Stock Dividend Policy in China

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ABSTRACT

Corporations in China have a split-share structure; contributed capital is comprised of both tradable and nontradable ownership shares. Approximately two-thirds of listed firms in China are State-controlled, either directly or indirectly; thus, the State is the largest shareholder in most Chinese firms. China’s tax code requires investors to pay taxes on cash dividends received, while capital gains from stock sales are untaxed. Individual shareholders would thus prefer capital gains to dividend income (the tax clientele theory). As a controlling shareholder, the State has the ability to direct dividend policy. Because the State receives no cash flow from the nontradable State shares it receives as stock dividends, there is an incentive for the State to cause the firms it controls to pay more cash dividends than stock dividends (the agency theory). Previous research finds that State-controlled firms pay more cash dividends than do non-State-controlled firms (Wang et al. 2010). This study examines the stock dividend policies of Chinese listed firms and finds that as State ownership decreases (and private ownership increases), stock dividend distributions increase. Our findings provide support for both the agency and the tax clientele dividend theories.

INTRODUCTION

Stock dividends enable firms to capitalize their retained earnings into their stock accounts, but do not provide a distribution of accumulated firm wealth to shareholders. Stock dividends have no direct impact on cash flow; thus, in the absence of an indirect influence on cash flow, there should be no impact on stock prices when there is a stock dividend announcement. However, researchers have reported positive abnormal returns around announcements of stock dividends (Firth, 1977; Foster and Vickery, 1978; Grinblatt et al., 1984; Murray, 1985; Lakonishok and Lev, 1987; Liljebom, 1989; McNichols and Dravid, 1990; Masse et al., 1997; Koski, 1998; Crawford and Franz, 2001; Chen et al., 2002; Anderson et al., 2001). Researchers have developed several hypotheses to explain why firms distribute stock dividends and why the market might react positively to a stock dividend announcement. In this study, we focus on agency and tax motivations as explanations for stock dividend declarations in China.

In China, cash dividends are immediately taxable to shareholders as income, while stock dividends are not taxed. In the absence of cash dividend payments, shareholders must sell shares to extract their ratable portion of accumulated firm wealth in the form of capital gains; moreover, there is no capital gains tax in China. Therefore, stock dividends may provide a convenient vehicle for managing capital gains extraction for individual shareholders (the tax clientele theory).

The State controls two-thirds of the firms in China and has the ability to determine the dividend policy of those firms it controls. With this ability, an agency conflict arises in that the State has an incentive to increase the cash flow it receives from shareholder taxes by causing firms to pay cash dividends rather than stock dividends (the agency theory).
Using firm data from the Chinese stock market, we examine stock dividend policy of Chinese firms from 1998 through 2008. With approximately two-thirds of China’s listed firms being State controlled, either directly or indirectly, there is a unique opportunity to examine differences in dividend policies between State-controlled and non-State-controlled firms.\(^1\)

Previous research finds that both the dividend amount and dividend likelihood of cash dividends are increasing in State ownership (Wang et al. 2010). In this paper, we find that both the amount and likelihood of stock dividend declarations in China are declining in the level of State control. Taken together, our findings are consistent with both the agency theory and the tax clientele theory.

Background information on the Chinese corporate economy and dividend policy is presented in the next section, followed by the derivation and description of our models. After providing a discussion of the results of tests, the final section contains a brief summary.

**BACKGROUND**

**China’s Capital Market Structure**

China’s stock markets opened in 1990 in Shenzhen and 1991 in Shanghai, primarily to raise money for the State and State-owned enterprises (SOEs) (Areddy et al., 2008; Joyce, 2008). Chinese listed firms use a “split-share structure,” in which two classes of stock are publicly traded and two classes are not.

Of the non-tradable shares, roughly half are owned by other Chinese firms, SOEs, or non-bank financial institutions; the remaining non-tradable shares are State shares, owned by government departments or by SOEs. Approximately two-thirds of the shares of most listed firms are non-tradable, and roughly two-thirds of the listed firms with tradable shares are State controlled, either directly or indirectly.\(^2\)

**Stock Dividend Research**

If stock dividends have no impact on cash flows, there should be no impact on stock prices. While stock splits and stock dividends could be seen as purely cosmetic, research has instead shown that the market reacts positively to the announcement of stock dividends (Koski, 1998; Crawford and Franz, 2001; Firth, 1977). Similar reactions have been found by Dhatt et al. (1997) in Korea, Masse et al. (1997) in Canada, Batchelor and Orakcioglu (2003) in Turkey, Wei et al. (2004) in China, and Bechmann and Raaballe (2007) in Norway. The signaling, optimal trading range, cash substitution, tax clientele, and agency theories have evolved to explain why a firm might prefer to declare stock dividends. We discuss these theories in more detail below.

**Dividend Signaling**

According to signaling theory, dividend announcements provide positive signals to investors about

\(^1\) For brevity, we refer to the government of the Peoples Republic of China as the State. Similarly, we use the phrase “State control” for direct or indirect ownership by governmental entities.

\(^2\) Gul et al. (2010) note that the likelihood the largest shareholder of a Chinese firm is government-related is around 66%. 
management expectations of future performance, and may convey more timely information than earnings (Bhattacharya, 1980; Miller and Rock, 1985; Ofer and Thakor, 1987; McNichols and Dravid, 1990). Stock dividend declarations may provide positive signals in that the reduced retained earnings constrain future cash dividends and indicate that firm management expects future investment opportunities and positive future performance (Ross, 1977; Leland and Pyle, 1977; Grinblatt et al., 1984; Baker and Phillips, 1993; Rankine and Stice, 1997; Bechmann and Raaballe, 2007).

While the market thus appears to view stock dividends as credible signals, they may be somewhat costly to shareholders in part because stock dividends improve the debt holders’ position at the expense of the shareholders (Rankine and Stice, 1997; Bechmann and Raaballe, 2007). Moreover, because future cash dividends are not proportionately increased with stock dividends, stock dividend signals may result in negative returns in the future (Bechmann and Raaballe, 2007). Robinson (2006) points out that there are more cost-effective methods to transmit information than through dividend policy.

**Optimal Trading Range**

Lev (1969) reports that there are industry norms for stock prices and that managers use stock dividends and stock splits to adjust stock prices to industry norms. Baker and Gallager (1980) survey managers and find that 93.7% of managers believe that splits keep a firms’ stock price within an optimal range. Lakonishok and Lev (1987) provide empirical evidence that firms use stock splits to shift share prices to an optimal trading level. With a lower stock price, there presumably would be an increase in demand for the shares; the increased demand would shift prices higher, creating the positive association that has been reported between stock prices and stock dividend announcements. Lakonishok and Lev (1987) also indicate that the optimal trading range hypothesis is more likely confirmed when examining stock splits rather than stock dividends since the firms that issue stock dividends already have low stock prices, and only need a relatively small increase in the number of shares outstanding to attain an optimal range.

**Cash Substitution**

According to the cash substitution theory, managers may believe that issuing stock dividends will act as a substitute for cash dividends (Lakonishok and Lev, 1987). A survey found that 40.8% of the managers use stock dividends to temporarily substitute for cash dividends (Baker and Phillips, 1993).

**Tax Clientelee**

Tax clientele theory maintains that investors prefer capital gains over dividends because dividend income typically receives a less favorable tax treatment than capital gains (Litzenberger and Ramaswamy, 1979; Poterba and Summers, 1984; Mann, 1989; Stulz, 1990; Brennan and Thakor, 1990; Allen et al., 2000). In China, cash dividends are taxed as ordinary income, while capital gains are not taxed. Stock dividends may thus provide individual investors with a convenient method for extracting profits from stock investments through capital gains.

**Agency**

Agency conflicts arise when the incentives of management are not aligned with the goals of the individual shareholders. According to agency dividend theory, dividend payouts may reduce agency conflict by depriving management of discretionary cash flows to appropriate and expend sub-optimally (Jenson and Meckling, 1976; Rozeff, 1982; Easterbrook, 1984; Crutchley and Hansen, 1989; Moh’d et al., 1998; Goshen, 1995; and Robinson, 2006).

The above tax clientele and agency theories about dividend policy are somewhat complicated by the
presence of a large blockholder (Jensen and Meckling, 1976; Shleifer and Vishny, 1986; Holderness, 2003). For example, when the State is the largest blockholder (generally the case in China), the taxation of corporate dividends received enables the State to extract disproportionately large benefits through cash dividend declarations. In this case, cash dividends would enable the State to extract economic rents (taxes) from the other shareholders, rather than deprive management of discretionary cash flows.

LaPorta et al. (2002) suggest that the largest shareholder often has effective control of the firm. With cash dividends being taxed as ordinary income and capital gains not taxed, there exists a substantial motivation for the State to prefer more cash dividend declarations. If the State is the largest shareholder, the State likely has the ability, as well as the motivation, to control dividend policy to maximize the State’s cash flows.

MODEL AND DATA

Previous research finds that cash dividend payments in China are increasing in both State and largest-blockholder ownership, consistent with the above “tax clientele” and “agency” theories of dividend policy (Wang et al., 2010). Alternatively, as individual ownership increases, the preference for taxable cash dividend payouts subsides. We thus hypothesize that as State shareholdings decrease (increase), the incidence of nontaxable stock dividend distributions should increase (decrease).

Table 1 provides the number of Chinese listed firms that pay cash dividends, stock dividends, both cash and stock dividends, or no dividends, for the years 1998 through 2008 inclusive. From table 1, a number of firms pay both cash and stock dividends in each sample year. The proportion of firms distributing stock dividends averages around [(1193/14099 =] 8.46 percent, while the proportion of firms paying cash dividends is around 54.2 percent. Note that in table 1 the number of firms paying stock (cash) dividends includes the number of firms paying stock (cash) dividends only plus the number of firms paying both stock and cash dividends. Thus, the total number of firms in (e.g.) 1998 is 434+(186-45)+(304-45)+45=879.

<table>
<thead>
<tr>
<th>Year</th>
<th>firms paying no dividends at all</th>
<th>firms paying stock dividends</th>
<th>firms paying cash dividends</th>
<th>firms paying both stock and cash dividends</th>
<th>Total number of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>434</td>
<td>186</td>
<td>304</td>
<td>45</td>
<td>879</td>
</tr>
<tr>
<td>1999</td>
<td>521</td>
<td>134</td>
<td>357</td>
<td>48</td>
<td>964</td>
</tr>
<tr>
<td>2000</td>
<td>345</td>
<td>125</td>
<td>768</td>
<td>104</td>
<td>1134</td>
</tr>
<tr>
<td>2001</td>
<td>405</td>
<td>103</td>
<td>791</td>
<td>86</td>
<td>1213</td>
</tr>
<tr>
<td>2002</td>
<td>521</td>
<td>70</td>
<td>685</td>
<td>62</td>
<td>1214</td>
</tr>
<tr>
<td>2003</td>
<td>588</td>
<td>100</td>
<td>675</td>
<td>87</td>
<td>1276</td>
</tr>
<tr>
<td>2004</td>
<td>576</td>
<td>63</td>
<td>808</td>
<td>56</td>
<td>1391</td>
</tr>
<tr>
<td>2005</td>
<td>677</td>
<td>58</td>
<td>707</td>
<td>49</td>
<td>1393</td>
</tr>
<tr>
<td>2006</td>
<td>678</td>
<td>102</td>
<td>769</td>
<td>81</td>
<td>1468</td>
</tr>
<tr>
<td>2007</td>
<td>649</td>
<td>164</td>
<td>855</td>
<td>145</td>
<td>1523</td>
</tr>
<tr>
<td>2008</td>
<td>719</td>
<td>88</td>
<td>922</td>
<td>85</td>
<td>1644</td>
</tr>
<tr>
<td>Total</td>
<td>6113</td>
<td>1193</td>
<td>7641</td>
<td>848</td>
<td>14099</td>
</tr>
</tbody>
</table>

To test our implicit hypothesis that stock dividend distributions are decreasing in State ownership, we
begin by adopting and modifying the dividends expectations model developed originally by Lintner (1956) and found subsequently in much dividend policy research (McDonald et al., 1975; Chateau, 1979; Shevlin, 1982; Partington, 1984; Leithner and Zimmermann, 1993; Dewenter and Warther, 1998; Robinson, 2006). Using the prior-year stock dividends ratio and earnings per share as predictors of the current-year stock dividends ratio, we examine State influence on the distribution of stock dividends by adding a parametric variable for the percentage share ownership of the State. Noting the incidence of both cash and stock dividend payments for many firms, we also add a variable capturing the cash dividends paid for each firm-year observation. This provides the ordinary least squares (OLS) model

\[ SD_{it} = \alpha_0 + \alpha_1 SD_{it-1} + \alpha_2 CD_{it} + \alpha_3 EPS_{it} + \alpha_4 STATE_{it} + \alpha_5 LEV_{it} + \alpha_6 LnASSET_{it} + \epsilon_{it} \]  

where:

- \( SD_{it} \) = the stock dividend ratio of firm i in year t;
- \( SD_{it-1} \) = the stock dividend ratio of firm i in year t-1;
- \( CD_{it} \) = the cash dividends per share of firm i in year t;
- \( EPS_{it} \) = the earnings per share of firm i in year t;
- \( STATE_{it} \) = the percentage ownership of the State through shares held by government departments and/or SOEs;
- \( LEV_{it} \) = the debt-to-assets ratio; and
- \( LnASSET_{it} \) = the natural log of total assets.

We include variables for firms size (LnASSET) and risk (LEV) to control for the possible influence of these variables on stock dividend distributions. Following the estimation of model (1) above, we further examine the impact of the largest shareholder on dividend policy by estimating the likelihood of a stock dividend distribution with the LOGIT model

\[ DSD_{it} = \alpha_0 + \alpha_1 SD_{it-1} + \alpha_2 CD_{it} + \alpha_3 EPS_{it} + \alpha_4 STATE_{it} + \alpha_5 LEV_{it} + \alpha_6 LnASSET_{it} + \epsilon_{it} \]  

where all variables are previously defined except:

- \( DSD_{it} \) = 1 if firm i pays a stock dividend in year t, and 0 otherwise.

Using the China Stock Market Accounting Research (CSMAR) database and the China Wind Financial database, we estimate models (1) and (2). We focus on listed firms for the years 1998-2008 because these years were relatively stable in terms of Chinese market regulatory characteristics, despite various reforms in corporate governance instituted in 2005. After excluding firms with insufficient data, our sample is roughly 13,340 firm-year observations, somewhat reduced from the 14,099 firm-year observations in table 1.

**RESULTS**

Coefficient estimates and two-tailed t-statistic p-values from the OLS estimation of model (1) are shown in table 2. Overall, the prior stock dividend ratio (SD_{it-1}) is not statistically-significant, suggesting that previous stock dividend amounts have little relevance for current stock dividend amounts. The coefficient on cash dividends per share (CD_{it}) is negative and significant overall (p-value=0.000), although it is significantly negative in six years and positive in two. The finding that cash and stock dividend amounts tend to move in opposite directions appears to provide support for the theory that stock dividends may be viewed as a substitute for cash dividends in years of poor operating performance. However, the coefficient on current earnings (EPS_{it}) is positive.

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3 We calculate the stock dividends ratio as the number of shares issued in a stock dividend expressed as a percentage of previously-outstanding shares.
and significant (p-value=0.000) overall and in 10 of 11 years. This indicates that stock dividend amounts are increasing in earnings, which contradicts the cash substitution theory. Although it could also be argued that the positive coefficient on EPS_{it} supports the theory that stock dividends are used to approximate a share price trading range, previous research has noted that stock splits are better suited for trading range optimality (Lakonishok and Lev, 1987).

Table 2: Results from OLS estimation of model (1), depicting coefficient estimates (and p-values).

<table>
<thead>
<tr>
<th>Year</th>
<th>Intercept (and p-value)</th>
<th>SD_{it} (and p-value)</th>
<th>CD_{it} (and p-value)</th>
<th>EPS_{it} (and p-value)</th>
<th>STATE_{it} (and p-value)</th>
<th>LEV_{it} (and p-value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998-2008</td>
<td>0.362 (0.000)</td>
<td>-0.003 (0.000)</td>
<td>-0.099 (0.000)</td>
<td>0.181 (0.000)</td>
<td>-0.039 (0.000)</td>
<td>0.004 (0.709)</td>
</tr>
<tr>
<td>1999</td>
<td>0.810 (0.000)</td>
<td>-0.170 (0.000)</td>
<td>-0.350 (0.000)</td>
<td>0.318 (0.000)</td>
<td>-0.047 (0.000)</td>
<td>0.026 (0.609)</td>
</tr>
<tr>
<td>2000</td>
<td>0.836 (0.000)</td>
<td>-0.066 (0.000)</td>
<td>-0.329 (0.000)</td>
<td>0.306 (0.000)</td>
<td>-0.067 (0.000)</td>
<td>0.063 (0.162)</td>
</tr>
<tr>
<td>2001</td>
<td>0.633 (0.000)</td>
<td>0.036 (0.000)</td>
<td>-0.287 (0.000)</td>
<td>0.275 (0.000)</td>
<td>-0.007 (0.000)</td>
<td>0.011 (0.010)</td>
</tr>
<tr>
<td>2002</td>
<td>0.404 (0.000)</td>
<td>0.057 (0.000)</td>
<td>-0.192 (0.000)</td>
<td>0.139 (0.000)</td>
<td>-0.009 (0.000)</td>
<td>0.001 (0.000)</td>
</tr>
<tr>
<td>2003</td>
<td>0.217 (0.000)</td>
<td>0.061 (0.000)</td>
<td>0.066 (0.000)</td>
<td>0.136 (0.000)</td>
<td>-0.119 (0.000)</td>
<td>0.016 (0.010)</td>
</tr>
<tr>
<td>2004</td>
<td>0.144 (0.000)</td>
<td>0.013 (0.000)</td>
<td>0.232 (0.000)</td>
<td>0.165 (0.000)</td>
<td>0.028 (0.000)</td>
<td>0.018 (0.000)</td>
</tr>
<tr>
<td>2005</td>
<td>-0.045 (0.000)</td>
<td>-0.050 (0.000)</td>
<td>0.003 (0.000)</td>
<td>0.142 (0.000)</td>
<td>-0.137 (0.000)</td>
<td>0.008 (0.000)</td>
</tr>
<tr>
<td>2006</td>
<td>0.327 (0.000)</td>
<td>-0.009 (0.000)</td>
<td>-0.240 (0.000)</td>
<td>0.170 (0.000)</td>
<td>0.026 (0.000)</td>
<td>-0.108 (0.001)</td>
</tr>
<tr>
<td>2007</td>
<td>0.102 (0.000)</td>
<td>0.116 (0.000)</td>
<td>-0.146 (0.000)</td>
<td>0.277 (0.000)</td>
<td>0.173 (0.000)</td>
<td>-0.013 (0.003)</td>
</tr>
<tr>
<td>2008</td>
<td>0.561 (0.000)</td>
<td>0.041 (0.000)</td>
<td>-0.106 (0.000)</td>
<td>0.367 (0.000)</td>
<td>0.059 (0.000)</td>
<td>-0.136 (0.004)</td>
</tr>
</tbody>
</table>

a. All F-statistics are significant at better than 1%.

The coefficient on STATE_{it} is negative and statistically-significant (p-value=0.000) overall and in four of 11 years. This result affirms our implicit hypothesis that as State ownership decreases (and private ownership increases), stock dividend distributions increase. This finding also supports both the agency and tax clientele theories. Although our risk variable (LEV_{it}) is not statistically-significant, firm size (LnSIZE_{it}) is negative and highly significant (p-value= 0.000 overall and in six of 11 years), consistent with both an increased incidence of stock dividends among smaller firms (Lakonishok and Lev, 1987) and a positive association between firm size and State ownership.

Table 3: Results from LOGIT estimation of model (2) depicting coefficient estimates (and p-values).

<table>
<thead>
<tr>
<th>Year</th>
<th>Intercept (and p-value)</th>
<th>SD_{it} (and p-value)</th>
<th>CD_{it} (and p-value)</th>
<th>EPS_{it} (and p-value)</th>
<th>STATE_{it} (and p-value)</th>
<th>LEV_{it} (and p-value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998-2008</td>
<td>2.477 (0.000)</td>
<td>0.235 (0.000)</td>
<td>-2.101 (0.000)</td>
<td>2.501 (0.000)</td>
<td>-0.280 (0.001)</td>
<td>-0.316 (0.021)</td>
</tr>
<tr>
<td>1999</td>
<td>7.336 (0.005)</td>
<td>-2.534 (0.010)</td>
<td>-4.679 (0.049)</td>
<td>6.500 (0.000)</td>
<td>-0.473 (0.190)</td>
<td>-0.245 (0.693)</td>
</tr>
<tr>
<td>2000</td>
<td>4.147 (0.103)</td>
<td>-0.865 (0.049)</td>
<td>-4.311 (0.109)</td>
<td>5.034 (0.000)</td>
<td>-0.595 (0.098)</td>
<td>-0.106 (0.851)</td>
</tr>
<tr>
<td>2001</td>
<td>4.841 (0.482)</td>
<td>-0.307 (0.482)</td>
<td>-4.818 (0.423)</td>
<td>4.930 (0.000)</td>
<td>-0.366 (0.273)</td>
<td>-0.437 (0.430)</td>
</tr>
<tr>
<td>2002</td>
<td>4.095 (0.694)</td>
<td>0.720 (0.811)</td>
<td>-6.543 (0.811)</td>
<td>4.857 (0.039)</td>
<td>0.121 (0.049)</td>
<td>0.016 (0.900)</td>
</tr>
<tr>
<td>2003</td>
<td>1.683 (0.811)</td>
<td>1.246 (0.567)</td>
<td>-1.427 (0.004)</td>
<td>3.722 (0.010)</td>
<td>-0.724 (0.009)</td>
<td>0.075 (0.090)</td>
</tr>
<tr>
<td>2004</td>
<td>0.811 (0.811)</td>
<td>0.978 (0.567)</td>
<td>-1.083 (0.009)</td>
<td>3.865 (0.009)</td>
<td>-0.750 (0.098)</td>
<td>0.049 (0.208)</td>
</tr>
<tr>
<td>2005</td>
<td>-0.474 (0.171)</td>
<td>-0.041 (0.191)</td>
<td>-0.283 (0.133)</td>
<td>3.425 (0.008)</td>
<td>-1.362 (0.121)</td>
<td>-1.365 (0.016)</td>
</tr>
<tr>
<td>2006</td>
<td>3.154 (0.491)</td>
<td>0.171 (0.191)</td>
<td>-3.522 (0.133)</td>
<td>2.408 (0.098)</td>
<td>-0.656 (0.121)</td>
<td>-1.356 (0.090)</td>
</tr>
<tr>
<td>2007</td>
<td>1.969 (0.851)</td>
<td>1.191 (0.851)</td>
<td>-2.491 (0.133)</td>
<td>2.294 (0.098)</td>
<td>-4.056 (0.121)</td>
<td>-1.191 (0.016)</td>
</tr>
<tr>
<td>2008</td>
<td>4.147 (0.008)</td>
<td>0.851 (0.008)</td>
<td>-1.375 (0.000)</td>
<td>2.522 (0.000)</td>
<td>1.130 (0.000)</td>
<td>0.445 (0.000)</td>
</tr>
</tbody>
</table>
Table 3 provides summarized results from the LOGIT estimation of model (2). The coefficient on prior stock dividends is positive and statistically-significant overall (p-value=0.011) and in six years of 11 years, suggesting that a firm is more likely to distribute a stock dividend if the firm has done so previously. Current cash dividends are negatively associated with the likelihood that stock dividends will be paid. As noted above, the negative coefficient on cash dividends suggests that stock dividends might be viewed by firms as a substitute for cash (the cash substitution theory). To confirm this interpretation, however, we would expect stock dividend likelihood to be decreasing in earnings. Instead, the coefficient on EPS$_{it}$ is positive and highly significant (p-value=0.000) overall and in 10 of 11 years.

Firm size is negatively associated with stock dividend likelihood overall (p-value=0.000), and risk (LEV$_{it}$) is negatively associated with stock dividend likelihood (p-value=0.021). The coefficient on STATE$_{it}$ is negative and statistically-significant in eight years, as well as overall (p-value=0.000). This suggests that the likelihood a stock dividend will be paid is decreasing (increasing) in government (private) ownership, consistent with both the agency and tax clientele theories.

### SUMMARY

Agency theory suggests that a firm’s controlling shareholder will direct the firm in a way that maximizes its preferences. Since cash dividends are taxed in China and capital gains are not, State-controlled firms have an incentive to pay cash dividends rather than stock dividends. Alternatively, the tax clientele theory suggests that individual investors prefer capital gains over cash dividends because dividend income typically receives a less favorable tax treatment than capital gains.

Approximately two-thirds of China’s listed firms are State-controlled, either directly or indirectly; thus, the State is usually the largest shareholder of most firms in China. We find that State-controlled Chinese firms are less likely to declare stock dividends than firms not controlled by the State. Taken together, these results are consistent with both the agency and tax clientele theories of dividend policy.

Our research highlights issues that policy-makers may wish to consider before issuing comprehensive regulations governing taxation and corporate payouts. With the U.S. increasingly involved in aiding companies through corporate bail-outs and government investments, our findings have potential implications not just for transitional economies, but for the U.S. and Western economies in general.

### REFERENCES


