Non-Controlling Majority Shareholder Exit Threats, Investor Types and Cash Dividend Policy

Yifan Zang[1, a]
[a]e-mail: yifanzang@outlook.com

[1]Faculty of Economics and Management, Communication University of China, Beijing, China

Abstract—This paper focuses on the impact of exit threat of non-controlling majority shareholders on the level of change of cash dividends of enterprises, using the data of Chinese listed companies from 2006 to 2015 as a sample to conduct an empirical study. The results show that: (1) Non-controlling majority shareholders can play a supervisory role over management and controlling shareholders through the governance mechanism of exit threat, promoting the improvement of the level of cash dividends in the current year and adjusting the current cash dividend policy which is not conducive to their own interests. (2) Institutional investors have more expertise and information, making the impact of their exit threat on cash dividend changes more significant. (3) Compared to SOEs, non-SOEs have a more significant governance effect on dividend policy due to the threat of exit by their non-controlling majority shareholders, as they are more influenced by share price movements in the capital market.

Keywords: Exit Threat; Institutional Investors; Nature of Property Rights; Cash Dividends

1. Introduction

As an important way to reward investors, cash dividends have an important impact on the development of the capital market. In China, there has been a low level of cash dividend payments or "iron chicken" companies not paying dividends, which has caused a lot of dissatisfaction among investors. The China Securities Regulatory Commission (CSRC) has issued several regulatory policies on dividends paid by listed companies since 2001 to address this issue at the macro level, encourage companies to pay appropriate cash dividends, better protect the interests of investors in the capital market, and enhance the capital market environment. At the micro level, however, Chinese shareholders' limited access to and ability to actively participate in governance, combined with the relatively serious one-share dominance phenomenon, has caused companies to commonly ignore the demand for cash dividends from significant shareholders and investors, leading to generally low levels of cash dividend payments. Therefore, to protect their interests, non-controlling large shareholders require more workable governance access.

With the increased liquidity in capital markets, academics have proposed a new path of large shareholder governance called "exit threat governance", a theory of governance that argues that large shareholders, as informed sources of information within the firm, can influence management decisions by actually or implicitly selling their shares and depressing the firm's stock price, i.e. through this risk of share price declines can discipline management behaviour and improve corporate governance (Palmiter [12], 2001; Edmans and Manso [5], 2011). As a governance

BDEIM 2022, December 02-03, Zhengzhou, People's Republic of China

DOI 10.4108/eai.2-12-2022.2328859

approach, the threat of exit can also be used to affect a company's dividend policy, acting as an effective check on listed companies' non-dividend behavior.

However, existing research has not fully investigated how the governance mechanism of exit threat affects the cash dividend payout. Based on this, this paper investigates the heterogeneous outcomes produced by this impact mechanism in the context of investor type and nature of ownership, as well as the impact of exit threat by non-controlling shareholders on the change of corporate cash dividend payout. Our study contributes to the current literature by exploring the influence of the threat of exit by non-controlling majority shareholders on the change of corporate cash dividend payout from the standpoint of corporate governance systems, which also provides new ideas to address the problem of low cash dividend payout in China. In addition, this paper places the study in the unique scenario of Chinese firms not paying dividends, highlights the governance effect of exit threat governance on cash dividend policy, and further refines the mechanism of the effect of exit threat on corporate financial decisions by non-controlling majority shareholders.

2. Theoretical Analysis and Research Hypothesis

The existing literature considers two distinct effects of of exit threats. Specifically, the threat of exit is effective in governing "bad" governance issues. A "bad" matter is a project that has negative cash flow, but which generates private profit for the manager (Admati [1], 2009). For example, the threat of exit can improve the quality of financial reporting (Dou [4], 2018), inhibit controlling shareholder self-interest, and reduce agency costs (Fang [7], 2014) and improve the efficiency of corporate investment (Sun [13], 2021). However, the threat of exit may not have a governance effect or may even have a negative effect on "good" governance, where "good" governance refers to projects that are cash flow positive but may not generate private profit for the manager or even harm his private profit (Admati [1], 2009). Overall, exit threat governance can be effective in disciplining the behavior of management and major shareholders.

2.1 Non-controlling majority shareholder exit threat governance mechanism and corporate cash dividend policy

As an informed source of internal corporate information, the "exit" of a non-controlling majority shareholder can convey adverse signals to the capital market about a company's declining value, causing non-informed investors to adopt a short-selling strategy, resulting in a decline or even a collapse in the company's stock price. The threat of exit, even if the majority shareholder does not actually exit, is sufficient to push the controlling shareholder to adjust its current financial decisions that are detrimental to the interests of the majority shareholder (Hope [9], 2017). At the same time, when formulating dividend payment policies, companies opt to pay cash dividends to satisfy the needs of non-controlling shareholders. By returning the free cash flow produced by the company's operations to the shareholders themselves, cash dividends can mitigate the conflict of interest between controlling and non-controlling shareholders (Porta [11], 2000), and send good signals to the capital market about expected future earnings to promote the company's appreciation to maintain the company's share price (Bhattacharya [2], 1979, Jensen [10], 1986). Therefore, the threat of exit as a form of governance can also be used to affect a company's dividend policy. Based on the above analysis, we can propose hypothesis 1.

H1: The threat of exit by non-controlling majority shareholders promotes the level of cash dividend payout by the company, i.e., the threat of exit by non-controlling majority shareholders is positively related to the level of cash dividend payout by the company.

2.2 The moderating effect of investor type

The behavior and information of different shareholders also vary considerably, with institutional investors being more professional and more active in governance than other investors. Compared with general investors, institutional investors have more professional advantages in data collection and analysis of issues and are better able to identify signals on company operation, governance and dividends, and make them public through some channels, which gives institutional investors a stronger voice. At the same time, as dividends are an important way of giving back to investors, institutional investors, with a higher shareholding, will take the initiative to collect information about the company and participate in corporate governance out of their interest. They will also look for cash dividends from publicly traded companies to limit management's use of "public power for private use" and other violations against other investors based on information asymmetry (Porta [11], 2000). Based on the above analysis, hypothesis 2 of this paper is proposed.

H2: Institutional investors holding shares as non-controlling majority shareholders can positively moderate the relationship between the threat of exit and the level of cash dividends paid by the company.

2.3 The moderating effect of the nature of the property rights of the enterprise

The governance effect of the threat of exit by non-controlling shareholders and the implementation of corporate cash dividend policies also depend on the nature of the ownership of the company to some extent, as there are differences in the governance structure and business environment of companies of different nature. Specifically, for state-owned enterprises (SOEs), in addition to economic interests, their business objectives also include political goals such as regulating the national economy and promoting social employment, and they have a more hierarchical chain of principals and agent, making the problem of "owner deficit" more serious (Hou [8], 2017). Therefore, shareholders and management of SOEs are less affected by the threat of exit by non-controlling shareholders, and their use of free cash flow is subject to government intervention. Moreover, with lower financing costs and abundant funding channels, state-owned enterprises are less susceptible to marketization and have a lower preference for paying cash dividends. In contrast, the business objectives of non-state enterprises are primarily oriented towards economic interests, and their management is under greater threat of a fall in share price caused by the exit signals from non-controlling shareholders. In addition, non-state enterprises face stricter conditions in the credit market and have more limited access to funding, which mainly from individuals and banks, so they are more inclined to pay cash dividends to signal good business and obtain more capital investment (Cullinan [3], 2016). Based on the above elaboration, hypothesis 3 of this paper is proposed.

H3: The relationship between the threat of exit by non-controlling shareholders and the level of cash dividends paid out by firms is more significant in non-state-owned firms compared to state-owned firms.

3. Research Design

3.1 Data sources and sample selection

The sample in this paper is selected from the CSMAR database of listed companies from 2006-2015 and the sample is screened as follows: (1) Exclude the sample of listed companies in the financial and real estate sectors; (2) Exclude the sample of companies with the trading status of ST and PT during the sample period; (3) Exclude the sample of companies with missing data of relevant data; (4) To avoid the effect of extreme values, 1% and 99% winsorize was applied to all continuous variables. The final sample of 11,602 observations was obtained.

3.2 Variable measurement

3.2.1 Dependent variable

This paper uses the change in cash dividends (Dividend) as the dependent variable and is measured by the change in pre-tax cash dividends per share paid in the current year compared to pre-tax cash dividends per share in the previous year.

3.2.2 Independent variable

This paper draws on Dou [4] et al. (2018) to construct a model to measure the exit threat of non-controlling majority shareholders (Exit) using the cross-product of stock liquidity and non-controlling majority shareholder equity concentration, with the econometric model shown in equation (1).

$$Exit = Turnover \times Bhcomp_{i,t} \tag{1}$$

Stock liquidity (Turnover) is the average daily stock turnover rate of outstanding shares. This variable takes the value of 1 when the average daily turnover rate of a company is greater than the median daily turnover rate of the same industry in the current year, otherwise it is 0.

For the ownership concentration of non-controlling majority shareholders (Bhcomp), this paper defines shareholders with shareholdings in the range of 5% to 50% as non-controlling shareholders regarding the provisions of the Company Law and measures the equity concentration of non-controlling majority shareholders using the Herfindahl index model, the equation for which is shown below.

$$Bhcomp_{i,t} = -1 \cdot \sum_{k=1}^{n} \left(\frac{Block_{i,t,k}}{Block_{i,t}} \right)^2 \tag{2}$$

3.2.3 Moderator

This paper has two moderating variables: institutional investor (Inst) and nature of ownership (Soe), which are calculated as:

Institutional investors (Inst): 1 if the shareholding of institutional investors is greater than 5%, 0 otherwise.

Nature of ownership (Soe): State-owned enterprises take the value of 1, and others take the value of 0.

3.2.4 Control variable

This paper chooses control variables for the financial features, the kind of ownership, and the characteristics of the board of directors refer to the existing literature. Table 1 provides a summary of the significant variables discussed in this study as well as the control variables.

Table 1. Description of variables

Variable type	Variable symbol	Variable name	Variable definition
Dependent variable	Dividend	Change in cash dividend	Cash dividends per share before tax paid in the year - Cash dividends per share before tax paid in the previous year
Independent variable	Exit	Non-controlling majority shareholder exit threat	Competitive shareholder environment × stock liquidity
	Bhcomp	Ownership Concentration	Concentration of non-controlling majority shareholders as measured by the Herfindahl Index
	Turnover	Stock liquidity	Average daily turnover rate of listed companies during the year
Moderator	Inst	Institutional Investor Holdings	Takes a value of 1 if the institutional investor's shareholding is greater than 5%, otherwise 0
	Soe	Nature of property	State-owned enterprises take a value of 1, others 0
Control variable	Size	Company size	Natural logarithm of the total assets
	Growth	Growth	Sales growth rate of the company for the year
	Age	Company age	Calculated as the natural logarithm of the year the company was listed plus 1
	RDInten	R&D intensity	R&D expenditure/total assets, takes a value of 0 if missing
	Lev	Company leverage	Total assets/Total liabilities
	MA	M&A expenses	M&A to total assets
	Top1	Shareholding of the largest shareholder	The ratio of the number of shares held by the largest shareholder to the total number of shares in the company, the value is 1 if the shareholding of the first

			largest shareholder is greater than 50%, otherwise it is 0
	lncash	Cash holding	Logarithm of cash and cash equivalents
	Ehold	Management shareholding	Takes a value of 1 if management shareholding exists, 0 otherwise
	Indep	Board independence	Number of independent directors as a percentage of board size
	Industry	Industry variables	Industry dummy variables, excluding financial sector

3.3 Model design and construction

This paper uses the following model for the main regression test.

$$Dividend_{i,t+1} = \alpha_0 + \alpha_1 Exit_{i,t} + \alpha_i \sum Control_{i,t} + \sum Industry + \sum Year \qquad (3)$$

4. Empirical Results and Analysis

4.1 Descriptive statistics

Table 2 reports the results of descriptive statistics for the main variables. As can be seen from the table, the mean value of the change in dividends (Dividend) for the sample companies was 0.013, with a minimum value of -0.45 and a maximum value of 0.6. The standard deviation of the change in cash dividends was 0.142, indicating an overall upward trend in the distribution of cash dividends in the sample companies over the period under examination and a wide variation in the level of change in cash dividends between companies. Ownership concentration (Bhcomp) has a mean value of -0.717, a median value of -0.671, indicating that equity is generally more concentrated among the non-controlling shareholders of the sample companies. The non-controlling majority shareholder exit threat (Exit) has a mean value of -0.348, a median value of -0.226 and a standard deviation of 0.395, demonstrating that there are considerable differences across the sample companies in the threat of non-controlling shareholder exit.

Table 2. Descriptive statistics for all variables

variable	N	mean	P50	sd	min	max
Dividend	26342	0.013	0	0.142	-0.45	0.6
Inst	26342	0.943	1	0.232	0	1
Soe	26342	0.384	0	0.486	0	1
Exit	26342	-0.348	-0.226	0.395	-1	0
Turnover	26342	0.509	1	0.5	0	1

Bhcomp	26342	-0.707	-0.671	0.274	-1	-0.115
Growth	25317	0.304	0.126	0.786	-0.645	6.101
RDInten	26177	0.017	0.012	0.019	0	0.09
Size	26341	21.97	21.8	1.245	19.6	25.93
Age	26342	8.636	7	6.825	-3	30
MA	26341	0.104	0	5.119	-0.001	768.2
lncash	26341	20.07	19.98	1.352	9.571	26.49
Lev	26341	0.429	0.41	1.223	-0.195	142.7
Top1	26342	0.168	0	0.374	0	1
Indep	26342	0.379	0.364	0.076	0	0.889
Ehold	26342	1	1	0	1	1

4.2 Regression analysis

4.2.1 Effects of exit threat of a non-controlling majority shareholder on corporate cash dividend policy

The findings of the regression between the change in cash dividends of enterprises and the governance of the threat of leave by non-controlling majority shareholders are shown in Table 3 Column (1) is a one-way regression of the exit threat (Exit) governance effect, which has a correlation coefficient of 0.035 and a t-value of -3.823 with a significant positive at the 1% level, demonstrating that, as anticipated, the exit threat of non-controlling majority shareholders encourages a rise in the size of corporate cash dividends. Columns (2) and (3) show the regression results with the inclusion of control variables and two-way fixed effects, respectively, and the results are consistent with the previous model, with the exit threat (Exit) variable being significantly positively correlated with the change in cash dividends (Dividend) at the 5% level, indicating that the threat of exit by non-controlling majority shareholders promotes an increase in the level of cash dividends for the firm. Hypothesis 1 of this paper was tested.

Furthermore, there is a significant positive relationship between stock liquidity (Turnover) and dividend changes (Dividend) under a two-way fixed effects model. This is because the increasingly liquid a firm's stock is, the more likely its non-controlling majority shareholders are to profit from the transaction and have a greater incentive to gather private information, and their threat of exit is more credible and has a greater impact on changes in a firm's cash dividends.

Table 3. Main effects regression results

	Dividend	Dividend	Dividend
	(1)	(2)	(3)
Exit	0.035***	0.020**	0.026**
	-3.823	-2.235	-2.159
Turnover	0.040***	0.018**	0.026***
	-5.467	-2.56	-2.663
Bhcomp	0	0.004	0.003
	(-0.018)	-0.648	-0.252
Growth		0.001	0.005**
	(-0.118)	(-1.633)	(-2.313)
N	12218	11602	11602
r2	0.005	0.005	0.154
ar2			-0.054

t statistics in parentheses

** p < 0.1, ** p < 0.05, *** p < 0.01*

4.2.2 The moderating effect of institutional investors' shareholdings on the threat of exit by non-controlling major shareholders and changes in corporate cash dividends

Table 4 presents the regression results for Hypothesis 2, the moderating effect of institutional investors as non-controlling majority shareholders on the threat of exit by non-controlling majority shareholders and changes in corporate cash dividends. Columns (1) and (3) show exit threat governance effect for companies with more than 5% ownership by institutional investors without and with year-fixed effects, respectively, while columns (2) and (4) show the impact for companies with no or less than 5% ownership by institutional investors. According to the regression results, at the 5% level, the threat of exit (Exit) is strongly correlated positively with the change in cash dividends (Dividend) for firms with 5% or more institutional investor ownership, regardless of whether the year-fixed effect is considered. In contrast, there is no significant relationship between exit threat (Exit) and change in cash dividends (Dividend) in companies where institutional investors do not hold shares or hold less than 5% of shares, suggesting that institutional investors, as non-controlling majority shareholders of companies, can enhance the facilitating effect of exit threat governance mechanism on the level of cash dividends of companies, testing hypothesis H2.

In addition, the regression results for the other variables show that stock liquidity (Turnover) can effectively facilitate the monitoring of corporate disclosure transparency by institutional investors in companies where they hold shares as non-controlling majority shareholders, making the impact of their exit threat on the change in cash dividends more significant.

Table 4. Regression results for the moderating effect of institutional investors

	Dividend	Dividend	Dividend	Dividend
	(1)	(2)	(3)	(4)
Exit	0.020**	0.102	0.028**	0.031

	-2.21	-1.436	-2.313	-0.3
Turnover	0.020***	0.05	0.027***	0.013
	-2.658	-1.068	-2.793	-0.19
Bhcomp	0.005	-0.076	0.007	-0.014
	-0.727	(-1.114)	-0.605	(-0.136)
Growth	0.001	0.012	0.004*	0.027*
Year	NO	NO	YES	YES
_cons	-0.039	-0.025	-0.173**	-0.886
	(-1.523)	(-0.115)	(-2.022)	(-0.900)
N	11002	600	11002	600
r2	0.004	0.021	0.166	0.395
ar2			-0.047	-0.101

t statistics in parentheses

** p < 0.1, ** p < 0.05, *** p < 0.01*

4.2.3 The Moderating Effect of the Nature of Ownership on the Threat of Exit by Non-controlling Major Shareholders and Changes in Corporate Cash Dividends

Table 5 presents the regression results of Hypothesis 3, i.e. the moderating effect of the nature of ownership on the threat of exit by non-controlling majority shareholders and the change in corporate cash dividends. The effects of the threat of exit by non-controlling majority shareholders and changes in corporate cash dividends are shown in columns (1) and (3) for state-owned enterprises, while the effects are shown in columns (2) and (4) for non-state-owned enterprises. It is evident that the threat of exit (Exit) and the change in cash dividends (Dividend) in non-state-owned enterprises are highly correlated at the 5% level, while the correlation was not shown in state-owned enterprises, regardless of whether the year fixed effect is considered. This demonstrates that the non-controlling shareholder exit threat governance effect is more significant in promoting higher levels of cash dividend payout in non-state-owned enterprises compared to state-owned enterprises, testing hypothesis 3.

Table 5. Regression results of the moderating effect of the nature of property rights

	Dividend	Dividend	Dividend	Dividend
	(1)	(2)	(3)	(4)
Exit	0.001	0.035**	0.009	0.038**
	-0.106	-2.478	-0.6	-2.024

Turnover	0.002	0.031***	0.011	0.037**
	-0.148	-2.92	-0.793	-2.572
Bhcomp	0.011	-0.002	0.006	-0.006
	-1.336	(-0.148)	-0.425	(-0.327)
_cons	-0.021	-0.064	-0.068	-0.441***
	(-0.739)	(-1.378)	(-0.629)	(-3.094)
N	5309	6293	5309	6293
r2	0.005	0.005	0.112	0.182
ar2			-0.074	-0.073

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

4.3 Robustness tests

This paper performs robustness checks by replacing the independent variables. The binary variable Turnover_y is constructed by replacing the measure of stock liquidity (Turnover) with a grouping by year and industry and taking a value of 1 when the average daily turnover rate of a company is above the median of the group and 0 vice versa, and bringing it into the original regression model for testing. The regression results are shown in Table 6. The findings are generally consistent with the main regression, indicating that the findings of this paper are robust.

Table 6. Robustness tests (replacing stock liquidity variables)

	Dividend	Dividend
	(1)	(2)
Exit	0.023***	0.024**
	-2.603	-2.036
Turnover_y	0.023***	0.026***
	-3.174	-2.753
Bhcomp	0.003	0.004
	-0.409	-0.384
Year	NO	YES

_cons	-0.058**	-0.185**
	(-2.129)	(-2.175)
N	11602	11602
r2	0.004	0.154
ar2		-0.053

t statistics in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

5. Conclusion

This paper explores the impact of the threat of exit by non-controlling majority shareholders on the movement of corporate cash dividends based on the analysis of data from listed companies in China from 2006-2015. The results show that: Firstly, non-controlling majority shareholders can play a good governance effect on management and controlling shareholders by exiting the threatened governance machine, adjusting the current cash dividend policy that is detrimental to their own interests and promoting a higher level of cash dividends for the year. Secondly, the moderating effect of introducing institutional investors as non-controlling majority shareholders' shareholdings was found to be effective in facilitating their monitoring of corporate disclosure transparency, making the threat of their exit more significant on the movement of cash dividends. In addition, considering the nature of the firm's ownership, the contribution of non-controlling shareholders' withdrawal from threatening governance to increasing the level of cash dividend payout is more significant for non-state-owned enterprises compared to state owned firms due to their greater exposure to share price movements in the capital market, a finding that still holds after robustness testing.

Based on the above findings, this paper makes the following recommendations. From the company's perspective, the company should fully mobilise non-controlling shareholders, especially institutional investors, to participate in corporate governance and improve the corporate governance system by increasing the voice of non-controlling shareholders in the formulation of corporate decisions, as well as their influence on controlling shareholders in terms of checks and balances and exit threats. From the regulator's point of view, it is important to safeguard the legitimate rights and interests of small and medium-sized investors, such as non-controlling shareholders, as well as to tighten up oversight of listed companies' cash dividend distribution policies to respect their autonomy in making decisions. And institutional investors ought to be encouraged to actively take part in corporate governance and fully utilize their monitoring position. Finally, in the current situation where China's corporate governance mechanism is still imperfect, increasing share liquidity and maximizing its beneficial effects on cash dividend policy can also improve the exit threat governance effect of non-controlling shareholders.

References

[1] Admati, A. R., & Pfleiderer, P. (2009). The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice. The Review of Financial Studies, 22(7): 2645–2685.

[2] Bhattacharya, S. (1979). Imperfect Information, Dividend Policy, and "The Bird in the Hand" Fallacy. The Bell Journal of Economics, 10(1): 259–270.

[3] Cullinan, C. , Zhang, J. , & Wang, F. , et al. (2016). Loan guarantees and the cost of debt: evidence from china. Applied Economics, 48(38): 3626-3643

[4] Dou, Y., Hope, O., Thomas, W., & Zou, Y. (2018). Blockholder Exit Threats and Financial Reporting Quality. CONTEMPORARY ACCOUNTING RESEARCH, 35(2): 1004–1028.

[5] Edmans, A., & Manso, G. (2011). Governance Through Trading and Intervention: A Theory of Multiple Blockholders. The Review of Financial Studies, 24(7): 2395–2428.

[6] Edmans, A., Fang, V. W., & Zur, E. (2013). The Effect of Liquidity on Governance. The Review of Financial Studies, 26(6): 1443–1482.

[7] Fang, V., Tian, X., & Tice, S. (2014). Does Stock Liquidity Enhance or Impede Firm Innovation? JOURNAL OF FINANCE, 69(5): 2085–2125.

[8] Li, G., Hou, Q., & Zhang, J. (2017) Government subsidies and corporate investment efficiency - An empirical analysis based on the Chinese institutional context. Audit and Economic Research, (04): 74-82.

[9] Hope, O. K., Wu, H., Zhao, W. (2017). Blockholder Exit Threats in the Presence of Private Benefifits of Control. Review of Accounting Studies, 22(2): 873-902.

[10] Jensen, M. C. (1986). Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers.American Economic Review, American Economic Association, 76(2): 323-329.

[11] Porta, R. L., Lopez-De-Silanes, F., & Vishny, S. (2000). Agency problems and dividend policies around the world. Journal of Finance, 55(1): 1-33.

[12] Palmiter, A. (2001). Mutual Fund Voting of Portfolio Shares: Why Not Disclose? Cardozo L. Rev., 23(4): 1419–1491.

[13] Sun, L., Phan, H. V., & Simpson, T. Financial Review. (2021). Blockholder exit threats and corporate cash holdings. Financial Review. https://ssrn.com/abstract=3862920