

**Private Placements, Cash Dividends and Interests Transfer:**

**Empirical Evidence from Chinese Listed Firms<sup>☆</sup>**

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Empirical Evidence from Chinese Listed Firms**

**Abstract:** In this paper, the relationship between private placements of common stocks and cash dividends for Chinese listed firms is investigated. It finds that Chinese listed firms pay more cash dividends after private placements than do those that are not involved in placements. Firms with large shareholders participating in private placements pay more cash dividends than those without large shareholders participation. These results indicate that the firms controlled by large shareholders have a high propensity for interests transfer in their cash dividend policies.

**Key Words:** Private Placements, Cash Dividends, Interests Transfer, Large Shareholders

## **1. Introduction**

As a flexible and elastic way of equity refinancing, private placements have come to serve a function in resource allocation in capital markets. Since the 1990s, private placements have been widely used in public equity markets, such as those in the U.K. and U.S.

On May 8, 2006, the China Securities Regulatory Commission (CSRC) issued the “Guidance for share issuance”, which set out the foundation of private placements. Private placements thus become an official part of equity refinancing in the capital markets in China. Since then, ever-growing numbers of private placements have become one of the most important parts of equity refinancing in China, and are currently used more often than rights offering or public offerings by Chinese listed firms.

Despite the prevalence of private placements, controlling shareholders and actual controllers of Chinese listed firms in private placements are vulnerable to market risk and price fluctuations. Consequently, the controlling shareholders and actual controllers are motivated to seek additional interests to compensate for the market risk and potential losses. A few recent studies have shown that there is interests transfer behavior operating in the issuance process of private placements (Cronqvist & Nilsson, 2005; Baek et al., 2006). Today, the Chinese stock market is an emerging market, and private placements are in a rapid growth stage in China. Presently, legal regulation, supervision and examination policies are inadequate. Thus, the unique Chinese setting of equity refinancing provides some space for interests transfer for the firms’ controlling shareholders through these private placements. The institutional background and high ownership concentration, in particular, also provide an institutional setting in which the issuing objects of private placements are seeking additional benefits to compensate for the associated risk. These factors may lead to more serious interests transfer behavior in Chinese listed firms, in private placements, than in firms in other countries.

“Interests transfer” is defined as controlling shareholders transferring assets and interests out of an enterprise to pursue private benefits (Johnson et al., 2000). It expropriates the interests of small shareholders or external investors. Most studies have shown that cash dividends can alleviate the agency problem between large shareholders and small shareholders (Faccio et al., 2001; Klaus et al., 2003). However, because of the special institutional setting in China and the inadequacy of the relevant laws and regulations, controlling shareholders may use cash dividends to expropriate the interests of small shareholders. Indeed, according to prior studies, a cash dividend has been widely used as an interests transfer tool by large shareholders to expropriate the interests of small shareholders in China (Yuan, 2001; Lee et al., 2002; Chen et al., 2003; Chen et al., 2003; Xiao, 2005; Deng et al., 2007; Wang et al., 2007; Xu et al., 2009).

Generally, Chinese listed firms raise large amounts of funds using equity refinancing to support new projects or expand the business operations. However, this refinancing method has also been used as an important tool by controlling shareholders to pursue their private benefits. Large shareholders then expropriate the interests of small shareholders through cash dividends (Liu et al., 2003; Zhang et al., 2005; Yu et al., 2010; Deng et al., 2013).

Prior studies have shown that large shareholders transfer the interests to themselves through high offer price discount rates, long suspension of listings, injection of bad assets, and earnings management (Chen et al., 2008; Wang et al., 2010; Wu et al., 2010; Zhang et al., 2008; Zhang et al., 2009; Zhang et al., 2010; Zhang, 2010). In such cases, the Chinese listed firms immediately pay cash dividends after the placement. By paying the cash dividends, large shareholders can transfer a larger proportion of the available funds out of the firms. On the one hand, this reduces the amount of the funds available to support a new project or expand the scope of operations. Thus, there is a conflict with the general refinancing purpose of such private placements. On the other hand, if Chinese listed firms have sufficient cash to

pay a cash dividend, then it raises the question as to why they place shares through private placements to large shareholders in the first place. Indeed, it seems doubtful that the real motivation of the Chinese listed firms in such refinancing lies in raising capital for new projects or expanding the scope of operations. One possible reason is that they transfer interests out of the firms through private placements or improve actual control rights. This process is more beneficial for large shareholders. Via private placements and cash dividend payment meshing with each other after the placement, large shareholders can increase their shareholdings without paying the full market price. Chinese listed firms use extant cash flow to compensate for the risk of their shareholdings. The firms may share in the benefits of placing shares that do not bring real income or appreciation in current asset values. Accordingly, small shareholders' interests decrease. The essence of this behavior can be regarded as an "interests transfer".

This paper extends previous studies on private placements as follows. First, it provides empirical evidence of the interests transfer problem, caused by cash dividends after a placement, which differs from Zhu et al. (2008), who illustrate the interests transfer phenomenon of a company using a low offer price along with a high cash dividend payment. Large shareholders transfer the interests, in cash dividends, to their pockets after the placement. Thus, they expropriate the interests of small shareholders. Second, the paper extends the interests transfer topic on private placements to consider dividend policy after a placement. Most prior studies on interests transfer focus on effects before or during the issuance process of private placements, including the mechanism of high offer price discount rate, long suspension of listing, injection of bad assets, and earnings management. Third, results of this study have empirical implications in the refinancing of private placements. Furthermore, it confirms that the refinancing of private placements has become a tool for controlling shareholders to pursue their private benefits and for large shareholders to expropriate the interests of small shareholders using cash dividends after a

placement.

The rest of this paper is organized as follows. Section 2 provides a literature review and hypothesis development. Section 3 explains the research design. Section 4 presents the main empirical analysis. The final section provides conclusions.

## **2. Related literature and hypothesis development**

### *2.1. Related literature*

La Porta et al. (1999) in a ground-breaking study document that ownership is commonly concentrated around the world, excluding the U.K. and U.S. Although ownership concentration avoids the agency problem between large shareholders and managers under ownership dispersion, in fact, it increases the opportunities for large shareholders to seek private benefits of control. Thus, it actually produces an additional agency problem between large shareholders and small shareholders (Shleifer et al., 1997). Johnson et al. (2000) describe this activity as “interests transfer” or “tunneling”. They suggest that this is a behavior of large shareholders, expropriating the interests of small shareholders. Other studies have explored the interests transfer problem of large shareholders from various perspectives, such as dividend policy (La Porta et al., 2000; Faccio et al., 2001), related transactions (Betrand et al., 2002; Bae et al., 2002; Cheung et al., 2006), and debt financing (Faccio et al., 2003; Aslan et al., 2008). Some studies have found that there is an interests transfer problem with large shareholders expropriating the interests of small shareholders in the issuance process of private placements. Cronqvist and Nilsson (2005) investigate the influence of control rights on equity refinancing in Sweden, finding that family controlled enterprises prefer to directionally place shares to family controlled members or to vote shares lower in order to avoid dilution of control rights. Baek et al. (2006) analyze the phenomenon of enterprise groups in Korea conducting interests transfer via private placements. They find that there is an interests transfer problem of controlling shareholders transferring benefits in private placements, with

the major issues including diluting the equity of minority shareholders and a higher offer price discount rate for shares to the controlling shareholders.

In China, the stock market has developed along with the reform of state-owned enterprises. The ownership of Chinese listed firms is highly concentrated, so that there is a pattern of large shareholders and small shareholders. Due to the inadequacy of relevant laws on investor protection and weak self-discipline, the agency problem between large shareholders and small shareholders is very serious. It has attracted ever-increasing attention around the world. Prior research have studied the interests transfer problem of large shareholders from different viewpoints, such as cash dividends (Yuan, 2001; Lee et al., 2002; Chen et al., 2003; Chen et al., 2003; Xiao, 2005; Deng et al., 2007; Yu et al., 2010; Su et al., 2014), related transactions (Li et al., 2005), and funds appropriation (Li et al., 2004). The agency problem of large shareholders has been discussed in the issuance process of private placements and interests transfer. First, there is an interests transfer problem in higher offer price discount rate in the issuance process of private placements. It has been found that the offer price, buying investors' identity, and shareholdings of large shareholders are associated (Chen et al., 2007; Zhang et al., 2008; Wang et al., 2010). Second, there is an interests transfer problem in that large shareholders choose a lower offer price through the choice of market timing and trade suspension to control the stock price before the placement. It has been found that large shareholders eventually realize interests transfer to themselves using a long trade suspension before the placement, pushing the stock price before the benchmark date, and placing shares to themselves at a lower offer price (Zhu et al., 2008; Wu et al., 2010). Third, there is an interests transfer problem when Chinese listed firms inject bad assets, manage earnings, and transfer wealth (Zhang et al., 2008; Zhang et al., 2009; Zhang et al., 2010; Zhang, 2010; Wang et al., 2010). Fourth, there is an interests coordination problem between large shareholders and small shareholders in the issuance process of private placements. Zhu et al. (2008) study the case of Yunnan Chihong Zinc & Germanium

Co., Ltd., and suggest that the issuance process of a private placement with a lower offer price is coordinated with a cash dividend payment by this company.

Overall, Chinese studies on the interests transfer problem in private placements have focused mainly on the lower offer price, long suspension of listing, injection of bad assets, and earnings management before or during the issuance process in private placements. However, few investigations have been reported on private placements in coordination with cash dividends from the perspective of the cash dividend after the placement.

## *2.2. Hypothesis development*

Cash dividends play a key role in alleviating the agency problem between large shareholders and small shareholders (Faccio, 2001; Klaus, 2003). In developed countries, laws for investor protection and supervision mechanisms are well established; small shareholders may force management to distribute cash dividends to meet the cash demands of investors in the absence of a profitable investment project (Johnson et al., 2000). In China, investor protection laws, however, have not been fully established. Internal shareholders can reduce free cash flows by cash dividend payments, expropriating the interests of external shareholders. It has found that, for Chinese listed firms, the cash dividend policy precludes some investors from obtaining a fair share of the benefits, and that large shareholders often expropriate the interests of small shareholders through cash dividends after equity refinancing (Yuan, 2001; Lee et al., 2002; Chen et al., 2003; Chen et al., 2003; Xiao, 2005; Lu et al., 2005; Deng et al., 2007; Wang et al., 2007; Xu et al., 2009; Liu et al., 2003; Zhang et al., 2005; Yu et al., 2010). Given the profit-driven nature of controlling shareholders, they have a strong incentive to use any potential opportunity to maximize their benefits.

There are three main issues in the successful implementation of private placements that affect the dividend policies of Chinese listed firms. They are



described below.

First, compared with other refinancing mechanisms, large shareholders gain more private benefits by paying a cash dividend after a placement. This activity has an impact on small shareholders' interests. The interests of internal investors, such as large shareholders, can be affected by the market reaction. With regard to competing firms, firms in private placements are more dominant in terms of growth, profitability, and operating performance. Large shareholders increasing their shareholdings through private placements will gain in both the long and short term. They gain from their shareholdings increasing in the long term and gain additional compensation from cash dividends. Meanwhile, because the behavior pattern of external investors typically does not change much, the market reaction is good for the internal investors. It enables the compensation and prospective benefits of the public offerings to be shared by the market. However, the behavior pattern of external investors in a public offerings can easily change. As the uncertainty of the market reaction increases, the benefits uncertainty of the internal investors also increases.

Second, there is a hidden interests transfer with a cash dividend after a placement. Small shareholders, however, accept it readily. In the placement year, firms pay a cash dividend immediately, distributing their interest to all shareholders, with the result that the cash dividend payment is a seemingly legal public benefit. A generous dividend policy allows investors to gain some return on their investment. Large shareholders purchase new shares using cash or assets, and then put some of the money back in their pockets through the cash dividend, as part of the return on their investment. The cash dividend is distributed in accordance with share holdings. Both large shareholders and small shareholders gain some return on their investment. The large shareholders' increased shareholdings lead to a stronger control position without much extra cost. Small shareholders expect a return on their investment, even if it means a large shareholder gains a lot of cash through a cash dividend, but relative to retained earnings, small shareholders have not gained much (Gordon, 1961). In the

stock market, nevertheless, a cash dividend payment is equated with good performance. Firms paying cash dividends can enhance their good impression with regulators and the public. Thus, the choice of a cash dividend payment to gain private benefits of control also helps to establish a good image.

Third, relative to other refinancing mechanisms, the offer cost of a private placement is typically low. There is no requirement for profitability in private placements. Private placements provide more space for large shareholders' opportunistic behavior with regard to grabbing money. Private placements do not require paying a high offer cost. Moreover, it can be relatively flexible regarding large shareholders' payments, in that they can choose to inject assets, asset replacements, or cash. There is no limit on the cash flow to distribute. Usually, firms manipulate earnings management in the year preceding a placement (Zhang, 2010). After a placement, the firm directly improves the distribution proportion of cash dividends, which has been in retained earnings for one or more years before the placement.

For small shareholders, there is a self-learning mechanism, in theory, in that small shareholders can discover the tactics of large shareholders in expropriating their interests through studying and investigating firm behavior over the long term. Why then are small shareholders willing to hold shares in listed companies rather than selling them after they have uncovered the interests transfer tactics of large shareholders?

It is well known that if small shareholders do sell their shares en masse, then large shareholders would be expected to suffer larger damage to their benefits over the long term. Thus, large shareholders try to reduce interests transfer behavior in expropriating the interests of small shareholders. It also makes large shareholders and small shareholders form an equilibrium game regarding the small shareholders' benefits loss.

However, given the unique Chinese institutional background, massive selling is largely a useless threat. Several reasons support this argument. First, when interests

transfer becomes a general behavior, small shareholders are not in the game with a particular listed company but rather with the market. That is, they do not really have a better choice, and the only way out is to leave the market. Thus, they do not gain much benefit from selling their shares. Second, small shareholders tend to focus on short-term interests. It is better for them to gain their share of a cash dividend than nothing. Even if small shareholders expect that large shareholders will transfer interests through a cash dividend after a placement, they continue to hold their shares. Small shareholders' interests may be expropriated by a cash dividend after a placement, but it is not a complete failure, at least. Third, the demonstration effect causes small shareholders to have strong expectations of a capital gain. For small shareholders, they rely on the bid-ask spread in the secondary market to gain part of their investment return. Large shareholders purchasing common stock in private placements lead the market to believe that the listed companies have optimistic perspectives. The demonstration effect causes small shareholders to have favorable expectations of a stock price increase, so the motivation to sell en masse after a cash dividend payment and placement is not obvious, at least. Fourth, the actual effects of the self-learning mechanism depend more on market conditions, good or bad, and especially market transparency. The unique Chinese governance structure makes asymmetric information a serious issue, causing the self-learning mechanism for investors to malfunction (Shay, 2004). For those large shareholders purchasing common stock in private placements, the price of institutional investors purchasing common stock in private placements is higher than theirs. The profitability of the new stock is not guaranteed, and they also need to pay the illiquidity cost. Additionally, because the shares of the institutional investors are mostly social public shares, they bear pressure from fund holders to share bonuses, so that they expect more cash than common shareholders, and they especially hope that an immediate cash bonus will alleviate cash flow pressure from the stock falling in a bear market. Thus, institutional investors have a common interest with the large shareholders in a cash dividend.

Thus, to grab extra profits, large shareholders use favorable terms in private placements and then pay cash dividends after a placement. In this case, the first hypothesis proposed is:

**Hypothesis1.** Chinese listed firms pay more cash dividends after private placements than those that are not involved in placements.

In family enterprises, large shareholders prefer private placements rather than public offerings to maintain controlling benefits without the dilution of controlling rights (Cronqvist & Nilsson, 2005; Baek et al., 2006). Generally, ownership concentration is prevalent in China. It is difficult for small shareholders to effectively supervise the behavior of large shareholders. The large shareholders can manipulate the offer price and timing. Although institutional investors participate in private placements, some degree of conspiracy between the institutional investors and large shareholders seems reasonable. The laws of investor protection are not strong in China. The large shareholders' opportunistic behavior produces an interests transfer problem in private placements. Prior studies have shown that large shareholders transfer interests to themselves through high offer price discount rate, long suspension of listing, injection of bad assets, and earnings management (Chen et al., 2008; Wang et al., 2010; Wu et al., 2010; Zhang et al., 2008; Zhang et al., 2009; Zhang et al., 2010; Zhang, 2010).

Chinese listed firms recognize rights parity between large shareholders and small shareholders after the non-tradable reforms. The large and small shareholders' benefits begin to converge. The behavior of large shareholders in expropriating small shareholders begins to ease. With the advantages of the high ownership concentration, large shareholders can make their firms pay more cash dividends (Bradford et al., 2013).

When purchasing common stock in private placements, large shareholders are then restricted from selling their shares for at least three years. The longer this lock period is, the greater the risk is. In particular, the controlling shareholder cannot share

in an increasing stock price. They still face the market risk of price fluctuations in the lock period. The large shareholders cannot trade their shares temporarily. Other methods for transferring corporate resources suffer from strict regulations, via the market and law. Cash dividends after a placement are within the scope of legal control. For large shareholders, the impulse of control benefits induces them to choose cash dividend payments to expropriate the interests of small shareholders. Through cash dividends after a placement, large shareholders may recover, effectively, most of the cost of the equity in various ways, and also reduce their market risk and losses due price fluctuations during the lock period. The controlling rights of large shareholders are strengthened without fully paying the corresponding cost. Thus, the second hypothesis is as follows:

**Hypothesis2.** Firms with large shareholders participation in private placements pay more cash dividends than firms without large shareholders participation.

### **3. Research Design**

#### *3.1. Sample formation*

##### *3.1.1. The sample firms*

An initial sample of 438 private placements of common stocks by public firms during the period 2006 to 2009 on the Shanghai and Shenzhen stock exchanges is obtained from CSMAR and WIND database. Using a matching firms approach, the relationship between private placements and cash dividends for Chinese listed firms is examined. In order to avoid the confounding effect including initial public offerings, rights offering, public offerings and convertible bonds, the research sample is selected if it meets the following requirements:

1. The firms must have issued A-shares.
2. Financial companies are not included (e.g. Banks or Security Company).
3. The firms have not undergone a private placement three years before or after, and have not carried out a rights offering, public offerings, or a convertible bonds.

After screening private placements according to these criteria, a final sample containing 221 firms is determined.

### *3.1.2. Matching firms*

The purpose is to examine the cash dividend changes in Chinese listed firms because of private placements or large shareholders participating in private placements. Thus, a corresponding matching firm is sought for each sample firm to control for other factors that may influence cash dividend policies. The benchmark for selecting a matching firm is based on the previous year's data for the sample firm. The matching firm for each sample firm is selected based on:

1. In addition to meeting the conditions for the sample firm selection, the firm has not carried out a private placement, initial public offerings, rights offering, public offerings, or convertible bonds during the sample period, and there is no special treatment or particular transfer.

2. The firm is in the same industry with an asset size within 20% to 200% of the sample firm. Then, the firm picked is the one with profitability (the ratio of earnings before interest and taxes/the total assets) closest to the sample firm.

3. If unable to find the 'right' matching firm according to the second condition, the test is loosened to the firm's asset size being within 70% to 120% of the sample firm, and the firm picked is the one with profitability closest to the sample firm without considering its industry.

4. Candidate matching firms have not accessed the private placement market for three years before the placement and have not carried out a rights offering, public offerings, or convertible bonds.

According to the above selection criteria, excluding the missing value and extreme value firms, ultimately there are 416 firms which include 221 firms in private placements and 195 matching firms.

**Table 1**  
Yearly distribution of private placements.

	2006	2007	2008	2009	Total
Participant	13	42	53	34	142
Non-participant	11	30	16	22	79
Total	24	72	69	56	221

The sample of 221 private placements of common stocks by public firms during the period 2006 to 2009 on the Shanghai and Shenzhen stock exchanges is chosen.

### 3.2. Models and variables

In recent years, difference in difference method (DID)<sup>1</sup> has been widely used in testing the impact of the policy reform and effect, such as tax bill (Guber et al., 1994; Maki, 2001); labor law of disabilities and child labourer (Gruber, 2000; Jolls, 2004), and European drunken driving bill (Albalade, 2008). Chinese scholars also analyze the fee and tax reform (Zhou et al., 2005), economic efficiency of area delegating power (Shi et al., 2007), and economic effects of the value added tax transformation policy (Nie et al., 2007).

Private placements in China have increased gradually year by year (as is shown in table 1). There may be a cash dividend payment difference between before and after a placement. There may also be a cash dividend payment difference between the placement firms and those that are not involved in private placements<sup>2</sup>. This is similar to a “natural experiment”. The placement firms are used as a “treatment group”. Those are not involved in private placements are considered the “control group”. Thus, a model is created for the first hypothesis.

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<sup>1</sup> Difference in differences (sometimes “Difference-in-Differences”, “DID”) is a technique used in econometrics that measures the effect of a treatment at a given period in time. It is often used to measure the change induced by a particular treatment or event, though it may be subject to certain biases (mean reversion bias, etc.). In contrast to a within-subjects estimate of the treatment effect (that measures the difference in an outcome after and before treatment) or a between-subjects estimate of the treatment effect (that measures the difference in an outcome between the treatment and control groups), the DID estimator represents the difference between the pre-post, within-subjects differences of the treatment and control groups.

<sup>2</sup> The company does not conduct any equity refinancing. In that, the refinancing method has been used as a tool for controlling shareholders to pursue their private benefits and for large shareholders to expropriate the interests of small shareholders using cash dividends after a placement. So choosing the company that does not conduct any equity refinancing is as a “control group”, then examines how the private firm as a “treatment group” affects cash dividends. It makes the results of this paper to have the better arguments.

$$Dps_{it} = \beta_0 + \beta_1 pipe_{it} + \beta_2 X_{it} + \mu_t + \alpha_i \quad (1)$$

In Equation 1,  $Dps$  is a cash dividend payment per share, and  $Dpsjzc$  is a cash dividend payment ratio that is cash dividend per share/net assets per share. ‘Pipe’ is a dummy variable for private placements; in private placements, it is one, and in firms with no private placements, it is zero.  $X$  indicates the control vectors that affect a firm that pays a cash dividend. including: size is the natural logarithm of the total asset size of the firm on the end of the year; lev is the total liabilities/the total assets on the end of the year; roa is the earnings/the total assets on the end of the year; growth is the increment of the total assets on the end of the last year/the total assets on the end of the year; lc5 is (the first five large shareholders’ shareholding rate - the first large shareholder’ shareholding rate)/the first large shareholder’ shareholding rate; qdps is the cash dividend on the end of the last year; cash is the operating cash flow net per share on the end of last year; eps is earnings per share on the end of the last year.  $\mu_t$  is a timing dummy variable.  $Year_0$  is a timing dummy variable. When the placement year is one, and else is zero.  $Year_1$  is a timing dummy variable. When the first year of private placements is one, and else is zero.  $Year_2$  is a timing dummy variable. When the second year of private placements is one, and else is zero.  $Year_3$  is a timing dummy variable. When the third year of private placements is one, and else is zero.  $\alpha_i$  is a characteristic that does not change over time.

Similarly, to test the second hypothesis, another model is created<sup>3</sup>.

$$Dps_{it} = \beta_0 + \beta_1 participate_{it} + \beta_2 X_{it} + \mu_t + \alpha_i \quad (2)$$

In Equation 2, with the exception of the ‘participate’ and timing dummy variables, the variables are the same as in Equation 1. ‘Participate’ is a dummy variable for the firm whose large shareholder participates in private placements; when large

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<sup>3</sup> There are several reasons for using the difference in difference method again. First, private placements in China have increased gradually year by year; large shareholders participate in placements; so large shareholders participating in placements have also increased gradually year by year. Second, there is a corporate governance difference between before and after large shareholders participation. In addition, there is a cash dividend payment difference between large shareholders participating in private placements and those without large shareholders participation. So, the economic effects of the event can be identified. Finally, the difference in difference method may better reflect the cash dividend payment change with large shareholders participation.



shareholder participates in private placements, it is one, and where large shareholder does not participate, it is zero.  $\mu_t$  is a timing dummy variable.  $Year_0$  is a timing dummy variable. When the year of large shareholder participation is one, and else is zero.  $Year_1$  is a timing dummy variable. When the first year of large shareholder participation is one, and else is zero.  $Year_2$  is a timing dummy variable. When the second year of large shareholder participation is one, and else is zero.  $Year_3$  is a timing dummy variable. When the third year of large shareholder participation is one, and else is zero.

**Table 2**

Summary statistics.

This table reports the summary statistics of variables. Dps is a cash dividend payment per share, and Dpsjzc is a cash dividend payment ratio that is cash dividend per share/net assets per share. Pipe is a dummy variable for private placements; in private placements, it is one, and in firms with no private placements, it is zero. Participate is a dummy variable for the firm whose large shareholder participates in private placements; when large shareholder participates in private placements, it is one, and where large shareholder does not participate, it is zero. Size is the natural logarithm of the total asset size of the firm on the end of the year. Lev is the total liabilities/the total assets on the end of the year. Roa is the earnings/the total assets on the end of the year. Growth is the increment of the total assets on the end of the last year/the total assets on the end of the year. Lc5 is (the first five large shareholders' shareholding rate - the first large shareholder' shareholding rate)/the first large shareholder' shareholding rate. Qdps is the cash dividend on the end of the last year. Cash is the operating cash flow net per share on the end of last year. Eps is earnings per share on the end of the last year.

Variables	N	Mean	Std	Median	Minimum	Maximum
Dps	2490	0.0753	0.138	0.0100	0	1.868
Dpsjzc	2490	0.0226	0.0404	0.0028	0	0.534
pipe	2490	0.202	0.402	0	0	1
participate	1326	0.2353	0.4243	0	0	1
size	2490	19.67	0.754	19.57	17.99	23.77
lev	2490	0.528	0.198	0.532	0.0183	1.939
roa	2490	0.0256	0.0986	0.0284	-2.7463	0.5235
qdps	2490	0.0758	0.129	0.0177	0	1.672
growth	2490	0.781	0.733	0.616	0	10.18
lc5	2490	0.186	0.126	0.164	0.0002	0.572
cash	2490	0.0884	0.630	0.0248	-4.165	4.847
eps	2490	0.194	0.418	0.156	-3.007	3.700

### 3.3. Descriptive statistics

Table 2 presents that the mean Dps of cash dividend payment per share is 0.075 yuan, the maximum is 1.868 yuan, and the minimum is zero. The mean Dpsjzc of cash dividend payment ratio is 0.023, the maximum is 0.534, and the minimum is zero. This indicates that there are more differences among Chinese listed firms that pay cash dividends. Some firms paying cash dividends are relatively very high.

## 4. Empirical analysis

### 4.1. Univariate analysis

#### 4.1.1. Cash dividend payment and cash dividend payment ratio: the sample firms and the matching firms

Table 3 presents the changes between cash dividend payment and cash dividend payment ratio before and after the placement. From Table 3, we can see:

First, the mean Dps of cash dividend payment per share for two years before the placement is 0.0618 yuan; the mean Dps of cash dividend payment per share for two years after the placement is 0.1125 yuan. This difference is statistically significant ( $t=-4.220$ ). The mean Dpsjzc of cash dividend payment ratio for two years before the placement is 0.0165; the mean Dpsjzc of cash dividend payment ratio for two years after the placement is 0.0319. This difference is also statistically significant ( $t=-4.478$ ). Thus, there is a significant difference in cash dividends between before and after the placement; Chinese listed firms pay more cash dividends after a placement than before. Relative to the matching firms that have not carried out any refinancing, the mean Dps of cash dividend payment per share for the two years before the placement and two years after the placement are 0.0630 and 0.0704 yuan, respectively; the mean Dpsjzc of cash dividend payment ratio for the two years before the placement and two years after the placement are 0.0180 and 0.0209, respectively. These difference are not statistically significant ( $t=-0.635$  and  $t=-0.9245$ ). Thus, there is no significant difference in the matching firms paying cash dividends for two years before the placement and two years after the placement.

Second, the difference in difference method shows that the difference between the sample firms and the matching firms is statistically significant ( $t=-2.784$  and  $t=-2.846$ ). The sample firms paying cash dividends before and after the placement differ significantly with respect to the matching firms.

Third, the sample firms paying cash dividends and the matching firms before the placement are not significantly different (the difference of the mean Dps is 0.0012 yuan,  $t=0.119$ ; the difference of the mean Dpsjzc is -0.0015,  $t=-0.632$ ). However, there are more sample firms paying cash dividends after the placement than the matching firms (the difference of the mean Dps is 0.0421 yuan,  $t=3.086$ ; the difference of the mean Dpsjzc is 0.0110,  $t=2.691$ ). This indicates that before the placement the sample firms and matching firms paying cash dividends are not different, but they are significantly different after the placement. This proves tentatively our expectation of the first hypothesis. Thus, it will seem to be a tool for large shareholders to gain private benefits, rather than funds for new projects or to expand the scope of operations.

**Table 3**  
Sample firms and matching firms.

	Mean (Dps)			Mean (Dpsjzc)		
	Before placement	After placement	Difference	Before placement	After placement	Difference
Sample firm	0.0618	0.1125	-0.0507*** (-4.220)	0.0165	0.0319	-0.0154*** (-4.478)
Matching firm	0.0630	0.0704	-0.0074 (-0.635)	0.0180	0.0209	-0.0029 (-0.9245)
Difference	-0.0012 (0.119)	0.0421*** (3.086)	-0.0433*** (-2.784)	-0.0015 (-0.632)	0.0110*** (2.691)	-0.0125*** (-2.846)

Dps is a cash dividend payment per share, and Dpsjzc is a cash dividend payment ratio that is cash dividend per share/net assets per share. Before placement: up to and including two previous years; After placement: up to and including two following years.

\*\*\* Indicates statistical significance at the 1% level.

4.1.2. Cash dividend payment and cash dividend payment ratio: large shareholders participate and non-participate

**Table 4**  
Large shareholders participate and non-participate.

	Mean (Dps)			Mean (Dpsjzc)		
	Before participate (-2~-1)	After participate (1~2)	Difference	Before participate (-2~-1)	After participate (1~2)	Difference
Participate	0.0620	0.1246	-0.0626*** (-3.927)	0.0163	0.0360	-0.0197*** (-4.167)
Non-participate	0.0615	0.0898	-0.0283* (-1.656)	0.0169	0.0242	-0.0073* (-1.713)
Difference	0.0005 (0.432)	0.0348 (1.594)	-0.0342* (-1.659)	-0.0006 (-0.202)	0.0118* (1.811)	-0.0124* (-1.695)

Non-participate are those without large shareholder participation. Before participate is two years before large shareholders participating in placements. After participate is two years after large shareholders participating in placements. Dps is a cash dividend payment per share, and Dpsjzc is a cash dividend payment ratio that is cash dividend per share/net assets per share.

\*\*\*Indicates statistical significance at the 1% level.

\* Indicates statistical significance at the 10% level.

Table 4 presents the changes between cash dividend payment and cash dividend payment ratio of large shareholders participating in placements and those without large shareholders participation. From Table 4, we can see: the mean Dps of cash dividend payment per share for two years before large shareholders participating in placements is 0.0620 yuan, the mean Dps of cash dividend payment per share for two years after large shareholders participating in placements is 0.1246 yuan. This difference is statistically significant ( $t=-3.927$ ). The mean Dpsjzc of cash dividend payment ratio for two years before large shareholders participating in placements is 0.0163, the mean Dpsjzc of cash dividend payment ratio for two years after large shareholders participating in placements is 0.0360. This difference is also statistically significant ( $t=-4.167$ ). The difference of the mean Dps and Dpsjzc for two years before large shareholders no participation and two years after large shareholders no participation are 0.0283 yuan and 0.0073, respectively. These differences are statistically significant ( $t=-1.656$  and  $t=-1.713$ ). It shows the firms without large

shareholders participation paying cash dividends also change between two years before and two years after. The difference and difference method indicates that the difference between large shareholders participating in placements and those without large shareholders participation are -0.342 and -0.0124, respectively; and they are statistically significant ( $t=-1.659$  and  $t=-1.695$ ). It indicates that large shareholders participating in placements pay more cash dividends than those without large shareholders participation. It proves preliminary the second hypothesis.

#### *4.2. Empirical results*

##### *4.2.1. Private placements and cash dividends*

Table 5 presents the result about the influence of private placements on cash dividends. Whether the dependent variable is cash dividend payment (Dps) or cash dividend payment ratio (Dpsjzc), the coefficients of 'pipe' in the model 1 and 3 are 0.0237 and 0.0244 respectively. These are significantly greater than zero, indicating that private placements result in a significant increase in cash dividends after a placement. To test the time change trend that private placements affect cash dividends, we examine the placement year and the year after the placement that affect cash dividends in model 2 and 4. In model 2 and 4, the coefficients of the placement year are significantly positive in the placement year. However, after the placement year, cash dividends are reduced year by year. Indeed, cash dividends in the second year are negative and not significant. From the view of all the samples in model 2 and 4, all estimates of pipe increase clearly. The estimates of 'pipe' from model 1 to 4 indicate a significant influence on cash dividends after a placement. These show that Chinese listed firms pay more cash dividends after the placement than do those that are not involved in private placements. This is consistent with our expectation of the first hypothesis.

##### *4.2.2. Large shareholders participation and cash dividends*

Table 6 presents that large shareholders participating in private placements affect

cash dividends. Whether the dependent variable is cash dividend payment (Dps) or cash dividend payment ratio (Dpsjzc), the coefficients of 'participate' in model 1 and 3 are 0.0282 and 0.0096, respectively. These are significantly greater than zero. These show that large shareholders participating in placements lead to increase cash dividends. To test the time change trend in whether large shareholders participating in placements increase cash dividends, we examine that the placement year and the year after large shareholders participation in placements affect cash dividends in model 2 and 4. The results indicate that firms with large shareholders participating in placements then pay more cash dividends than those without large shareholders participation. Cash dividends are increased significantly in the placement year. However, cash dividends do not significantly decrease from the first to second year, and they increase significantly in the third year. From model 1 to 4, the coefficients of 'participate' are statistically significant. These show that firms with large shareholders participating in placements pay more cash dividends than those without large shareholders participation. This is consistent with our expectation of the second hypothesis.

What is noticeable is that. In table 5, the coefficient of 'pipe' in the placement year is positive significantly in order to test the time change trend private placements affect cash dividends that in the placement year and the year after the placement. In table 6, the coefficient of 'participate' in the placement year is positive significantly in order to test the time change trend in whether large shareholders participating in placements affect cash dividends. These indicate that firms controlled by large shareholders have a significant interests transfer preferences in their cash dividend policies.

#### *4.3. Robustness test*

To further investigate the robustness of the results, firms which halt private placements are chosen as control sample. Syl is chosen as growth index. Zycash that is free cash flow per share is chosen as capital operation ability. Accordingly,

robustness analysis tests the influence of either private placements or the participation of large shareholders on cash dividends.

**Table 5**  
Regression of private placements affecting cash dividends.

	Dps		Dpsjzc	
	(1)	(2)	(3)	(4)
pipe	0.0237*** (2.64)	0.0244*** (2.65)	0.0085*** (2.88)	0.0096*** (3.17)
year <sub>0</sub>		0.0125* (1.68)		0.0046* (1.87)
year <sub>1</sub>		0.0015 (0.20)		-0.0025 (-0.98)
year <sub>2</sub>		-0.0009 (-0.11)		-0.0010 (-0.39)
year <sub>3</sub>		0.0124 (1.63)		0.0022 (0.89)
size	-0.0392*** (-3.24)	-0.0398*** (-3.29)	-0.0138*** (-3.49)	-0.0144*** (-3.64)
lev	-0.0280 (-1.25)	-0.0281 (-1.26)	-0.0141* (-1.93)	-0.0145** (-1.98)
roa	0.109*** (4.48)	0.107*** (4.39)	0.0288*** (3.60)	0.0285*** (3.55)
qdps	-0.261*** (-11.17)	-0.261*** (-11.18)	-0.0771*** (-10.07)	-0.0766*** (-10.00)
growth	0.0444*** (5.21)	0.0450*** (5.19)	0.0163*** (5.84)	0.0163*** (5.75)
lc5	-0.0414 (-1.10)	-0.0412 (-1.09)	-0.0001 (-0.01)	-0.0019 (-0.15)
cash	0.0021 (0.82)	0.0025 (0.97)	0.0005 (0.59)	0.0006 (0.72)
eps	0.0231*** (3.69)	0.0250*** (3.94)	-0.0011 (-0.51)	-0.0004 (-0.17)
Constant	0.0005 (0.17)	-0.0047 (-0.88)	0.0002 (0.24)	-0.0005 (-0.30)
R-squared	0.09	0.09	0.08	0.09
Obs	2490	2490	2490	2490

This table reports the coefficients for private placements affecting cash dividends. With the exception of the timing dummy variables, other variables are the same as in Table 2. Year<sub>0</sub> is a timing dummy variable. When the placement year is one, and else is zero. Year<sub>1</sub> is a timing dummy variable. When the first year of private placements is one, and else is zero. Year<sub>2</sub> is a timing dummy variable. When

the second year of private placements is one, and else is zero. Year<sub>3</sub> is a timing dummy variable. When the third year of private placements is one, and else is zero. \*\*\*, \*\* and \* indicate statistical significance at the 1%, 5% and 10% levels, respectively.

**Table 6**  
Regression of large shareholders participation affecting cash dividends.

	Dps		Dpsjzc	
	(1)	(2)	(3)	(4)
participate	0.0282*** (3.01)	0.0296*** (3.12)	0.0096*** (2.89)	0.0109*** (3.22)
year <sub>0</sub>		0.0262*** (2.87)		0.00675** (2.08)
year <sub>1</sub>		0.0087 (0.93)		-0.0015 (-0.46)
year <sub>2</sub>		0.0022 (0.23)		-0.0027 (-0.79)
year <sub>3</sub>		0.0261*** (2.78)		0.0063* (1.89)
size	-0.0448*** (-3.66)	-0.0473*** (-3.85)	-0.0127*** (-2.92)	-0.0132*** (-3.04)
lev	-0.0038 (-0.15)	-0.0023 (-0.09)	0.0011 (0.12)	0.0011 (0.11)
roa	0.136*** (3.70)	0.129*** (3.52)	0.0433*** (3.33)	0.0421*** (3.24)
qdps	-0.148*** (-5.19)	-0.152*** (-5.32)	-0.0781*** (-7.71)	-0.0788*** (-7.78)
growth	0.0390*** (4.08)	0.0396*** (4.08)	0.0131*** (3.87)	0.0132*** (3.84)
lc5	0.0043 (0.11)	0.0097 (0.24)	0.0101 (0.72)	0.0102 (0.72)
cash	0.0017 (0.62)	0.0023 (0.83)	0.0002 (0.19)	0.0004 (0.45)
eps	0.0155** (2.04)	0.0206*** (2.66)	0.0004 (0.13)	0.0023 (0.85)
Constant	0.0005 (0.14)	-0.0120* (-1.85)	-0.0002 (-0.20)	-0.0021 (-0.91)
R-squared	0.07	0.08	0.09	0.10
Obs	1326	1326	1326	1326

This table reports the coefficients for large shareholders participation affecting cash dividends. With the exception of the timing dummy variables, other variables are the same as in Table 2. Year<sub>0</sub> is a timing dummy variable. When the year of large shareholder participation is one, and else is zero. Year<sub>1</sub> is a timing dummy variable. When the first year of large shareholder participation is one, and



else is zero. Year<sub>2</sub> is a timing dummy variable. When the second year of large shareholder participation is one, and else is zero. Year<sub>3</sub> is a timing dummy variable. When the third year of large shareholder participation is one, and else is zero. \*\*\*, \*\* and \* indicate statistical significance at the 1%, 5% and 10% levels, respectively.

**Table7**

Robustness test of the influence of private placements on cash dividends.

	Dps		Dpsjzc	
	(1)	(2)	(3)	(4)
pipe	0.0281** (2.46)	0.0388*** (3.30)	0.0090*** (2.91)	0.0109*** (3.46)
year <sub>0</sub>		0.0225** (2.00)		0.0081*** (2.74)
year <sub>1</sub>		-0.0383*** (-2.96)		-0.0059* (-1.94)
year <sub>2</sub>		0.0091 (0.74)		-0.0013 (-0.41)
year <sub>3</sub>		-0.0042 (-0.35)		0.0022 (0.73)
size	-0.0422** (-2.55)	-0.0432*** (-2.61)	-0.0127*** (-2.88)	-0.0124*** (-2.80)
lev	0.0012 (0.03)	-0.0131 (-0.30)	-0.0067 (-0.59)	-0.0075 (-0.66)
roa	0.545*** (6.17)	0.546*** (6.19)	0.167*** (7.02)	0.167*** (6.92)
syl	0.0018* (1.81)	0.0042*** (3.09)	0.0079** (2.28)	0.0083** (2.35)
lc5	-0.0040 (-0.29)	-0.0087 (-0.62)	-0.0002 (-0.06)	-0.0013 (-0.35)
eps	0.0148 (1.31)	0.0197* (1.69)	-0.0002 (-0.04)	0.0004 (0.05)
zycash	-0.0022 (-0.89)	-0.0021 (-0.87)	-0.0032 (-0.55)	-0.0023 (-0.39)
Constant	-0.0027 (-0.66)	-0.0029 (-0.36)	-0.0008 (-0.77)	-0.0018 (-0.83)
R-squared	0.05	0.06	0.07	0.09
Obs	1409	1409	1410	1410

The table reports the coefficients for the influence of private placements on cash dividends. With the exception of syl and zycash, other variables are the same as in Table 2. Syl is chosen as growth index. Zycash that is free cash flow per share is chosen as capital operation ability. \*\*\*, \*\* and \* indicate statistical significance at the 1%, 5% and 10% levels, respectively.

Table 7 shows the robustness test about the influence of private placements on cash dividends. From model 1 to 4, results show the influence of private placements on cash dividends are significantly positive, suggesting that the cash dividends are increased after private placements. It further supports the first hypothesis.

**Table 8**

Robustness test of the influence of large stockholders participating in placements.

	Dps		Dpsjzc	
	(1)	(2)	(3)	(4)
participate	0.0362*** (2.74)	0.0458*** (3.43)	0.0101*** (2.85)	0.0119*** (3.32)
<i>year</i> <sub>0</sub>		0.0244** (2.17)		0.0087*** (2.95)
<i>year</i> <sub>1</sub>		-0.0353*** (-2.78)		-0.0051* (-1.69)
<i>year</i> <sub>2</sub>		0.0099 (0.80)		-0.0009 (-0.29)
<i>year</i> <sub>3</sub>		-0.0021 (-0.18)		0.0028 (0.91)
size	-0.0417** (-2.55)	-0.0415** (-2.54)	-0.0122*** (-2.78)	-0.0118*** (-2.68)
lev	-0.0169 (-0.40)	-0.0368 (-0.87)	-0.0098 (-0.84)	-0.0142 (-1.22)
roa	0.538*** (6.08)	0.537*** (6.08)	0.168*** (6.99)	0.165*** (6.78)
syl	0.0019* (1.90)	0.0042*** (3.05)	0.0076** (2.16)	0.0079** (2.22)
lc5	-0.0001 (-0.01)	-0.0032 (-0.23)	0.0012 (0.33)	0.0003 (0.09)
eps	0.0142 (1.25)	0.0190 (1.64)	0.0001 (0.01)	0.0006 (0.09)
zycash	-0.0023 (-0.93)	-0.0022 (-0.91)	-0.0035 (-0.60)	-0.0026 (-0.45)
Constant	-0.0017 (-0.41)	-0.0027 (-0.34)	-0.0004 (-0.42)	-0.0017 (-0.80)
R-squared	0.05	0.06	0.07	0.08
Obs	1409	1409	1410	1410

The table reports the coefficients for the influence of large stockholders participating in placements. With the exception of syl and zycash, other variables are the same as in Table 2. Syl is chosen as growth index. Zycash, that is free cash flow per share, is chosen as capital operation ability. \*\*\*, \*\* and \*

indicate statistical significance at the 1%, 5% and 10% levels, respectively.

Table 8 shows there is the robustness test about the influence of large stockholders participating in placements. Results from model 1 to 4 show the influence of participation of large stockholders on private placements are significantly positive, suggesting that large stockholders participating in placements pay more cash dividends than do those without large shareholders participation. It further supports the second hypothesis.

## **5. Conclusions**

Herein, the relationship between private placements of common stocks and cash dividends for Chinese listed firms is investigated. With a specific sample of Chinese listed firms in private placements from 2006 to 2009 on the Shanghai and Shenzhen stock exchanges. It finds that Chinese listed firms pay more cash dividends after the placement than do those that are not involved in placements. Firms with large shareholders participating in placements pay more cash dividends than those without shareholders participation. The results indicate that the firms controlled by large shareholders have a high propensity for interests transfer in their cash dividend policies.

Large shareholders have controlling rights advantages and internal motivations for interests transfer. There are few effective constraints to paying cash dividends after a placement. There is a veneer of legitimacy when large shareholders expropriate small shareholders through providing a cash dividend after a placement. The cash dividend payment gradually becomes an interests transfer tool for large shareholders to grab extra profits. It is fully beyond the CSRC's purpose that the refinancing qualification of a Chinese listed firm is linked to the level of dividend payment to protect the small shareholders. Therefore, regulators should deal with this emerging phenomenon by improving the laws and regulations. The CSRC should actively push equity refinancing of private placements and simultaneously regulate the behavior of

large shareholders in paying cash dividends after a placement. Then, a cash dividend payment can serve as a tool for investors to share in benefits fairly. The CSRC needs to effectively protect the rights of small investors and promote healthy coordinated development in the capital markets.

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