

# Unraveling the dividend puzzle: A field experiment

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Discussed by Xiumin Martin

# Summary

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- Horse race study on which of the four dividend theories apply to Chinese firms.
  - Agency
  - Signaling
  - Tax
  - A bird in hand
- Field experiment

# Summary

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- Findings:
  - Agency costs theory is supported
  - Results are stronger for weakly governed and opaque firms.

# Overall assessment

Ellahie and Kaplan (2021, JAR)

**TABLE 1**  
*Sample and Key Descriptive Statistics*

No.	Country	<i>Institutional Quality</i> (Normalized)	<i>Speed of Adjustment</i> (SOA)	<i>Gross Payout SOA</i>	<i>POS-NEG SOA</i>	<i>Median Payout Ratio</i>	Number of Dividend-Paying Firms
1	Japan	0.76	0.28	0.38	0.22	0.27	4,538
2	USA	0.90	0.27	0.50	0.21	0.38	4,285
3	China	0.38	0.68	0.66	0.05	0.31	2,525
4	United Kingdom	0.98	0.30	0.40	0.06	0.46	2,178
5	India	0.42	0.49	0.53	0.05	0.20	1,735

The questions are important.

Dividend payout is volatile, and thus has a greater potential for testing dividend theories.

# Comments

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- Background on payout policies in China
- Experimental design
- Mechanisms
- Empirical analysis
- External validity

# Comment

## Background of dividend policies in China

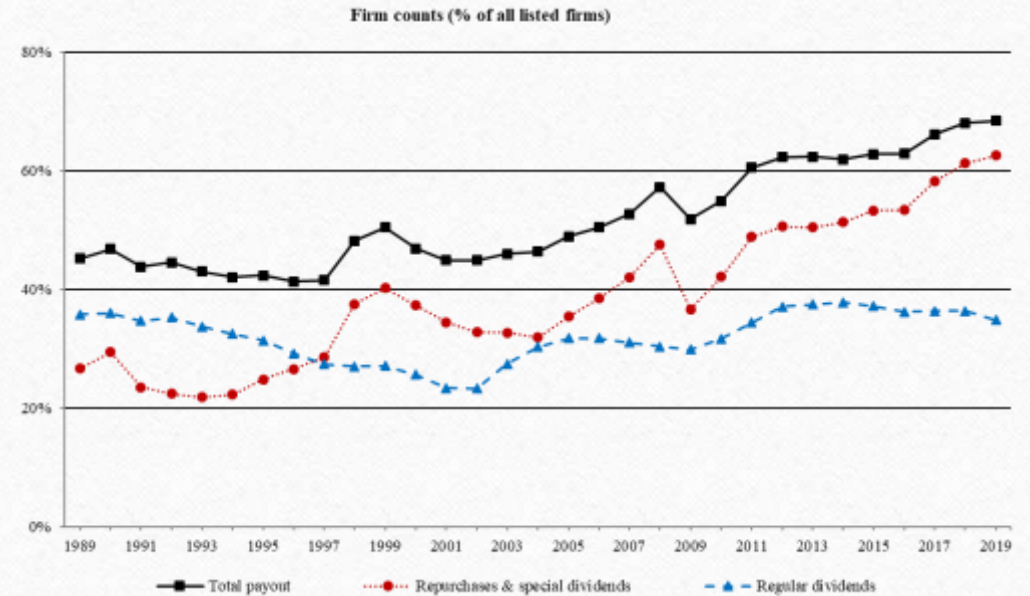
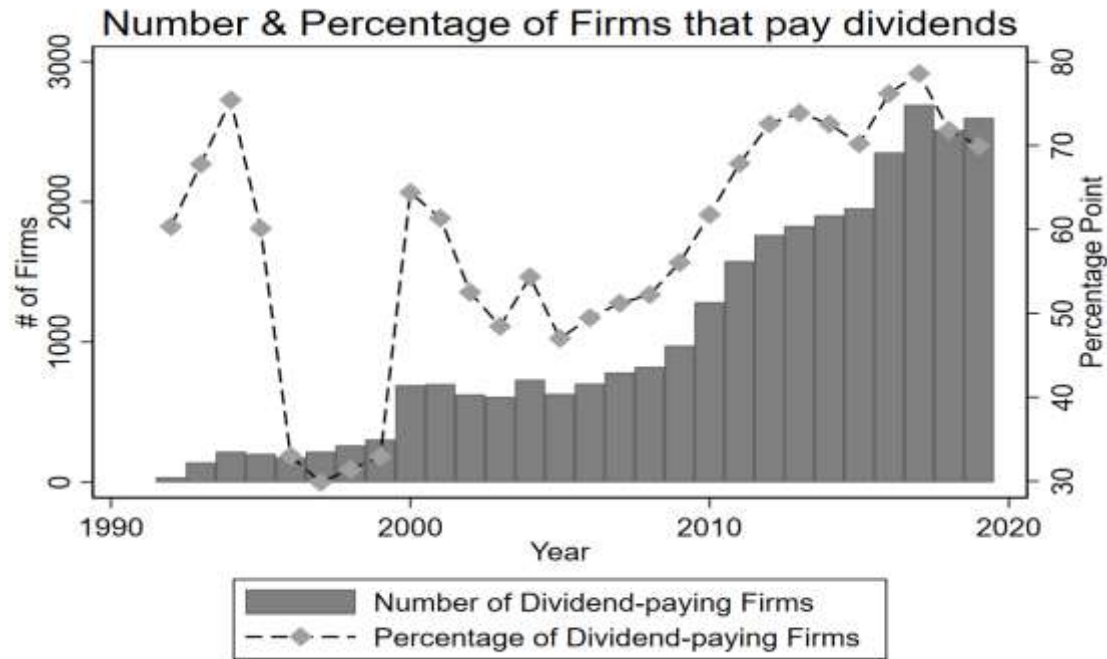
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# Dividend regulation in China



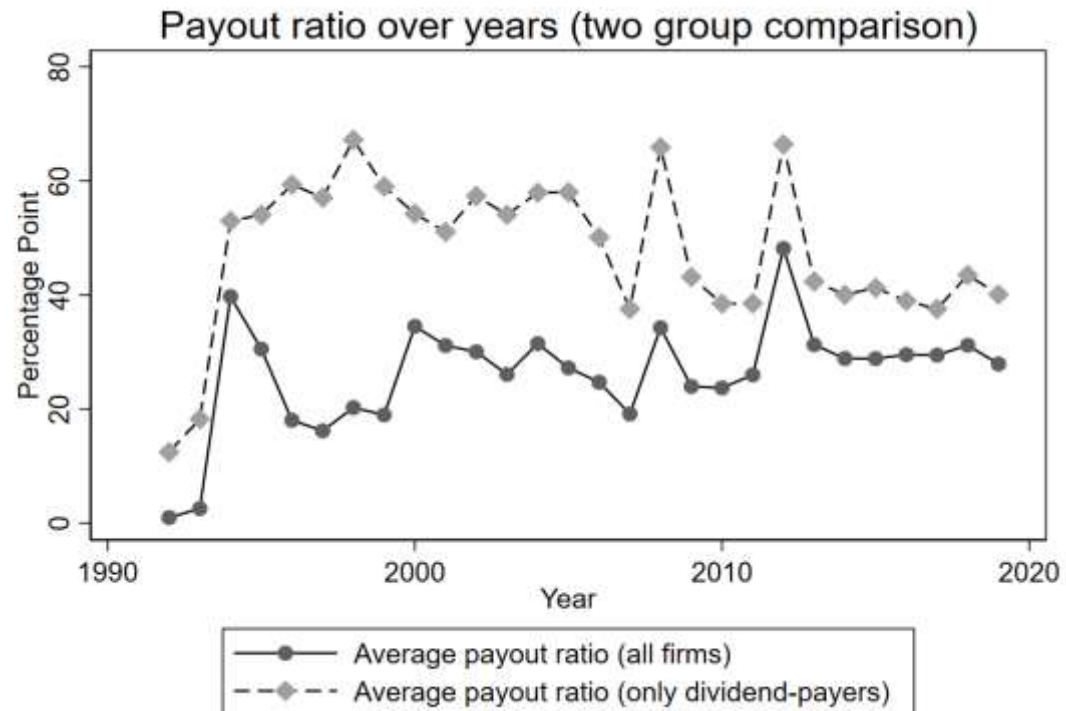
- Chen (2014, Finance Research)  
Firm dividend policy is largely shaped by government policy.
- Dividend measure should use the average distributable earnings as the deflator for robustness check.

# Dividend policy in China





# Dividend policy in China



## Payout ratio:

dividend amount / net profit  
attributable to parent company

# Literature on dividend policy in China

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- Agency theory
  - Chen et al. (2012, RFS)
  - Agency costs: Split share reform reduces cash holdings and increase dividend payout.
- Signal
  - Wang and Wang (2014, Economics Research)
  - Signaling based on small IPO firms.
- Tax

# Suggestion 1

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- More discussion on
  - The evolution of dividend regulation in China;
  - Literature on payout based on Chinese firms

Will provide a backdrop for the current study.

# Comment 2

Does the treatment only capture what the theory says?

Appendix Table 3: Theory and theory + call treatment templates (translated from Chinese)

Theory	Theory treatment	Theory + call treatments (call for an <i>increase</i> in dividends)	Theory + call treatments (call for <i>initiating</i> dividends)
Agency theory	A firm's managers are more likely to overinvest and overspend when the firm has too much cash. Reducing its cash holding may improve shareholder value.	A firm's managers are more likely to overinvest and overspend when the firm has too much cash. Reducing its cash holding may improve shareholder value. Should the firm increase cash dividends?	A firm's managers are more likely to overinvest and overspend when the firm has too much cash. Reducing its cash holding may improve shareholder value. Should the firm start paying cash dividends?
Bird-in-hand	Relative to capital gains that come with share price changes and fluctuate from time to time, I like cash dividends because they give me a sense of certainty.	Relative to capital gains that come with share price changes and fluctuate from time to time, I like cash dividends because they give me a sense of certainty. Should the firm increase its cash dividends?	Relative to capital gains that come with share price changes and fluctuate from time to time, I like cash dividends because they give me a sense of certainty. Should the firm start paying cash dividends?

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- The pronoun used in agency theory differs from other treatment messages.
  - "I" represents one individual (3 treatments);
  - "A firm" represents the average investor (Agency theory treatment).

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2. How do “Theory +call” differ fundamentally from “theory”?

- Theory messages are not neutral;

# Suggestion 2

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1. How to fix?  
Change "agency theory" treatment to:

"I believe the firm overinvests and overspends as it has too much cash. Reducing its cash holding may improve shareholder value."

# Suggestion 2

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1. How to fix?  
Or change the wording of the treatment message for other three theories to:

“.... Investors (⊕) like.....”



# Comment 3

## Mechanisms

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Phone calls, emails, and text msgs

- What are the response rates?
- What are the email addresses used? Personal or universities'?
- How did the RA introduce himself/herself in the call?

# Comment 4

## Empirical analysis

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### Agency cost proxies

- Executive pay
- Independent directors
- Analyst coverage
- Institutional ownership

In China, agency costs -> minority and majority shareholders-> Measure of related party transactions

# Comment 5

## External validity and caveat

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- Has a broad implication for countries with weak investor protection institutions.
- The insignificant results can be due to small sample size.

# Conclusion

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- Well done
- An important topic
- Provide more background of Chinese firms dividend policy.
- Consider the possibility that the wording of the message rather than the underlying theory causes the response.