor.org](http://www.better-investor.org)). For example, an investor who is a NAIC member can buy a share of stock for a \$7 setup fee to enroll, a \$10 price fluctuation fee, plus the cost of the share (Cintron, 1999). Still others, such as StockPower, operate online DSPPs for corporations, which are more cost effective and provide greater speed than paper-based systems (Beeler, 2000).

So why do DSPPs matter to individual investors? The answer is simple. DSPPs are a relatively cheap and convenient way to buy stocks and to build a portfolio. Also, DSPPs almost always come with DRIPs, which first require investors to own an initial share. DSPPs provide one way for clearing that hurdle. A few companies offer one-share purchase plans, which allow investors who have never owned stock in a company because of high initial investment requirements to buy a single share. Most companies with DSPPs, however, require a minimum investment. Some companies will waive their minimum initial investment if investors join their automatic debit plan. For example, IBM's plan requires \$50 a month for 10 months in lieu of a \$500 minimum investment (Cintron, 1999).

In this paper, we examine the role of DSPPs in contributing to the growth and popularity of direct investing. We investigate four major research questions to help investors understand why companies offer such plans and what lies ahead for DSPPs.

1. What are the most important *reasons* that companies establish DSPPs?
2. What *factors* contribute to the ability of DSPPs to attract investors?
3. What *views* do companies hold about their DSPPs?
4. What views do companies hold about the future prospects of DSPPs?

Although this study is largely exploratory, we examine two hypotheses about the reasons companies offer DSPPs. Our first hypothesis is that firms offer DSPPs for both relationship-related (such as to increase the stockholder base and to build shareholder loyalty and goodwill) and economic (such as to raise new equity in a less expensive manner) reasons.

Our second hypothesis is that managers are unlikely to admit using DSPPs as a means of diluting the influence of institutional investors. Although the conventionally advocated objective of the firm is maximization of stockholders' wealth, this objective is inconsistent with many empirical observations. For example, Grinyer et al. (1999) find support for the notion that managers recognize the interests of a wider set of participants, including themselves, rather than stockholders alone. Thus, managers might use DSPPs to their own advantage at the expense of a healthy governance structure. By using DSPPs to attract individual investors, managers may be able to frustrate activism by institutional investors. This is because individual investors are less able than institutions to mount efforts to control the behavior of managers. Although managers might use DSPPs in a manner that exacerbates agency problems, we are skeptical about their willingness to admit this motive. We further discuss the rationale for both hypotheses in Section 3.

Our study is important for several reasons. First, although many studies have investigated DRIPs, little academic research exists about companies that sell shares directly to the public, except a preliminary study by Steinbart and Swanson (1998). Our study extends their research beyond examining firms' motivations for offering DSPPs by investigating the factors leading to success in attracting investors and views about specific present and future issues involving DSPPs. Second, the American Association of Individual Investors (2001) notes that the increase in the number of companies offering direct initial shares is a "major trend." Third, the results of our study may provide useful information both to investors who are considering whether to participate in such plans and to firms that are debating whether to initiate or terminate DSPPs.

The results of our survey are reassuring. As expected, respondents establish DSPPs for both relationship-based and economic reasons. Respondents, on average, do not admit to using DSPPs as a means of diluting the influence of institutional investors. Not surprisingly, low cost combined with ease and convenience contributes to a plan's success in attracting investors while the promotional restrictions of the Security and Exchange Commission (SEC) retard growth. The view that DSPP investors will be able to buy stocks directly from companies via the Internet is also not surprising.

The organization of the remainder of this paper is as follows. In the second section, we provide a brief discussion of DRIPs and the origin of DSPPs. In the third section, we present various motives for offering DSPPs. We describe the sample, survey, and research method in the fourth section. In the fifth section we present and analyze the results of our mail survey. We offer some concluding remarks in the final section.

## **2. Background of DRIPs and DSPPs**

A DRIP allows participants to accumulate shares of a company's common stock directly from the issuer by reinvesting dividends. Such plans are particularly appropriate for buy-

and-hold investors. Early plans, called market plans, attracted investors because they provided a relatively convenient and inexpensive way to accumulate shares of particular issuers through the automatic, regular reinvestment of cash dividends (Pettway and Malone, 1973; Davey, 1976; Baker and Seippel, 1980). With market plans, issuers use the funds available from dividend reinvestment, and in some cases optional cash payments, to acquire shares in the open market. Later, some companies, initially utilities, established new-issue plans in which they issued new shares. Such plans provide a relatively economical mechanism for raising capital, while simultaneously improving shareholder relations and broadening and stabilizing the issuer's shareholder base (Fredman and Nichols, 1979, 1982; Baker and Seippel, 1981; Baker and Johnson, 1988, 1989; Roden and Stripling, 1996).

Since the introduction of the first DRIP in 1968, these programs have undergone considerable evolution (Baker and Meeks, 1990). Perhaps the greatest change involves plan features. Examples of innovative plan features include optional cash payments, discounts, partial reinvestment of dividends, and automatic investments through an investor's checking account (Baker and Johnson, 1988). Research shows that plan features, especially the discount feature, which gives investors a way to buy shares below market price, positively affect participation rates (Baker and Johnson, 1988; Todd and Domian, 1997). Many issuers now permit participation in their DRIPs after an initial direct share purchase from the company instead of requiring prior share ownership. This change allows investors who want to join the plan to bypass brokers. As previously mentioned, such plans are called DSPPs.

Until December 1994, creating a DSPP required a company to go through an expensive and arduous process that took many months to complete. Then, the SEC (1994) simplified the process and streamlined the filing procedures thus reducing the time for program establishment and eventual approval. Specifically, the SEC provided a class exemption from Rule 10b-6 under the Securities Exchange Act of 1934, subject to certain conditions, to facilitate the availability of certain dividend reinvestment and stock purchase plans to investors. The new procedure greatly reduced development time and expense, which prompted the rise of DSPPs.

The SEC also tightened the reins on the kinds of advertising it permits for certain types of plans. For example, SEC regulations forbid companies with bank-sponsored plans from aggressively advertising their DSPPs. Although an issuer can place tombstone advertisements, it cannot make blanket mailings to the general public (MacQuarrie, 1995). About 60% to 70% of companies use bank-sponsored DSPPs. Companies often favor bank-sponsored plans because of their distribution network. That is, a bank can generally reach a larger scale audience than the audience the company can reach on its own. However, unsolicited advertising material can be sent to a wide variety of people under a registered DSPP. Under a registered plan, the issuer has to register the shares and have a higher level of direct involvement than a bank-sponsored plan.

Despite these limitations, DSPPs experienced substantial growth from the mid- to late-1990s because they served the interests of both investors and participating companies. DSPPs are especially popular among individual investors. For example, when Exxon launched its DSPP, the company received 50,000 inquiries and opened 25,000 new shareholder accounts in the first month. Texaco's plan further exemplifies shareholder demand. In 1998, four years after initiating its DSPP, Texaco's plan held 120,000 registered sharehold-

ers. In recent years, a lack of marketing and a reluctance to launch new plans are the main reasons for the slow growth. Also, many companies with the biggest DSPPs have merged.

### **3. Motives for offering DSPPs**

Several reasons may account for the attractiveness of DSPPs among individual investors. One reason is that many plans offer the opportunity to buy shares with little or no commission (Bierman, 1997). Although fees vary by plan, many plans allow investors to participate in DSPPs at much lower fees than even the cheapest discount broker. Other attractive features of DSPPs include automatic reinvestment of dividends when liked to a DRIP, no intermediaries when buying stock, no sales calls from brokers, small initial (\$50–1,000) and additional (\$10–100) investments, protection of private information, and the availability of preauthorized monthly electronic transfers from bank accounts (Williams and Oden, 1997).

Although direct investing has advantages, it exacts a toll through hefty paperwork, cumbersome bookkeeping, and tax-return nightmares. For example, stock acquired through a DSPP is a separate account. Small infrequent purchases complicate the task of calculating a stock's basis and capital gain when an investor sells. Other disadvantages include fees and hidden brokerage commissions and the difficulty of making quick purchases and sales. Although traditional direct-investing plans can take days to sell, some Web-based services, such as Netstock Direct, offer immediate sales of certain stocks for a fee of about \$20 (Mcnamee, 1999).

Steinbart and Swanson (1998) examine the motivations of 78 firms offering DSPPs before December 31, 1995. Based on a telephone survey and analysis of plan prospectuses, their evidence shows that firms offer such plans with the objective of broadening their shareholder base. Moreover, most prospectuses indicated that firms would acquire shares in the market, rather than raising additional equity capital through such plans. These findings are consistent with a relationship-related motivation, not an economic motivation, for DSPPs. Additional analysis shows that firms offering DSPPs subsequently experience a significant decrease in the number of shares held per shareholder. Thus, DSPPs appear to be successful in broadening a firm's shareholder base. Because the growth in DSPPs is a recent phenomenon, the Steinbart-Swanson study only provides preliminary evidence about the motivations for DSPPs.

#### *3.1. Economic motives for offering DSPPs*

Several motivations may underlie why firms offer DSPPs. According to the economic motivation, firms offer DSPPs as an alternative method of raising additional equity at lower cost than an underwriting. Companies, particularly those of small-to-midsize, can issue new shares or use treasury stock through DSPPs that cost much less than charged by investment bankers. According to Scholes and Wolfson (1989), companies may be able to save as much as 5% of the amount of capital raised by dealing directly with investors. Most investors who participate in such programs also reinvest dividends. This means the company keeps the

dividends instead of sending them to the shareholders. These retained dividends can be substantial over time and can help to fund operations.

Raising equity through a DSPP may also mitigate the negative price effect associated with a primary offering of seasoned equity. Previous research shows that announcements of underwriting new stock or stock-rights offerings are associated with negative abnormal stock returns (Asquith and Mullins, 1986; Smith, 1977). Researchers such as Myers (1984) attribute part of this market reaction to signaling or asymmetric information. When a company sells stock, investors interpret this to mean that the stock is overvalued and react negatively to the news. Unlike new stock or stock-rights offerings, the research on the stock-price reactions to announcements of DRIPs is mixed and inconclusive (Hansen et al., 1985; Peterson et al., 1987; Dubofsky and Bierman, 1988; Dhillon et al., 1992; and Roden and Stripling, 1996).

Unlike the sale of new stock, DSPPs offer shares on a continuous basis. Because the company is not choosing a specific time to issue stock, the concern about asymmetric information may be of less importance to investors (Scholes and Wolfson, 1989). In turn, the stock price reaction to sales of stock through a DSPP may differ from the negative impact on stock prices associated with the sale of new stock. Based on the stock return behavior of firms offering DSPPs and a portfolio of matched control firms offering DRIPs without direct stock purchase, Steinbart and Swanson (1998) find no evidence that the decision to adopt a DSPP adversely affected investors.

Another potential economic benefit of DSPPs is that they facilitate continuous buying activity in a company's stock. That is, these shareholders often invest small amounts constantly over time with the DRIP feature. Such activity could help to keep the stock afloat during a bear market. Steady buying activity could also provide some price support to the shares and contribute to more stable prices, especially for thinly traded stocks (Carlson, 1998).

### *3.2. Relationship-based motives for offering DSPPs*

Another explanation for offering DSPPs involves relationship-based considerations, which may be designed to reduce management's governance problems. According to this view, companies use DSPPs as a way to cement relationships with shareholders and to increase their shareholder base, especially among individual shareholders. The belief is that such investors will be more long-term oriented, more loyal to company management, and less vocal than institutional investors on corporate governance issues involving proxy votes (Scholes and Wolfson, 1989).

Companies are seeing the number of registered shareholders decline because so many shares are held in "street name" at brokerage houses rather than appearing on the corporate records ("on record") in the shareholder's name. DSPPs typically require investors to have one or more shares registered "on record" rather than in the "street name" of the broker or bank that may have purchased the shares for the investor. This trend could make companies uncomfortable. By building a base of direct shareholders, a company might be less vulnerable to an institutional sell-off or to losing favor with a brokerage firm.

Another relationship-related belief, but with economic overtones, is that by turning

shareholders into customers companies can solidify market share by strengthening brand loyalty. For example, Beeler (2000) reports the results of a survey showing that 83% of shareholders are more likely to buy from a company in which they own stock. Her results also show that such customers spend an average 54% more than nonshareholders, visit stores or Web sites 69% more often, and are two to three times as likely to refer friends to a company.

Since the mid-1980s, shareholder activism by institutional investors has gained increased prominence (Gillan and Starks, 1998). Friedman (1996) notes that before the 1980s, when individuals held the majority of shares of stock, little evidence exists that shareholders effectively acted to restrict management's behavior. Increased shareholder activism by institutions has coincided with the rapid increase in institutional investor holdings during the last two decades. Because of a free-rider problem, only a large shareholder has the incentive to undertake monitoring or other costly control activities. In their examination of the effectiveness of shareholder activism by institutional and individual investors, Gillan and Starks (2000) find that noncoordinated activism has been relatively ineffective when measured by voting outcomes. In contrast, proposals sponsored by institutional investors or coordinated groups of investors receive significantly more votes. Because management has few means to combat the influence of institutional investors, management may view a DSPP as a means of diluting the influence of institutional investors by increasing the number of small, individual investors.

#### 4. Methodology

In this section we discuss the sample and mail survey used to obtain data for this study.

##### 4.1. Sample

We obtained the initial sample of 227 firms from *The Individual Investor's Guide to Dividend Reinvestment Plans* (1999) and supplemented this with information from several newsletters and services on the Internet including Netstock Direct ([www.netstockdirect.com](http://www.netstockdirect.com)), Society for Direct Investing ([www.sdinews.org](http://www.sdinews.org)), and the DRIP Investor ([www.dripinvestor.com](http://www.dripinvestor.com)). We limited our analysis to those firms offering DSPPs as of December 31, 1999. Our final sample consists of 267 firms including those that established DSPPs before and after the SEC's December 1994 liberalization of Rule 10b-6. These firms tend to be large, mature firms in such industry groups as financials, utilities, basic materials, conglomerates, and consumer noncyclical goods. Thus, our sample is consistent with evidence provided by Michal (1999, 2001).

In February 2000, we contacted each firm by telephone or e-mail to determine the person most directly involved with the firm's DSPP, typically someone in the Investor Relations Department. We also asked each firm to send a prospectus of its DSPP. In early March 2000, we sent a personalized letter and survey to the director of investor relations or the appropriate individual who supervised each plan. To increase the response rate, we sent an e-mail reminder in mid-March to nonrespondents. In mid-April, we sent a second personalized letter

and survey to nonrespondents. Each survey contained a tracking number to identify the respondent and to avoid double-counting responses. Because the information sought was not sensitive in nature, we do not believe that having anonymous responses, which would preclude follow-up contacts, was necessary. We promised confidentiality to each respondent. The survey yielded 73 responses, 53 from the first mailing and 20 from the second mailing, giving a response rate of 27.3%.

#### *4.2. Survey*

We tested preliminary versions of the survey among seven MBA students and three finance faculty members. Based on their feedback, we made changes to the wording on some questions. The final version of the two-page survey contained two parts consisting of a total of 39 questions. The first part included 31 closed-end questions: 18 questions concerned issues about each company's DSPP and 13 questions involved issues about the future of DSPPs in general. We focused on asking closed-end questions to lessen the subjectivity that Steinbart and Swanson (1998) faced with classifying their responses to the open-ended question in their telephone survey. Our survey asked respondents to indicate their level of agreement with each issue on a five-point scale:  $-2 =$  strongly disagree,  $-1 =$  disagree,  $0 =$  no opinion,  $+1 =$  agree, and  $+2 =$  strongly agree. For the 31 closed-end questions included in the first part of the survey, we use one-sample  $t$  tests to determine whether the level of agreement or disagreement differs significantly from 0, which represents a "no opinion" response.

The second part of the survey included six open-ended questions and two "yes/no" questions. The open-ended questions focused on each company's DSPP and included questions about when the company established its DSPP, its reasons for establishing a DSPP, the percentage of outstanding shares sold through its DSPP, the success of its DSPP in attracting investors, and the factors contributing either to "limited success" or "success." The final two "yes/no" questions dealt with how each company obtains shares of common stock needed for its DSPP and whether the company had a dividend reinvestment plan before establishing a DSPP.

### **5. Results**

In this section, we present and discuss the results of our mail survey in five subsections. The first subsection presents the profile of the responding companies offering DSPPs, including the ways in which these companies obtain shares of common stock needed for their DSPPs. The second subsection discusses the most important reasons companies established DSPPs. The third subsection presents the respondents' views about the factors that contribute to the success of their DSPPs in attracting investors. The fourth subsection examines the views of respondents about their own DSPPs. The final subsection presents and discusses the respondents' views about the future of DSPPs in general. Because the sample size of responses varies by question, the maximum number of responses, unless otherwise noted, is 73.

### 5.1. Profile of responding companies

The following presents a profile of the responding companies. Where possible, we use prospectuses to cross check the accuracy of the responses. In those few cases where the respondents and prospectuses give inconsistent information, we report the data provided in the prospectuses.

The survey asked the respondents to indicate the year in which their firms initiated a DSPP. Of the 71 firms responding to this question, 22.5% established their DSPPs before the SEC liberalized Rule 10b-6 in December 1994 and the remaining 77.5% established their plans between January 1995 and December 1999. The distribution of the 55 firms that established DSPPs after the SEC's liberalization is as follows: 7 in 1995, 11 in 1996, 16 in 1997, 18 in 1998, and 3 in 1999. A total of 50 of the 73 firms (68.5%) had a DRIP before establishing a DSPP. Thus, the majority of companies amended their existing plans to enable investors to make at least initial purchases of their stock directly through the plan.

Another question asked about the percentage of outstanding shares that the respondents' companies had sold through their DSPPs. Only 47 of the 73 companies responded to this question. This low response rate may reflect the lack of ready availability of this information to some respondents. Of the 47 respondents, slightly more than half (53.2%) sold 1% or less of their total shares using DSPPs; 25.5% between 2% and 5% of their shares; and 8.5% between 6% and 10% of their shares. Only 12.8% of the companies sold more than 10% of their shares using DSPPs.

The survey also asked respondents to indicate how their companies obtain the shares of common stock needed for their DSPPs. Respondents could answer either "yes" or "no" to each of four sources. Although 69 of the 73 respondents answered this question, we received 89 responses because some companies use multiple sources to obtain shares. Of the 89 responses, 60 companies (67.4%) buy shares in the open market, 17 companies (19.1%) use authorized but unissued shares, 10 companies (11.2%) use shares held as treasury stock, and 2 companies (2.3%) acquire shares through negotiated transactions in the secondary market. Of the 60 firms that buy shares in the open market, 11 of these firms also use other sources.

### 5.2. Reasons for offering DSPPs

Our first research question involves determining the most important *reasons* that companies establish DSPPs. The survey asked respondents to list the *two* most important reasons for their company establishing a DSPP. The 67 respondents gave a total of 129 responses.

For the full sample, Table 1 shows the most important reasons for offering DSPPs are to build shareholder loyalty/goodwill (27.1%) and to attract shareholders (22.5%). These reasons are consistent with those reported by Steinbart and Swanson (1998) who found that the major motivations for establishing DSPPs were for relationship-related considerations. According to this view, management offers DSPPs in order to attract a large number of smaller investors in the belief that such investors are more likely to follow a buy-and-hold strategy and consequently to be loyal to management. The third most important reason for offering DSPPs is to raise equity/support the share price (13.2%). Although not shown in Table 1, our data show that this economic reason is more important to firms with new-issue

Table 1  
Reasons for offering DSPPs

| Reason                                          | Responses<br>(n = 129) | Rank |
|-------------------------------------------------|------------------------|------|
| Build shareholder loyalty and goodwill          | 27.1%                  | 1    |
| Attract shareholders                            | 22.5                   | 2    |
| Raise equity/support share price                | 13.2                   | 3    |
| Meet investors' requests                        | 10.1                   | 4    |
| Provide a low cost and convenient way to invest | 9.3                    | 5    |
| Remain competitive                              | 8.5                    | 6    |
| Provide dividend reinvestment                   | 4.7                    | 7.5  |
| Other                                           | 4.7                    | 7.5  |
| Total                                           | 100.1                  |      |

Percentages do not add to 100 due to rounding.

This table reports the responses to the question "In your opinion, what were the *two* most important reasons that your company established a DSPP?" A total of 67 of the 73 respondents answered this question. Because respondents could give up to two reasons, the number of responses totaled 129.

versus market plans. According to the economic argument, firms view new-issue plans as a cheaper alternative for raising capital than underwriting.

### 5.3. Success in attracting investors

Our second research question focuses on determining the *factors* contributing to the success of DSPPs in attracting investors. Given the importance that respondents attach to attracting investors, the survey asked respondents to characterize the success of their DSPPs in achieving this objective. Based on 66 responses, 15 firms (22.7%) characterized success as "less than expected," 43 firms (65.2%) "as expected," and 8 firms (12.1%) as "greater than expected." These results show that more than three-quarters of the respondents believe that their DSPPs meet or exceed expectations. Partitioning the sample into firms with market and new-issue plans produced similar results.

To determine the factors that contributed to the success of their DSPPs in attracting investors, the survey asked two open-ended questions. If respondents answered "less than expected," the survey asked them to indicate the *two* factors that contributed most to the "limited success" of their company's DSPP. If respondents answered "as expected" or "greater than expected," they were asked to give the *two* factors that contributed to the "success" of their company's DSPP. We placed the responses into general categories. As Table 2 shows for the full sample, promotional restrictions (33.3%) and lack of interest (18.5%) are the primary reasons for the "limited success" in attracting investors. On the other hand, respondents attribute "success" in attracting investors mainly to the low cost (27.2%) and to the ease and convenience of the plan (21.0%). The top ranked factors remain essentially the same after partitioning the sample into firms with market versus new-issue plans.

Table 2  
Factors contributing to the success of a company's DSPP in attracting investors

| Factor                                                                                       | Responses<br>(n = 27) | Rank |
|----------------------------------------------------------------------------------------------|-----------------------|------|
| A. Limited success: less than expected success in attracting investors                       |                       |      |
| Promotional restrictions (e.g., lack of advertising)                                         | 33.3%                 | 1    |
| Lack of interest by investors                                                                | 18.5                  | 2    |
| High institutional ownership                                                                 | 11.1                  | 4    |
| Sector or market                                                                             | 11.1                  | 4    |
| Other                                                                                        | 11.1                  | 4    |
| Cost of the plan to investors                                                                | 7.4                   | 6.5  |
| Time lag in buying/issuing shares                                                            | 7.4                   | 6.5  |
| Total                                                                                        | 99.9                  |      |
| B. Success: as expected or greater than expected success in attracting investors<br>(n = 81) |                       |      |
| Low cost                                                                                     | 27.2%                 | 1    |
| Ease and convenience of plan to investors                                                    | 21.0                  | 2    |
| Promotion of the plan to investors                                                           | 13.6                  | 3.5  |
| Low investment required to participate in the plan                                           | 13.6                  | 3.5  |
| Other                                                                                        | 12.3                  | 5    |
| Strong company performance (e.g., increase in stock price over time)                         | 8.6                   | 6    |
| Interest in plan by investors                                                                | 3.7                   | 7    |
| Total                                                                                        | 100.0                 |      |

Percentages may not add to 100 due to rounding.

This table reports the factors that respondents believe contributed to the success of their company's DSPP in attracting investors. Only 66 of the 73 firms responded to this question. Of the 66 responses, 15 companies characterized the success of their company in attracting investors as "less than expected," 43 companies "as expected," and 8 companies as "greater than expected." If respondents answered "less than expected," the survey asked them to indicate the two factors that contributed most to the "limited success" of their company's DSPP. If respondents answered "as expected" or "greater than expected," they were asked to give the two factors that contributed to the "success" of their company's DSPP.

#### 5.4. Views about a company's DSPP

The third research question seeks to determine the *views* that companies hold about their DSPPs. The survey asked recipients to indicate their level of agreement or disagreement with each of 18 statements (referred to later as S#). Because some could argue that a number of items are fact based and are better suited for "yes/no" or "true/false" responses, we report the responses as either "agree" or "disagree" plus "no opinion."

As Table 3 shows, respondents express very high levels of agreement with statements about the role of their DSPPs in attracting more individual shareholders (S8 and S5). The preference of individual shareholders over institutional shareholders (S8) stems from the former being stable and long-term oriented (S5) and not because they are less vocal than institutional investors (S17) or because the broadened base reduces the possibility of unwanted takeovers (S13). In fact, these last two issues are the only two statements in which the respondents, on average, disagree. Our results show, however, that almost half of the respondents to S17 and S13 express "no opinion," which is by far the highest of any of the 18 issues. This finding may suggest that respondents truly have not formed an opinion about these two issues or, if they have formed an opinion, are reluctant to admit that corporate

Table 3  
Issues involving the DSPPs of responding companies

| S# | Statement                                                                                                                    | <i>n</i> | Disagree<br>–1 and –2 | No<br>opinion | Agree<br>+1 and +2 | Mean  | <i>t</i> value | Rank |
|----|------------------------------------------------------------------------------------------------------------------------------|----------|-----------------------|---------------|--------------------|-------|----------------|------|
|    | Our DSPP:                                                                                                                    |          |                       |               |                    |       |                |      |
| 12 | Gives investors an option of having their dividends reinvested for no/low fee.                                               | 72       | 0.0%                  | 2.8%          | 97.3%              | 1.76  | 30.600**       | 1    |
| 8  | Is more attractive to individual than institutional investors.                                                               | 73       | 0.0                   | 6.8           | 93.2               | 1.73  | 25.270**       | 2    |
| 7  | Provides investors with a low cost way to buy and sell our stock.                                                            | 73       | 2.7                   | 2.7           | 94.5               | 1.67  | 21.382**       | 3    |
| 5  | Attracts stable, long-term oriented individual investors.                                                                    | 73       | 0.0                   | 12.3          | 87.7               | 1.29  | 16.261**       | 4    |
| 6  | Offers the flexibility of buying both full and fractional shares.                                                            | 71       | 5.6                   | 12.7          | 81.7               | 1.28  | 11.442**       | 5    |
| 2  | Improves our shareholder relations.                                                                                          | 73       | 2.7                   | 11.0          | 86.3               | 1.22  | 13.890**       | 6    |
| 1  | Broadens our shareholder base.                                                                                               | 73       | 5.5                   | 5.5           | 89.0               | 1.16  | 13.021**       | 7    |
| 4  | Builds goodwill for our company in the marketplace.                                                                          | 73       | 1.4                   | 17.8          | 80.8               | 1.05  | 12.784**       | 8    |
| 9  | Attracts individual investors who are loyal to company management.                                                           | 73       | 5.5                   | 27.4          | 67.1               | 0.86  | 8.171**        | 9    |
| 11 | Is a less costly source of raising common equity than using underwriters.                                                    | 68       | 14.7                  | 36.8          | 38.5               | 0.47  | 3.575**        | 10   |
| 10 | Is not suitable for investors who want to trade shares held in our plan.                                                     | 70       | 21.4                  | 40.0          | 38.5               | 0.29  | 2.163**        | 11   |
| 14 | Helps turn shareholders into customers of our company's products or services.                                                | 72       | 25.0                  | 29.2          | 45.8               | 0.24  | 1.790          | 12   |
| 3  | Provides price support for shares.                                                                                           | 73       | 21.9                  | 43.8          | 34.2               | 0.09  | 0.766          | 13   |
| 15 | Exposes investors to adverse price fluctuations due to the time lag to buy or sell shares.                                   | 72       | 25.0                  | 41.7          | 33.4               | 0.07  | 0.627          | 14   |
| 18 | Offers shares on continuous basis resulting in a less negative impact on stock prices than using a secondary stock offering. | 70       | 24.3                  | 40.0          | 35.7               | 0.03  | 0.245          | 15   |
| 16 | Creates record-keeping problems for investors because of the varied cost basis of shares.                                    | 72       | 33.3                  | 33.3          | 33.3               | 0.01  | 0.110          | 16   |
| 17 | Attracts individual investors who are less vocal than institutional investors on corporate governance issues.                | 72       | 26.4                  | 48.6          | 25.0               | –0.03 | –0.261         | 17   |
| 13 | Helps ward off unwanted takeover attempts by attracting individual investors.                                                | 71       | 38.0                  | 49.3          | 12.7               | –0.44 | –3.591**       | 18   |

Percentages may not add to 100 due to rounding.

\*, \*\* Indicates statistical significance at the 0.05 and 0.01 levels, respectively.

This table reports descriptive statistics of responses to 18 statements about DSPPs. Respondents indicated their level of agreement/disagreement to each statement on a five-point scale: –2 = strongly disagree, –1 = disagree, 0 = no opinion, +1 = agree, and +2 = strongly agree. For presentation purposes, the responses are collapsed into three groups: disagree, no opinion, and agree. The responses are listed according to their means from highest to lowest. One-sample *t* tests are used to test whether the means differ significantly from 0 (no opinion) using two-tailed tests.

actions may exacerbate agency problems. Relating to our second hypothesis, we infer from our results that only a small proportion of firms may use DSPPs to dilute the influence of institutional investors.

Companies use DSPPs to attract individual shareholders by offering them an opportunity to reinvest dividends (S12), by affording them an inexpensive means to buy and sell shares (S7), and by providing them with the flexibility to buy fractional or full shares (S6). Thus, by attracting more individual investors by offering DSPPs, companies can broaden their shareholder base (S1), improve shareholder relations (S2), and build goodwill (S4). The high level of agreement with these statements is consistent with relationship-related considerations for offering DSPPs.

Respondents express much weaker support for statements involving economic reasons for DSPPs. For example, only 38.5% of the respondents agree with the notion that their DSPPs provide a less costly source of raising common equity than using underwriters (S11) and only 34.2% agree that their DSPPs provide price support for shares (S3). These results are not surprising given that only 17 of 73 firms issue new shares to fund their DSPPs.

### *5.5. Future of DSPPs*

The fourth research question examines the views of respondents about the future of DSPPs. The survey asked respondents to indicate the level of agreement or disagreement with 13 statements relating to the future of DSPPs in general. Panel A of Table 4 shows the level of agreement or disagreement with each of five statements about the circumstances that may prompt firms to offer DSPPs. Respondents show the highest level of agreement with the statement that companies are likely to adopt DSPPs if they need to add small investors to the shareholder base (S23). In fact, 79.4% of the respondents agree with this statement. This response is consistent with the importance that respondents place on attracting individual shareholders as previously shown in Tables 1 and 3. Respondents also strongly agree that consumer or service-oriented companies (S20) and those whose competitors already offer DSPPs (S19) are likely to adopt DSPPs. Consumer or service-oriented companies may view stockholders as potential customers. Thus, by using DSPPs to increase the shareholder base, companies may also increase their revenues. Adopting a DSPP may reduce the perceived competitive advantage that companies with existing DSPPs have. Of the five statements, respondents show the lowest level of agreement with the notion that companies are likely to adopt DSPPs if they have a pressing need for additional equity capital (S22). Again, this response may reflect the fact that most of the respondents' companies do not use their DSPPs as a way to raise new capital.

Panel B of Table 4 shows the circumstances under which companies are unlikely to adopt DSPPs. The concern about the high potential cost of operating these plans (S24) is a primary deterrent to adopting DSPPs. This concern appears justified because, as Panel B of Table 2 shows, low cost is the top-ranked factor contributing to the success of a company's DSPP.

Panel C of Table 4 provides respondents' views about five statements involving DSPPs within the next few years. Most respondents (86.3%) agree with the notion that DSPP investors will be able to buy stocks directly from companies via the Internet (S27). Now, DSPPs offer a competitive advantage over online brokers for ease of getting started because

Table 4  
Issues involving the future of DSPPs

| S#                                                       | Statement                                                                                                                            | n  | Disagree<br>-1 and -2 | No<br>opinion<br>0 | Agree<br>+1 and +2 | Mean  | t value  | Rank |
|----------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|----|-----------------------|--------------------|--------------------|-------|----------|------|
| A. Companies are <b>LIKELY</b> to adopt DSPPs if they:   |                                                                                                                                      |    |                       |                    |                    |       |          |      |
| 23                                                       | Need to add small investors to the shareholder base.                                                                                 | 73 | 5.5%                  | 15.1%              | 79.4%              | 1.00  | 10.689** | 1    |
| 20                                                       | Are consumer or service-oriented companies.                                                                                          | 73 | 2.7                   | 21.9               | 75.4               | 0.96  | 10.154** | 2    |
| 19                                                       | Have competitors that already offer DSPPs.                                                                                           | 72 | 11.1                  | 16.7               | 72.2               | 0.80  | 7.358**  | 3    |
| 21                                                       | Face an increasingly competitive environment.                                                                                        | 72 | 2.8                   | 48.6               | 48.6               | 0.60  | 6.207**  | 4    |
| 22                                                       | Have a pressing need for additional equity capital.                                                                                  | 73 | 16.7                  | 37.5               | 45.9               | 0.36  | 2.774**  | 5    |
| B. Companies are <b>UNLIKELY</b> to adopt DSPPs if they: |                                                                                                                                      |    |                       |                    |                    |       |          |      |
| 24                                                       | Are concerned about the high cost of operating these plans.                                                                          | 73 | 16.5                  | 12.3               | 71.2               | 0.75  | 6.369**  | 1    |
| 26                                                       | Are concerned about the regulator restrictions that prevent advertising these plans.                                                 | 73 | 28.8                  | 31.5               | 39.7               | 0.11  | 0.970    | 2    |
| 25                                                       | Believe that these plans could dilute the interests of controlling shareholders.                                                     | 73 | 35.6                  | 35.6               | 28.8               | -0.10 | -0.867   | 3    |
| C. Within the next few years:                            |                                                                                                                                      |    |                       |                    |                    |       |          |      |
| 27                                                       | DSPP investors will be able to buy stocks directly from companies via the Internet.                                                  | 73 | 4.1                   | 9.6                | 86.3               | 1.31  | 13.797** | 1    |
| 30                                                       | DSPPs will tap into the retirement market by including IRA and Keogh investing.                                                      | 73 | 15.1                  | 24.7               | 60.3               | 0.48  | 4.636**  | 2    |
| 31                                                       | Direct purchase plans will emerge for assets such as corporate bonds, preferred stock, convertible bonds, and government securities. | 73 | 27.4                  | 42.5               | 30.1               | -0.04 | -0.395   | 3    |
| 28                                                       | DSPPs will grow dramatically if interest rates rise and financial markets weaken.                                                    | 73 | 26.0                  | 60.3               | 23.7               | -0.29 | -1.720   | 4    |
| 29                                                       | DSPPs will include such features as limit purchase orders and stop-loss orders.                                                      | 73 | 38.4                  | 42.5               | 19.1               | -0.30 | -2.511*  | 5    |

\*,\*\* Indicates statistical significance at the 0.05 and 0.01 levels, respectively.

Percentages may not add to 100 due to rounding.

This table reports descriptive statistics of responses to 13 statements about the future of DSPPs in general. Respondents indicated their level of agreement/disagreement to each statement on a five-point scale: -2 = strongly disagree, -1 = disagree, 0 = no opinion, +1 = agree, and +2 = strongly agree. For presentation purposes, the responses are collapsed into three groups: disagree, no opinion, and agree. In Panels A–C, the responses are listed according to their means from highest to lowest. One-sample *t* tests are used to test whether the means differ significantly from 0 (no opinion) using two-tailed tests.

such plans generally require a low minimum account deposit and permit full and fractional shares of stock via DSPPs. Adopting this feature would further enhance the competitiveness of DSPPs compared with Internet brokers. Using an Internet-based model of the plan would also reduce costs when compared to the cost of mailing and administering a paper-based system. Because investors are moving in the direction of the Internet in increasing numbers, companies are likely to move their plans to the Internet. From the perspective of investors, Internet-based plans have added advantages of speed and convenience compared to paper-based plans.

Respondents also show moderate agreement with the statement that DSPPs will tap the retirement market by including IRA and Keogh investing (S30). Respondents generally disagree with or have no opinion about the statement that DSPPs will include such features as limit purchase orders and stop-loss orders.

## 6. Conclusion

Direct investing through DSPPs has shown substantial growth since the mid-1990s. We survey representatives of 267 U.S. companies that had DSPPs by the end of 1999 to determine their *reasons* for establishing such plans, the *factors* contributing to their success in attracting investors, and their *views* about the future of DSPPs. Based on 73 responses, the evidence from our mail survey shows that firms offer DSPPs for both relationship-based and economic reasons. We find little support for the notion that firms use DSPPs to reduce the influence of institutional investors. The major factors contributing to a plan's success are low cost combined with ease and convenience but promotional restrictions limit the ability of firms to attract investors.

In the future, companies are likely to adopt DSPPs if they want to add small investors to the shareholder base but not if they are concerned about the high cost of operating these plans. Most respondents foresee that investors will be able to buy stocks directly from companies via the Internet making DSPPs more competitive with online brokers. Because investors are moving in the direction of the Internet in increasing numbers, companies are likely to respond by either dropping their paper-based model in favor of an Internet-only plan or encouraging participants to use appropriate websites. Participation in DSPPs by individual investors may increase if companies decide to use their DSPPs to tap into the retirement market by including IRA and Keogh investing.

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