Corporate Governance and Cash Dividend Policy in China: An Empirical Analysis

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Abstract: This paper provides an empirical analysis about the relationship of corporate governance and cash dividend policy in China. The results show that equity structure and the cash dividends are related. Other factors such as executive pay are related to cash dividends. This paper also analyzes the requirement of cash dividends on behalf of the corporate governance or big shareholders "Tunnel behavior" condition. This paper also discusses whether the cash dividend policy stands for the protection of shareholders or as a means of plunder, and put forward the effectiveness judgment of cash dividend policy from the view of corporate governance.

Keywords: Corporate governance, cash dividend, Shareholders’ equity

1. INTRODUCTION

Corporate governance theory is an important part of modern enterprise theory; it can greatly impact the company’s operations. And the dividend policy is also influenced by corporate governance condition, as an important modern company management decision. The corporate government mechanism and operation mode decided the enterprise stakeholders’ dominant strength of dividend policy, so as to determine the profit tendency of the dividend policy. Therefore, dividend policy is financial problems and corporate governance issues in essence.

1.1 Corporate governance and Cash dividend policy

Chinese listed companies have the characteristics of highly centralized equity, This kind of equity characteristics also turn the behavior of big shareholder’s “tunnel behavior” into possible. Under the condition of high concentration, the big shareholders use their controlling position, transferred listed company’s cash resources and profit to themselves and their subsidiaries through associated transaction, asset acquisition and other means, against the interests of small and medium-sized shareholders.

Presently, the corporate governance theory and cash dividend policy are still in the development stage in China, so them are flawed. The Chinese corporate governance structure has unreasonable management structure, centralized equity and weak independence of director structure. While dividend policy has low dividend payment rate, serious cash short-term behavior and it lack of stability and long-term planning. There are two different views about the relationship of corporate governance and cash dividend policy in abroad. The distribution of cash dividend maybe the performance that protect the minority shareholder interest from big shareholders, maybe it is a tool that help big shareholders occupy small shareholders interests.(La Porta et al,2000). While in domestic, scholars think except the two possibilities, it is also possible that the above two results coexist situation. The reason resulting three conclusions is imperfect capital market and complicated situation of governance. Although those three views conclusion is different, but generally think that the company management situation is one of the important factors to influence cash dividend policy.

The results of this empirical analysis show that equity structure and the pay dividends to shareholders are related. Share ratio of the largest shareholder cannot significantly affect the distribution of cash dividend policy; and the higher the share ratio of state-owned shares, the company more tend to issue cash dividends. Executive
pay and other factors is related to pay dividends to shareholders, among them, there is a significant positive correlation between YEAR and pay dividends to shareholders, LEV is not significant effect on pay dividends to shareholders, the audit opinion type not significantly influence the pay dividends to shareholders. There is a negative correlation between the proportion of the independent directors and the pay dividends to shareholders, the company scale is significant positive related to the pay dividends to shareholders.

1.2 Significance

The contribution of this paper mainly reflects on four aspects: 1) This paper use the state-owned shareholding ratio as a research variable, instead of the nature of the controlling shareholder, thus it can not only to found out whether the state-owned shares will effect company, but also can found out that the extent of different state-owned shareholding ratio influence on dividend policy. 2) This paper also joined the top three executive compensation amounts as a research variable, which can be very rare used in the previous articles. This paper hold the view that the executive pay is an important incentive factors in enterprise management, it can affect the formulation implementation of cash dividend policy. 3) Through the empirical study we found that the equity structure is related to the dividends policy, and other corporate governance factors like executive pay, LEV also related to the cash dividends policy. 4) The empirical analysis give a more comprehensive analysis of corporate governance with cash dividend policy influence. It have important theoretical and realistic significance to correct understanding of the current corporate governance status and the present situation of the cash dividend policy, clear the relationship between them, promote regulators to company cash dividend policy correct supervision and optimize corporate governance level.

2. LITERATURE REVIEW

The scholars of domestic and overseas have made a lot of research achievements in the field of corporate governance and dividend policy, but mostly were single one-sided study. The interest conflict between Insiders and outside is the core problem in modern company theory (Bearn and Means, 1932; Jensen and Meckling, 1978). Current research is mainly based on the mature markets such as Britain and America which has highly dispersed ownership structure, but highly dispersed ownership structure only exists in a few countries such as Britain and America. In reality, the situation of equity concentration is even more common (Claessen, 2000: Faccio and Lang. 2002: La Porta et al., 1999). In order to get more profit, big shareholders have strong dynamic intend to manager for supervision, and relatively centralized control also make big shareholders of the company has enough decision-making behavior influence, so when companies have a controlling shareholder, the main agency problem is the conflict of interest between controlling shareholder and minority shareholders (Shleifer and Vishny, 1997).According to Denis and McConnell (2003)’s research, we found that the controlling shareholder can damage the interests of small and medium shareholders outside not only by appointed management directly, but also can mostly exploitation the interest of small and medium shareholders outside by "Tunneling" (Tunneling) way. Big shareholders will be more willing to corporate earnings in the company, not payout pay dividends to shareholders to investors.

La Porta, etc. (2000) argues that cash dividend payout ratio can be significantly higher in the state that have good investors protection and lower agency cost than the state of weak investors protection and higher agency cost. Current studies indicate that the controlling shareholders of shareholding ratio on the influence of the behavior by interests alignment effect and entrenchment effect (Ierisen and Meckling, 1976; Morck, etc. 1988). Theoretically, the dividend is an effective replacement of corporate governance mechanism as a mechanism that can effectively reduce the agency cost (Easterbrook, 2004).

Many theory think that is negative correlation between dividend payments proportion and the proportion of the shares of the company management hold, and more dispersion the company shares is, more higher the
proportion of dividend payments is (Rozeff, 1982). While in Chinese market, small and medium-sized shareholders’ protection has become the restriction of corporate governance, and bonus system is the most important part in small and medium-sized shareholders’ rights protection. (Li, 2012)

As the main scheme of material interest distribution in listed companies, the cash dividend policy will be influenced by corporate governance situation, which reflects on a particular stakeholder orientation. Therefore, we can measure corporate governance status by analysis the cash dividend policy. In other words, the difference of corporate governance status can affect the cash dividend policy at different extent. This paper will analyzed the impact of corporate governance owners, management, board of directors and stakeholders behavior from the perspective of Chinese listed companies’ corporate governance emphatically, and tries to found out how corporate governance influenced on the cash dividend policy.

Since Fischer Black (1976) proposed the “mystery of the dividend”, the debates about dividend policy have never stopped. Theoretically, when our market stays in strict hypothesis conditions, dividend policy can’t effect on the enterprise's value or stock price, i.e the dividend policy is irrelevant in perfect market. But in face of Chinese market, underdeveloped capital market and imperfect market mechanism, how would the dividend policy play its role? The study found that cash dividend can effectively reduce the big shareholders’ occupation of company cash flow, and limit major shareholder to grab the company surplus interests, also can be an important tool to reduce the conflicts between shareholders and management.

These domestic scholars didn’t reach a conclusion on the relationship between corporate governance and cash dividend policy. While foreign scholars’ systematic research can be more perfect than domestic, but because of the special economic market background in China, so those research results can’t be used on Chinese market analysis directly. Therefore, the empirical research about the relationship between corporate governance and dividend policy make sense to promoting the standardization process of the Chinese dividend policy, can optimizing the dividend policy and so on, it is of great theoretical and realistic significance. In addition, this paper also discusses whether the dividend policy stands for the protection or pillage for shareholders.

3. **EMPIRICAL ANALYSIS**

3.1 **Research variables**

The research variable in this paper shown in the table 1:

<table>
<thead>
<tr>
<th>Variables</th>
<th>Code</th>
<th>Explain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend payout ratio</td>
<td>DIVI</td>
<td>Reflects the dividend policy</td>
</tr>
<tr>
<td>Year</td>
<td>YEAR</td>
<td>Set 2007=0; 2008=1; 2009=2; 2010=3; 2011=4</td>
</tr>
<tr>
<td>The proportions of the independent directors</td>
<td>PID</td>
<td>Reflects the independence of the board directors</td>
</tr>
<tr>
<td>Share ratio of the largest shareholder</td>
<td>SRLS</td>
<td>Reflects the equity concentration</td>
</tr>
<tr>
<td>The top three executive compensation</td>
<td>TEA</td>
<td>Incentive factors</td>
</tr>
<tr>
<td>Opinion</td>
<td>OPIN</td>
<td>The standard unqualified opinion=1, Other comments type=0</td>
</tr>
<tr>
<td>The state-owned shareholding ratio</td>
<td>STAT</td>
<td>Proportion of state-owned shares may affect the enterprise's control degree</td>
</tr>
<tr>
<td>LEV</td>
<td>LEV</td>
<td>Company financial leverage</td>
</tr>
<tr>
<td>Size</td>
<td>SIZE</td>
<td>The natural logarithm of company assets</td>
</tr>
</tbody>
</table>

Variable declaration: 1) the dependent variable is cash dividend payout ratio, with Y said. 2) Corporate governance characteristics, a total of eight independent variables. Eight independent variables were: year, the proportion of the independent directors, the share ratio of the largest shareholder, the top three executive
compensation amounts, audit opinion type, the state-owned shareholding ratio, LEV, and the company scale.

3.2 Research Hypotheses

According to the above analysis, put forward the following research hypotheses:

**Hypothesis 1:** There is a positive correlation between the equity structure and the cash dividend payout ratio.

Shareholder structure is the most influential management mechanism of investor protection, company's shareholding structure not only can affect the controlling shareholders to other shareholders to exploitation ability, also will influence its exploitation motivation. Especially when investors lack of the enough protection judicial system, equity structure is more important on the influence of investor protection (Lins, 2003). If the degree of country’s judicial system for small and medium-sized shareholders protection is curtailed, the different arrangement of equity structure will influence the cash dividend payout ratio in listed company. The controlling shareholder exploitation control behavior is the total equilibrium results of private income and sharing revenue maximization. (Henrik and Nilsson, 2003).

The different ownership structure to the controlling shareholder control for private income behavior influence, which produces different agency problem and different kinds of agency problem, will lead to different kinds of pay dividends to shareholders behavior. Therefore, we suppose that there is correlation between company’s equity structure and the cash dividend policy certainly. So, this paper set Hypothesis 1: There is positive correlation between equity structure and cash dividend payout ratio.

While state-owned shares are not positive supervisors in the corporate governance structure, is difficult to effectively supervision and restraint managers. Because lack of supervision, in order to reduce the agency conflict between managers, they are more likely to take issue cash dividend policy to reduce managers free cash flow, so as to reduce the agency cost. Therefore, state-owned shares are related to cash dividend payments, i.e., the greater the share ratio of state-owned shares of listed companies tends to release the cash dividend payments.

The first big shareholders occupy the dominant position of the company, and the first big shareholders have the request of payout cash dividend. There are many empirical studies shown that, the first big shareholders achieve the interests delivery “tunneling” through the cash dividend policy. Therefore, we hold the view that the share ratio of the largest shareholder is related to cash dividend payments.

**Hypothesis 2:** There is a correlation between the top three executive compensation amounts, company size or other factors and the cash dividend payout ratio.

Not only the equity structure of enterprise's can influence on cash dividend policy, many corporate governance factors such as the proportions of the independent directors, executive salary, LEV and other factors also can effect on the drafting and implementation of the cash dividend policy.

Independent director can safeguard the interests of small and medium shareholders effectively (Li, 2005). Generally speaking, the independent directors in listed company mostly are experts or scholars from universities. They have rich knowledge and experience for the development of the company strategic decision to provide a meaningful help and guidance, ensure the development of the company. At the same time, they won’t take other duties except director, so there is no possible to affect its make independent and objective judgment. So we think that the higher the proportion of the independent directors, the more likely pay dividends to shareholders.

LEV is an important long-term debt paying ability index, it can reflecting the debt proportion in total assets obtained, and measure the protection for the benefit of creditors in liquidation. Higher ratio means heavier debt burden, the listed companies mostly tend to keep the benefits to improve the company's financial situation, so the possibility of pay dividends to shareholders is smaller. Managers’ compensation is one of the important incentive factors in enterprise manages; it helps to make managers and external shareholders' interests aligned, reduce the motivation of consumption and deprived shareholders’ wealth. We think that executive shareholding
ratio is generally low, improve the shareholding ratio can reducing agency conflict effective. Therefore, the paper believes that managers’ compensation is related to cash dividend payments.

### 3.3 Sample Source

This chapter used the test data form the CSMAR database, test time range from 2008 to 2010 years. In addition, this paper also treat the sample as the following several aspects: 1) Eliminate the data of financial industry. 2) Eliminate the data of ST/PT kind of listed companies in China. Our country began to implement ST system since the April 22, 1998; the object is appears to abnormal financial position or other abnormal condition of the listed companies. This type of company has worse performance and financial situation, higher investment risk, so this paper not be included in the study sample; 3) Eliminated the loss data or data unable to get listed company data.

### 3.4 Descriptive statistics

After screening, this paper collected a total of 3927 data, description statistical analysis the data for each year separately and the results such as table 2 and table 3.

#### Table 2 Dividend payout ratio descriptive statistics

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Max</th>
<th>Min</th>
<th>Mean</th>
<th>number of enterprise</th>
<th>Number of enterprise to pay dividend</th>
<th>Payment proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>832.07%</td>
<td>0</td>
<td>27.18%</td>
<td>542</td>
<td>301</td>
<td>55.54%</td>
</tr>
<tr>
<td>2008</td>
<td>1120.02%</td>
<td>0</td>
<td>36.76%</td>
<td>628</td>
<td>175</td>
<td>27.87%</td>
</tr>
<tr>
<td>2009</td>
<td>2302.06%</td>
<td>0</td>
<td>22.56%</td>
<td>735</td>
<td>131</td>
<td>17.82%</td>
</tr>
<tr>
<td>2010</td>
<td>632.16%</td>
<td>0</td>
<td>14.43%</td>
<td>862</td>
<td>129</td>
<td>14.97%</td>
</tr>
<tr>
<td>2011</td>
<td>2682.94%</td>
<td>0</td>
<td>16.31%</td>
<td>1160</td>
<td>135</td>
<td>11.64%</td>
</tr>
</tbody>
</table>

According to the data in table 2, it is known that the proportion of pay dividends enterprise in Chinese market is very small, and the trend is decline. And dividend payout ratio is very low, the Max of dividend payout ratio is not more than 40%, generally is about 20%, Chinese pay dividends to shareholders situation is not good.

#### Table 3 Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Max</th>
<th>Min</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>DIVI</td>
<td>26.83</td>
<td>0</td>
<td>0.22</td>
<td>0.85</td>
</tr>
<tr>
<td>YEAR</td>
<td>4.00</td>
<td>0</td>
<td>2.37</td>
<td>1.40</td>
</tr>
<tr>
<td>PID</td>
<td>0.67</td>
<td>0.11</td>
<td>0.37</td>
<td>0.51</td>
</tr>
<tr>
<td>SRLS</td>
<td>0.89</td>
<td>0.04</td>
<td>0.36</td>
<td>0.15</td>
</tr>
<tr>
<td>TEA</td>
<td>1590500.00</td>
<td>29970.00</td>
<td>1282979.90</td>
<td>1276068.10</td>
</tr>
<tr>
<td>OPIN</td>
<td>1.00</td>
<td>0</td>
<td>0.98</td>
<td>0.15</td>
</tr>
<tr>
<td>STAT</td>
<td>0.97</td>
<td>0</td>
<td>0.12</td>
<td>0.20</td>
</tr>
<tr>
<td>LEV</td>
<td>82.56</td>
<td>0</td>
<td>0.38</td>
<td>1.37</td>
</tr>
<tr>
<td>SIZE</td>
<td>27.75</td>
<td>15.56</td>
<td>21.60</td>
<td>1.37</td>
</tr>
</tbody>
</table>

### 3.5 Empirical Analysis

Then we set a regression model like that:

\[
DIVI = 1*YEAR + 2*3 + 4*5 + 6*7 + 8*
\]

We analyzed the nine variables of the regression analysis and correlation analysis, and the results shown in table 4 and table 5:
Then we use the SPSS to analysis the coefficients of the variable, and results shown in table 5.

The data in table 4 is the results of regression model. It shows, no matter which regression index, the company's YEAR (YEAR), SIZE (SIZE), LEV (LEV), the proportion of state-owned shares holding has a significant effect to the company's dividend payout ratio. When the dependent variable for dividend payout ratio, the regression coefficient of year is 0.073, at significance level is 1%, related to the dividend payout ratio and significant. When the dependent variable for dividend payout ratio, the regression coefficient of SIZE is 0.084, the significance level is 1%, related to the company's dividend payout ratio and significant, while LEV (LEV)'s regression coefficient is 0.005, and related to the company's dividend payout ratio, but not significant.

We also found that the equity structure can effect on cash dividend payout ratio importantly. Share ratio of the largest shareholder as dependent variable for dividend payout ratio of regression coefficient is 0.020, and is related to the dividend payout ratio, but not significant. The state-owned shareholding ratio's regression coefficient is 0.065, the significance level is 1%, and the dividend payout ratio are related, and in 1% significance level. The proportion of the independent directors' regression coefficient is 0.020, and negative correlation to the dividend payout ratio. The audit opinion type's regression coefficient is 0.001, and negative correlation to the dividend payout ratio, but not significant. The top three executive compensation amounts' regression coefficient is 0.022, is related the dividend payout ratio, but not significant.
4. CONCLUSION

Through the empirical analysis in this paper, we can draw the conclusion: There is a correlation between corporate governance and the cash dividend policy. The equity structure is related to the cash dividends policy. Share ratio of the largest shareholder is related to dividends policy, but not significant. It means that that share ratio of the largest shareholder did not significantly affect the distribution of cash dividend policy in Chinese market. There is significant positive correlation between the state-owned shareholding proportion and dividend policy, it means higher state-owned shareholding ratio, the company more tend to issue cash dividends and different state-owned shareholding ratio will impact formulation and implementation of the cash dividend policy in different degree.

There is correlation between executive salary and other factors and pay dividends to shareholders; there is a significant positive correlation between YEAR and cash dividend. LEV can’t significant effect on dividends policy; the audit opinion type can’t significantly influence the dividends policy. Executive salary is related the dividend payout ratio, but not significant. From the point of view of senior management, the factor of senior management is still not clear, and it needs to be studied further.

There is negative correlation between the proportion of the independent directors and the dividends policy, i.e., the higher the proportion of the independent directors, the company doesn’t tend to issue cash dividends. This may be due to our country listed company ownership structure is too concentrated, and the big shareholder can control the board of directors, can’t supervision and check and balance of insider effectively. On the other hand, although many of the listed company independent directors are experts or scholars comes from the institutions and scientific research institutions, however, the independent directors are busy in completing their scientific research work, can't take enough time and energy to participate in the major policy decisions of the board of directors, weakening the supervision function of large shareholders and management. The independent directors didn’t play its role, the governance effect of directors is still needs improving. There is a significant positive correlation between company scale and the dividends policy, i.e., the bigger listed companies prefers to pay more cash dividends. Because the large companies pay more attention to the company’s brand awareness and reputation, and willing to capital market transmission positive through the distribution of cash dividend information, so as to improve the overall value.

In order to improve the Chinese economic market, we must strengthen the legal environment construction of securities market, regulate the cash dividend payment system in our country; and try our best to perfect the governance structure; strengthen the education of investor, set up the concept of long-term investment, make them participate in the decision-making behavior, supervision and restraint actively.

5. DEVELOPMENT CONTENT

5.1 Dividend policy stands for the protection of small and medium-sized shareholders’ equity

Someone suggesting that corporate governance and investor protection is complements rather than substitutes (Todd Mitton, 2004). In the countries or regions with better legal protection system, the small and medium-sized shareholders’ legal protection level is proportional to the payment of cash dividend especially; the cash dividend is the substitutes for small and medium-sized shareholders’ legal protection. Shareholders can force company’s issue cash dividends by legal, so as to prevent the big shareholders form occupying too much cash, improve the legal risk of occupation, and increase the cost of occupy.

When the company needs to raise funds from outside, they should build a credit mechanism to protect the small and medium shareholders’ interests from occupy. And the method of building reputation mechanism is to pay cash dividends. Legal protection in China is improving, but the legal protection for small and medium-sized shareholders is still weak. So this paper thinks the dividend policy is substitutes for small and medium-sized
shareholders’ legal protection.

5.2 Dividend policy stands for small shareholders' interests expropriated by control shareholders.

The control shareholders can infringe on the interests of small and medium-sized shareholders through the distribution of cash dividend, and mainly performance in two ways: the control shareholder occupy a large amount of money and the control shareholders share out bonus can achieved the purpose of cash.

Theoretically, big shareholders have two ways of obtaining investment return: cash dividends and equity transfer. But the procedure of equity transfer is very tedious, fairness, and must be approved and cleared by stock exchange. So the big shareholders rarely use the method of equity transfer. In reality, the cash dividends should are required to pay the income tax (20%), and the control shareholders can take a lot of money of various sorts directly, so they are not necessarily in such complicated way. And cash dividends need to take out a large number of funds assign to the small and medium-sized shareholders, thus, reduce the cash flows which can be take up directly. Therefore, companies seldom have power to return small and medium-sized investors by pay dividends to shareholders.

REFERENCES