

A Note on Determinants of Dividend Policy among Chinese Firms



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This paper explores the impact of ownership structure on the choice of dividend policies in Chinese firms. In addition, the paper also examines the effects of ownership concentrations on valuation of Chinese firms. We find that relatively greater government ownership negatively affects firm value in China. In addition, we find that investors prefer cash dividends over stock dividends in Chinese firms, even though cash dividends are subject to income taxes. We also find that the presence of both government and foreign investors in Chinese firms, gear the dividend policies towards cash dividends in those firms. Finally, we find that firms with higher dividend payout policies and firms with cash dividend policies have higher valuation compared to firms with no dividend payout policies or stock dividend payout policies.

Keywords: Ownership Structure, Government Ownership, Dividend Policy, Chinese Privatized Firms

1. Introduction

The seminal papers of Modigliani and Miller (1958 and 1961) paved the way for a substantial amount of theoretical and empirical research studying the consequences of dividend policy on firm value. Corporate profits can be paid to shareholders as dividend payments or retained within the firm for reinvestments in future profitable projects. Firms rely on their own retained earnings as significant sources of capital for financing future projects. Shleifer and Vishny (1997) argue that dividend policy can mitigate agency problems between corporate managers and stockholders. Dividend payments paid to shareholders reduce free cash flow in the firm, thus preventing managers from using such funds for their own benefit or pet projects.

The agency approach of analyzing dividend policy is different from the theoretical models of Modigliani and Miller (1961). The agency approach treats firm dividend policy and investment policy as interconnected. DeAngelo et al. (2006), argue that dividend payments can shield managers from making investments in unprofitable projects. Also, it reduces the risk for investors by providing them with a return on their investment. However La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000), show that firm profits can be siphoned by large shareholders at the expense of minority shareholders, especially in situations where dominant shareholders are governmental entities. Large shareholders can get preferential treatment and use their dominant position for asset diversion, employment benefits, and transfer prices.

The empirical research on corporate governance and protection of outside investors and creditors from firm managers sheds light on some important agency problems and irregularities that arise with the presence of a large shareholder. (Shleifer and Vishny, 1997). Most often, the presence of a large shareholder induces preferential treatment and decreases minority shareholders rights. This especially true in countries with emerging financial systems, newly established capital markets, and mixed ownership structures. According to La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000), the presence of laws protecting shareholders and creditors is crucial in mitigating agency problems.

The most prominent example of the above-mentioned agency problems arises when a country's governing body is the majority shareholder in a firm. Megginson and Netter (2001), define privatization as a government's political and economic policy of selling state-owned enterprises (SOEs) to private entities. However, in most privatized firms, the government holds a stake in the newly privatized SOEs. A country that deserves special attention is China. In the early 1990s, The People's Republic of China started a large privatization process to liberalize and grow the economy. The government initiated the sale of all SOEs (except the largest and most critical to the country's strategic survival) to private investors. Also, to facilitate the privatization process and assure its success by providing the newly privatized SOEs access to capital and financial markets, the government created two stock exchanges one in Shanghai and one in Shenzhen. (Lin, 2000; Lin, Cai, and Li, 1998; Bai, Li, and Wang, 1997).

Two important characteristics distinguish the Chinese privatization process from its counterparts. First, the presence of two distinct government agencies – the state government and provincial authorities – as stakeholders in the privatized SOEs creates a mixed ownership structure, which in turn, creates very interesting dynamics related to the right of control and the right of return – the two tenets of ownership. Second, in the Chinese political and socio-economic culture, the SOEs have additional social responsibilities which when coupled with the presence of mixed ownership structure might hinder the performance of SOEs and increase the agency relationships to which the minority shareholders are exposed. (Megginson and Netter, 2001; Cao et al., 2017).

The role of a firm's dividend policy is directly related to mitigating the agency relationships that arise among the different shareholding constituents in a firm. (Easterbrook, 1984; Jensen, 1986; Fluck, 1998, Myers, 1998) The payout of corporate profits to shareholders is a form of corporate governance mechanism that reduces the private benefits of control, the appropriation the firm's resources for personal use and the commitment of funds towards unprofitable projects. (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 2000). As a consequence, minority shareholders have a preference for dividends over retained earnings. The empirical studies relate corporate payout decisions and the form of payments to various firm characteristics such as profitability, investment opportunities, earnings prospects, and signaling considerations.

In this paper, we study the dividend payout policy of Chinese SOEs by investigating the dynamic relationships between ownership structures, dividend payments and profitability. In addition, we investigate the impact of taxes on dividend payments. The reason for studying Chinese firms is that agency problems have a relatively greater presence in China when compared to other countries. The presence of a large dominant government as a majority shareholder creates a totally different dynamic which in turn exposes minority shareholders to greater agency problem exposure. In addition, the

Chinese government with its ability to enact rules and regulations, have provided almost tax-exempt status on capital gains derived from stock sales, while, in contrast, dividends are taxed as income. Section 2 of the paper provides an overview of Chinese regulations regarding taxation on dividends. Section 3 of the paper summarizes the current literature. Section 4 describes the data and methodology. Section 5 presents our empirical findings. Section 6 concludes.

2. Overview of Taxation in China

The China Securities Regulatory Commission (CSRC) publishes the rules and regulations governing public companies listed on Shanghai and Shenzhen stock exchanges. The regulations regarding taxes on cash dividends paid by Chinese listed companies have undergone several changes. Since 2011, the taxes on cash dividends are levied as income taxes averaging 20%. Specifically, the taxes follow a graduated three tier system based on the amount of time the shares are held. The CSRC website provides information on how taxes are levied:

1. Dividends are subject to 20% income tax for shares held for less than one month.
2. Dividends are subject to 50% of the 20% income tax for shares held between one month and one year.
3. Dividends are subject to 25% of the 20% income tax for shares held for more than one year. (CSRC, 2012)

Overall, the taxes on dividends varies depending on the holding period, ranging from 5% to 20%.

Concerning the capital gains taxes on stocks, the Chinese regulations exempt capital gains derived from stocks from any individual income tax. This exemption applies to any type of shares other than A-shares. A-shares are the government owned shares, which are generally non-tradable. (CSRC, 2012)

One of the long-term objectives of the Chinese government from their mass-privatization process of state owned enterprises (SOEs) was to encourage investment in the Chinese economy on a long-term basis. The tax rules and regulations were adopted in order to implement those policies and attract investors with long-term investment horizons to the Chinese economy.

3. Literature Review

Modigliani and Miller (1961) propose that dividends payouts are irrelevant to firm value. They argue that investors would be indifferent between payout policies and retention policies because investors have the ability to sell their shares if they need cash or reinvest any cash into the stock for additional capital gains. Miller and Rock (1985) posit the existence of asymmetry of information between firm owners and managers. They propose a model where the dividend announcement is a method to mitigate this asymmetry of information. They argue that managers choose carefully the timing and the magnitude of the dividend announcement in order to convey new information about the firm value and its future earning potential to the market.

Jenson and Meckling (1976) propose the free cash flow hypothesis as an explanation for agency conflicts that arise between shareholders and managers. They argue that dividend payments are a mechanism that reduces agency conflicts by distributing free cash flow back to the shareholders when firms do not have profitable projects. Jensen (1986) and Stulz (1990) come to similar conclusions. Easterbrook (1984) argues that

agency costs can be reduced through dividend payments. He explains that dividends provide a market based mechanism to reduce agency costs and provide monitoring of firm managers.

Rozeff (1982) examines the monitoring effects of inside ownership on management. In unregulated industries, he finds that firms with substantial inside ownership, have higher dividend payout ratios. He concludes by asserting inside ownership enhances firm value. Similar results were reported by Myers and Majluf (1984).

According to LaPorta et al. (1999), in firms controlled by large shareholders, agency problems can be more pronounced. Large controlling shareholders can have different and often conflicting interests with minority shareholders. In most instances, the controlling shareholder will try to maximize his own interests by influencing management. LaPorta et al. (1999) conclude that if other investor interests are the same as the controlling shareholder's interests, then the outside investors benefit from whatever actions the controlling shareholder takes. However, when the controlling shareholder and outside investors have opposite interests, then agency problems become more nuanced, with the controlling shareholder maximizing its own interests and at the same time hurting the interests of other shareholders.

More recent studies explore the connection between corporate governance, ownership structure and dividend policy characteristics. (Aivazian, Booth, and Cleary, 2003; La-Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2000). Mitton (2004) studies the impact of corporate governance practices in emerging markets. He reports a positive relationship between corporate governance rating and dividend payouts. He argues that agency problems can be reduced with higher dividend payout ratios. In addition, he finds a positive relationship between corporate governance ratings and high dividend payout ratios. Cao et al., (2017) report a large positive impact which foreign shareholders exercise on corporate governance practices in China. In particular, they report higher dividend payout ratios in firms with significant foreign ownership.

4. Hypotheses Development

La Porta et al., (1999) argue that firms are run very inefficiently in countries where the government is a large shareholder and particularly in those countries where rules and regulations do not provide any protection to small shareholders. They suggest that in such countries, the government uses firms for political objectives rather than to increase value for all shareholders.

Meggison et al., (1994) argue that in many instances, privatizations do not work as intended. Especially when the large controlling shareholder is the government. They provide evidence that in such situations, the government control and monitoring activities are weak, and the managerial discretion can be without focus. Shleifer and Vishny (1997) provide similar argument about the severity of managerial control issues in the presence of large government owned firms. From the previous discussion, and in particular, based on LaPorta et al. (1999) arguments about the presence of large controlling shareholders in a firm, we hypothesize the following:

H₁: Government ownership in Chinese firms has negative impact on firm value.

Gugler (2003) proposes the double principal-agent problem in state-controlled enterprises. He argues that government ownership in corporations do not provide with effective monitoring of management, which leads to larger principal-agent problems.

Furthermore, since the country's citizens are the ultimate owners through the government ownership, thus the double principal-agent problem. Gugler (2003) concludes that in such situations, and in order to demonstrate to shareholders their success in monitoring and guiding the management, higher dividends are paid in state-controlled firms.

In studies on Chinese firms, Wei et al. (2004), Wang et al. (2011) and Lam et al. (2012) conclude that there is positive relationship government ownership and cash dividends. Based on the above discussion, we hypothesize that in Chinese firms investors would prefer cash dividends over stock dividends.

H₂: Investors would prefer cash dividends over stock dividends.

Glen et al. (1995) provide evidence of positive impacts that foreign investors have in firms in emerging markets. They argue that foreign investors provide better monitoring effects because of their expertise and knowledge of better standards and practices. In addition, the presence of foreign investors attracts more foreign analysts who follow the firm and provide independent valuation opinion, and put more pressure on management to disclose financial policies. Therefore, Glen et al., (1995) propose that with the presence of foreign ownership, there is less need for dividend policies that support minority and small shareholders.

In addition, Brennan (1970), Elton and Gruber (1970) and Litzenberger and Ramaswamy (1979), argue in countries where tax regulations provide preferential treatment for capital gains over cash dividends, investors would prefer stock dividends over cash dividends. Therefore, because of tax regulations, firms may adjust their dividend policies to accommodate investors' preferences. Based on the above discussion, and the fact that according to the Chinese regulations, capital gains arising from stock sales are not taxed, while cash dividend payments are taxed as income.

H₃: The presence of foreign investors will increase stock dividends payout over cash dividend payouts.

5. Data and Methodology

The sample of firms used for this study consists of Chinese firms that issued either stock dividends or cash dividends or combination of both during the 2005 to 2018 time period. The data is collected from the GTA-CSMAR database. The sample excludes financial sector firms such as banks, insurance companies etc., since they have different accounting procedures and dividend policies.

In order to test hypothesis 1, the negative impact of government ownership on firm value, we use four specifications of multivariate OLS regressions (Paskelian et. al, 2018, Paskelian et. al, 2010 and Paskelian et al., 2009). The dependent variable in all four specifications is the firm value defined as the market value of equity plus the book value of debt; while the independent variables are ownership variables, dividend policy variables and financial accounting variables. Similarly, we test hypothesis 2, the investors' preferences for cash dividends and hypothesis 3, the presence of foreign investors would increase stock dividends, with multivariate OLS regression. Three different dependent variables are used: Total Dividend payout ratio, Cash Dividend Payout Ratio and Stock Dividend Payout Ratio. The independent variables are ownership and financial accounting variables. (Paskelian et. al, 2018, Paskelian et. al, 2010 and Paskelian et al., 2009).

6. Descriptive Statistics

Table 1 provides information about the type of dividends paid by Chinese firms over the period 2005 to 2018.

Table 1: Number and Composition of Dividends

The Table provides information about the type of dividends paid, and the number of firms paying each type of dividend per year. For each year from 2005 to 2018, the “No Dividend” column lists the number of firms that pay no dividend at all; “Stock Dividend” column lists the number of firms that pay stock dividends only; “Cash Dividend” column lists the number of firms that pay cash dividends only; “Both Stock and Cash Dividend” column lists the number of firms that pay both stock and cash dividends. Note, the firms listed in the “Both Stock and Cash Dividends” are also listed in the “Stock Dividend” and “Cash Dividend” columns respectively. The total number of firms is calculated by subtracting the column “Both Stock and Cash Dividend” from both “Stock Dividend” and “Cash Dividend” columns. For example, for year 2005, the total number of firms is $640+(48-41)+(687-41)+41 = 1334$.

Table 1 Number and Composition of Dividends

Year	No Dividend	Stock Dividend	Cash Dividend	Both Stock and Cash Dividend	Total
2005	640	48	687	41	1334
2006	658	51	715	45	1379
2007	634	84	768	69	1417
2008	687	76	815	107	1471
2009	701	82	811	95	1499
2010	712	94	823	72	1557
2011	734	93	834	95	1566
2012	736	101	841	85	1593
2013	748	94	839	67	1614
2014	759	75	852	86	1600
2015	791	71	861	92	1631
2016	808	70	868	104	1642
2017	816	62	911	95	1694
2018	828	71	920	101	1718

The vast majority of dividend paying Chinese firms paid cash dividends, while a much smaller number of paid stock dividends, and similarly a small sample paid both cash and stock dividends. The striking puzzle in the type of dividends paid is related to the Chinese taxing regulation on dividends. Despite the fact that cash dividends are taxed while stock dividends are not, still the major form of dividend was cash. Furthermore, the number of firms paying cash dividends have been increasing since 2005, from 687 to 920 firms; while the number of firms paying only stock dividends increased from 48 to 71.

The descriptive statistics for the sample of firms used in this paper are contained in Table 2 including the mean, median, standard deviations of all the different variables used in the study.

Table 2: Descriptive Statistics

This Table provides summary statistics for the sample. The dataset comprises 1587 firms covering the period from 2005 to 2018. The descriptive statistics include: Equity ownership of the top five officers (Inside Ownership), government ownership, percentage of foreign investors in the company (Foreign), sales, total assets, firm leverage (Leverage), ratio of the market value to book value of assets (Market-to-Book), the percentage of the cash and stock dividends distributed to the shareholders (Payout Ratio), earnings before extraordinary items plus interest, deferred tax credits and investment credits (Earnings), the percentage of the cash dividend distributed to shareholders (Cash Dividend Ratio) and the percentage of the stock dividend distributed to the shareholders (Stock Dividend Ratio).

Table 2 Descriptive Statistics

	Mean	Median	Standard Deviation
Inside Ownership	0.031	0.394	1.824
Government Ownership	0.371	0.468	3.117
Foreign Ownership	0.184	0.258	3.254
Sales (Millions of Yuan)	4,284	2,078	9,472
Assets (Millions of Yuan)	5,239	1,987	10,254
Leverage	0.325	0.218	0.169
Market-to-Book	2.952	2.084	1.476
Payout Ratio	0.208	0.387	1.128
Earnings	0.074	0.081	1.239
Cash Dividend Ratio	0.185	0.423	1.084
Stock Dividend Ratio	0.082	0.194	0.489

The three variables related to dividends are payout ratio which is the total dividend payout ratio, cash dividend ratio and stock dividend payout ratio. The payout ratio has a mean of 20.8%, a median of 38.7% and standard deviation of 112.8%. There large value of the standard deviation indicates large variability in dividend payouts among Chinese firms. The cash dividend ratio has a mean value of 18.5%, a median of 42.3% and a standard deviation of 108.4%. The cash dividend ratio also has large variability among Chinese firms having large standard deviation. The stock dividend ratio has a mean value of 8.2%, a median of 19.4% and a standard deviation of 48.9%. The three dividend variables imply large variations in dividend policy among the Chinese firms.

Government ownership has a mean value of 37.1%, a median of 46.8% and a very large standard deviation 311.7%. The government ownership variable is large and highly skewed. The Chinese government has substantial shares in the listed companies, and in some companies the government ownership is very high. The inside ownership variable has a mean of 3.1% and a median of 39.4% and a standard deviation of 182.4%. Inside ownership also seems to have large variability among Chinese firms. The foreign ownership variable has a mean value of 18.4%, a median of 25.8% and a large standard deviation of 325.4%. Again, there seems to be large variability in foreign ownership among Chinese firms. The average firm in the sample has sales of approximately \$4.3 billion Yuan; assets of approximately \$5.2 billion Yuan; a leverage ratio of 32.5%; market to book ratio of approximately 2.95; and average earnings per share ratio is 7.4%.

Table 3: Correlations

This Table provides data on the correlations between ownership variables and dividend payout ratios. The dataset comprises 1587 firms covering the period from 2005 to 2018.

Table 3 Correlations

	Government Ownership	Inside Ownership	Foreign Ownership
Total Dividend Payout	0.4189	0.5271**	0.6271***
Cash Dividend Payout	0.4162	0.6625**	0.8625***
Stock Dividend Payout	0.3814	0.1871	0.2847

*, ** and *** are significant at 10%, 5% and 1% respectively.

Table 3 shows correlation coefficients between the three dividend variables and the three ownership variables in this study. The total payout ratio is positively and significantly related to inside ownership and foreign ownership. Cash dividend payout is positively and significantly related to inside ownership and foreign ownership. Stock dividend payout does not have significant correlation with the ownership variables.

Overall, firms with higher inside ownership and higher foreign ownership will have higher overall payout ratios and higher cash dividend payments. Government ownership does not have an impact on the dividend payout policies according to the correlations. In addition, foreign ownership has the most significant correlation with overall payout and cash payout policies.

7. Multivariate Regression Analysis

We study the relationships between dividend policy, firm value and ownership structure using multivariate cross-sectional regression analysis. The dependent variable is the value of the firm which is defined as the sum of the market value of equity, the book value of short-term debt, and the book value of long-term debt. The independent variables reflect ownership variables and firm specific factors and dividend policy variables. (Paskelian et. al, 2018, Paskelian et. al, 2010 and Paskelian et al., 2009).

Table 4: Regression Analysis – Firm Value

This Table provides regression results of the determinants of the firm value; four different specifications are used, the first using only governance variables as the independent variables, the second using accounting variables related to operating performance and the total payout ratio, the third using both governance and company specific variables and the cash payout ratio, and the fourth using both governance and company specific variables and the stock payout ratio. Firm value is defined as the market value of equity plus the book value of debt.

Table 4 Regression Analysis – Firm Value

	Firm Value	Firm Value	Firm Value	Firm Value
Intercept	0.428	0.597	0.841	0.863
Inside Ownership	-0.384**		-0.408**	-0.413**
Government Ownership	-0.861***		-0.594***	-0.628***
Foreign Ownership	0.423***		0.758***	0.815***
Sales (Millions of Yuan)		0.830		
Net Assets (Millions of Yuan)	0.423**	0.458**		
Leverage		-0.389*		
Market-to-Book		0.415**	0.618***	0.628***
Payout Ratio		0.847***		
Cash Payout Ratio			0.681***	
Stock Payout Ratio				0.115

*, ** and *** are significant at 10%, 5% and 1% respectively.

In model 1, we analyze the impact of ownership variables alone on the firm value. The result reflects the negative and significant impact of government ownership on Chinese firm value. Furthermore, model 1 also reflects the negative impact of inside ownership on Chinese firm value. In contrast, foreign ownership has a very positive impact on firm value. Finally, sales has a positive impact on Chinese firm value.

In model 2, we use accounting variables and the total payout ratio only as the independent variables. The result reflects the positive and significant impact of total dividend payout on the firm value. The accounting variables do not provide any surprising results. Firm value is positively affected by sales and market-to-book ratio, while it is negatively affected by leverage.

In Models 3, we use ownership variables and cash dividend payout ratio as independent variables. The results confirm the findings from model 1 as far as ownership variables. Both government and inside ownership impact firm value negatively and significantly. While foreign ownership impacts firm value positively and significantly. The cash payout ratio has substantial positive impact on firm value as well.

Finally, in model 4 we use a setup similar to model 3, except using the stock dividend payout ratio rather than the cash dividend payout ratio. The results do not indicate any significant impact of the stock dividend payout ratio on the firm value. Further, the results reconfirm the previous results of ownership variables on firm value.

Our results confirm hypothesis 1, we find that the presence of large government ownership, decreases the Chinese firm value. In addition, we also find that the presence of foreign ownership in Chinese firms, have positive impact on firm value. Our results also shows that higher dividends in general have positive impact on firm value, also in particular, we find that the higher the cash dividend payments the higher the firm value. However, we do not find any significant relationship between stock dividend payments and firm value, thus confirming our hypothesis 2 that investors prefer cash dividends over stock dividends. This result is feels somehow counterintuitive to the Chinese regulations because cash dividends are taxed while stock dividends normally do not have any taxations.

Table 5: Regression Analysis –Dividends

This Table provides OLS regression results of the determinants of dividend payments; three different dependent variables are tested. The first uses total dividend payout ratio as dependent variable, the second uses stock dividend payout ratio as dependent variable, and the third uses the cash dividend payout ratio as dependent variable.

Table 5 Regression Analysis –Dividends

	Total Dividends	Stock Dividends	Cash Dividends
Intercept	0.057	0.174	0.258
Inside Ownership	0.098*	0.047	0.057*
Government Ownership	0.128*	-0.847	0.118*
Foreign Ownership	0.237***	0.024***	0.347***
Sales (Millions of Yuan)	0.274	0.159	0.051
Net Assets (Millions of Yuan)	0.117**	0.184**	0.139**
Leverage	-0.173	-0.284	-0.247
Market-to-Book	0.874	0.741	0.681
Earnings	0.628**	0.217*	0.714***

*, ** and *** are significant at 10%, 5% and 1% respectively.

In Table 5, we study the determinants of dividend payout policies among Chinese firms. In each of the models 1 through 3, we use total dividend payout, stock dividend payout and cash dividend payout as dependent variables respectively. The independent variables are the ownership variables and the accounting variables in all three models.

In model 1, the dependent variable, total dividend payout is very significantly and positively affected by foreign ownership, also surprisingly both inside and government ownership have positive and somehow significant impact on the total dividend payout as well. As far as accounting variables, only earnings and sales have positive and significant impact on total dividend payout ratio.

In model 2, the dependent variable, the stock dividend ratio is positively and significantly affected by the foreign ownership variable only among the ownership variables. Similar to model 1, earnings and sales have positive and significant impact on stock dividend payout as well.

In model 3, the dependent variable, the cash dividend ratio is positively and significantly affected by foreign ownership variable as well as inside ownership and government ownership variables to a lesser extent. Similar to models 1 and 2, earnings and sales have positive and significant impact on cash dividend payout as well.

The results in Models 1 through 3 suggest that the presence of foreign ownership in Chinese firms influences firm dividend policy. In particular, firms with more foreign ownership tend to pay more dividends in general and cash dividends in particular. This result is contrary to our hypothesis 3. Also, our results suggest that government ownership influences dividend policies in Chinese firms, in particular, government ownership impacts cash dividend payments while it has no effect on stock dividends. We also find that inside ownership influences dividend payments and in particular cash dividend payments.

8. Conclusions

Our study examines the relationship between ownership structure, firm value and dividend policies in Chinese firms. We explore three hypotheses. First, higher government ownership affects negatively firm value. Second, investors in Chinese firms have preference of cash dividends over stock dividends. Third, the presence of foreign ownership induces firms to pay more of stock dividends rather than cash dividends. Our results strongly support two of the three hypotheses. We confirm that high government ownership has a negative impact on firm value in Chinese firms. Also, we confirm investors' preferences of cash dividends over stock dividends. However, we find that the presence of foreign ownership have positive impact on cash dividend payments among Chinese firms. The presence of higher levels of foreign ownership in Chinese firms leads to relatively higher cash dividend payments rather than stock dividend payments.

Our results do not provide any support to tax preferences among investors in Chinese firms. On the contrary, we find investors in general prefer cash dividends over stock dividends. Even though, in China, cash dividends are taxed as income while stock dividends normally are not taxed because of the exemption of capital gains on stocks from taxation. Our results indicate that investors provide higher valuation to firms with high payout policies, and in particular cash payout policies.

Our paper suffers from some limitations which can provide opportunities for future studies. First, we use government ownership as an aggregate measure that includes the Chinese Central government as well as regional governments. It would be more interesting to study the impact of different government ownership structures such as regional governments, state agencies, etc., on firm value and dividend policies. Second, our results provide a surprising dilemma between the negative impact of the Chinese government ownership on firm value, and their preferences for higher cash dividend payments. The propensity to pay high cash dividends suggests maybe there are other motives or factors affecting those policies. The corporate governance literature provides an explanation in terms of expropriation mechanisms that governments use to extract private benefits of control. It would be very interesting to study empirically if there are in fact, expropriation of private benefits by the Chinese government using the dividends are the preferred mechanism.

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