

The Effect of Ultimate Controller's Changing on Cash Dividend Payment Tendency

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Abstract—Nowadays, since the most of individual investors provide money to company for real cash inflows, paying cash dividend, as the main way to pay money back to the investors, is definitely paid more attention to. But for the company, keeping money in itself can help to grab development opportunities in time. This essay reveals the possible outcomes in dividend policy because of the ultimate controller's changing. Given to the results of existing research works and the data from Chinese listed companies, after exemplifying some typical cases, the conclusion can be illustrated clearly: The ultimate controller's changing effect cash dividend payment by generating disputes of share transfer, complicating the pyramid-shaped shareholding structure, and damaging corporate governance and operating ability. Further more, auditing and cash dividend payment are substitutes for each other as corporate economic supervision tools. Meanwhile, auditing can reduce the negative influence of ultimate controller's changing so that investors can get more cash dividend. This paper offers a new perspective for studies about the factors of cash dividend tendency and briefly discusses how the heated topic of auditing exerts influence on the relationship.

1 INTRODUCTION:

With the awareness of investing the available money in company rising rapidly, the company's dividend policy is by no means shed light on, especially the cash dividend payment. Compared with institutional investors, the individuals care the money that is paid back more rather than corporate right of control, so the factors of cash dividend payment tendency are studied for a long time and in many degrees. However, the ultimate controller's changing have barely been mentioned. In reality, given to share transactions for mergers and acquisitions, or inheritance, the ultimate controller's changing happens frequently. Meanwhile, China Securities Regulatory Commission published 'Measures for the Administration of the Material Asset Restructurings of Listed Companies (2019 Amendment)' in 2019, in which CSRC canceled the rule that the listed company need to be examined and approved when changing ultimate controller. It is realistically significant to associate it with cash dividend payment tendency. As a result, the changing will happen more frequently in the future. Based on the research outcome of Fang Xi from School of economics, Shandong University from the perspective of lower marginal benefits and controller's tunneling[1], the assumption that the ultimate controller's changing will reduce the corporation's cash dividend payment can be made. This paper opens up a new researching degree to study the tendency of cash dividend payment so that the minority shareholders can invest more cautiously. What's more, according to the analysis above, auditing functions are discussed and the suggestions about auditing is made for minority investors and certified public accountants.

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2 THE RELATIONSHIP BETWEEN THE CHANGING OF ULTIMATE CONTROLLER AND CASH DIVIDEND PAYMENT TENDENCY

2.1 From the aspect of disputes of share transfer

Normally, when share is transferred between two individuals, the disputes are prone to happening. It is no doubt that the methods to change the ultimate controller are always linked to share transactions. The ambiguous equity ownership because of the dispute attributes to the fact that both of the arguers would not like to pay cash dividend. Evidently, the ultimate controller has the most share of the company, and cash dividend is paid per share, therefore the cash dividend is a large amount of money. They have to restrain the manager's behave in dividend policy, waiting until the ownership is determined, or else a new problem will make the situation more confusing. But since after a long time of disagreement, they will ask for judicial decision and this dispute will not exist for a long time. In this essay, as most of disputes of share transfer can be solved in two years, it is more rigorous to add a limit of two years.

A telling example is that in December 2016, a Chinese listed company called Chtc Helon Co.,ltd. was involved in a dispute. Its original ultimate controller Xine Group Co., ltd. signed a share transferring agreement with Zhong hong Group Co., ltd. , exchanging all the share of Chtc Helon Co.,ltd. so that its ultimate controller would change. The two companies had argued for almost a year in many

details of signing process and until 2017, this case was determined by justice. According to the statement published by Chtc Helon Co.,Ltd., in the years of 2016 and 2017, the company did not pay cash dividend[2].

2.2 From the aspect of complicating pyramid-shaped shareholding structure

The ultimate controller’s changing promotes a complicated pyramid-shaped shareholding structure in length and width. Fang Qian did a research on controller’s changing and she found that, as the table I shows, among all the companies with controller chain changing from 2005 to 2014, most of companies have more intermediate holding companies, leading to a more complicated pyramid-shaped share holding structure[1]. The leverage of ultimate control is amplified, rising the second-type agency costs and the first-type agency costs [3].

*2.2.1 Complicated pyramid-shaped shareholding structure rises the second-type agency costs:*The leverage of ultimate control which is amplified can provide more chances for the ultimate controller to exert influence on the company’s all aspects with less money.

This behavior is also called tunneling. Specifically, doing connected transactions, offering illegal guarantee and taking away subsidiary’s commercial opportunities are three of the most typical tunneling methods in reality. Although it is possible for the ultimate controller who has the most cash flow rights to promote corporate internal governance and supervise managers’ behavior, this positive externalities is obviously weaker than the negative externalities[4]. The new ultimate controller tends to manipulate the whole control chain and gains benefit by predatory easily, so it is reasonable that the subsidiary is less likely to pay cash dividend for keeping more money in itself. It is unfair for the individual investors who have less rights than the ultimate controller.For example, Zhongtian Energy Ltd. faced to a change in ultimate controller in 2019. The two original ultimate controllers: Deng Tianzhou and Huang Bo control the Zhongtian Energy through only one other company called Qing Dao Zhongtian Asset Management Ltd. , but the new control chain is more complex: new ultimate controllers -- Xue Dongping and Guo Siying affect Zhongtian Energy Ltd. through five steps including Shanghai Gifan Asset Management Co., Ltd., Morita Investment Group Ltd.,

TABLE I. ULTIMATE CONTROLLER’S CHANGE EFFECT PYRAMID-SHAPED SHARE HOLDING STRUCTURE FROM 2005 TO 2014 [1].

Year	The rate of ultimate controller changed (%)	The change of Pyramid-shaped share holding structure					
		The change of Intermediate holding companies			The change of Holding chains		
		The overall number	The number of companies increased	The number of companies decreased	The overall number	The number of companies increased	The number of companies decreased
2005	94(7.50)	109(8.69)	69(63.30)	40(36.70)	62(4.94)	44(70.97)	18(29.03)
2006	118(9.41)	165(13.16)	99(60.00)	66(40.00)	103(8.21)	62(60.19)	41(39.81)
2007	115(9.17)	155(12.36)	102(65.81)	53(34.19)	94(7.50)	71(75.53)	23(24.47)
2008	78(6.22)	139(11.08)	97(69.78)	42(30.22)	95(7.58)	61(64.21)	34(35.79)
2009	85(6.78)	147(11.72)	89(60.54)	58(39.46)	100(7.97)	66(66.00)	34(34.00)
2010	61(4.86)	109(8.69)	75(68.81)	34(31.19)	89(7.10)	64(71.91)	25(28.09)
2011	76(6.06)	161(12.84)	121(75.16)	40(24.84)	127(10.13)	103(81.10)	24(18.90)
2012	65(5.18)	130(10.37)	80(61.54)	50(38.46)	114(9.09)	76(66.67)	38(33.33)
2013	64(5.10)	127(10.13)	79(62.20)	48(37.80)	119(9.49)	76(63.87)	43(36.13)
2014	60(4.78)	130(10.37)	88(67.69)	42(32.31)	119(9.49)	92(77.31)	27(22.69)
overall	816(6.51)	1372(10.94)	899(65.52)	473(34.48)	316(2.52)	715(69.96)	307(30.04)

China Morita Enterprise Group Co. Ltd., Shanghai Web Investment Co., Ltd., and Zhenlin Investment Holdings Co. Ltd. . Accordingly, until the first half year of 2020, Zhongtian Energy Ltd. has not paid any dividend[5].

2.2.2 Complicated pyramid-shaped shareholding structure rises the first-type agency costs: Following the discussion above, the possibility for ultimate controller to manipulate the company rises with the changing. The creditors have to worry about safety of their money invested in company. So, the interest rate on bonds increases, which represents the first-type agency costs between shareholders and creditors. Although the positive externalities caused by the changing also exist, it is obvious that the negative ones can not be totally counteracted. The benefit of financing support provided

by ultimate controllers is far less than the loss of ultimate controller’s predatory and of the increasing interest request [4] . For one thing, the rising financial costs reduce net income, and as a result, to keep enough money in company, the company will not pay dividend. For another, enormous potential risk holds creditors with low risk appetite back, so financing can be really hard. To ensure constant cash flow, the company prefer to retain money rather than pay dividend.

2.3 From the aspect of the effectiveness of corporate internal governance

The ultimate controller’s changing is always accompanied by top management team’s changing. Walsh investigated 55 listed American companies and 37% of them had top management team members quitting within two years

after ultimate controller's changing. Dennis and Serrano found that 27.3% of companies whose ultimate controller changed between 1983 and 1989 lost their top management members within two years. In addition, higher dismissing rates are shown in other studies. Among them, the most significant one is that in the 1980s, Kenndey and Limmack worked out 65.84% of British listed companies changed their CEO after alternation of ultimate controllers. Shi Shuiping in Department of Accounting, School of Management, Jinan University proved the ultimate controller's change leads to tunneling by forming unstable top management team and poor corporate internal governance. He made a descriptive statistics on the research sample and the control sample, and found the overall trend of the encroachment of the interests of major shareholders after the ultimate controller changed. As the table II shows, the amount of ultimate controller's expropriation are definitely large and even increased with the time passing. What's more, large proportion of top management group members were replaced to facilitate future expropriation after the ultimate controller changed[6]. Therefore, aiming to invade more benefit, the ultimate controllers would not give the cash dividend back to the other shareholders. Stock dividend policies that will not change anything are the best choice for them in contrast to cash dividend.

2.4 From the perspective of operation

The alternation of ultimate controllers can exert influences on the company's operation and reduce the cash dividend payment further. To be more specific, it mainly acts on two aspects: company's development strategy and major clients.

2.4.1 Company's development strategy: Mostly, different ultimate controller may have different views in the company's past, present and future. Therefore, the new ultimate controller would make some significant changes on the whole strategy of the company including

sales plan, main business and so on. Whether the new strategy is reasonable in this situation or not, these changes can easily form a unstable development orientation. Entering a new market and quitting the original one cost the company a lot of extra money which can be a big burden for gain profit in a long time.

On the other hand, entering a new market is a long-term project, hence, the company makes profit at the beginning is very hard. Although the company occasionally makes it, the profit will be retained for investing in the next step. There is no additional money to pay dividend; What's more, under the unprofitable circumstances for a long time, the ultimate controller may lose confidence and are more likely to turn to an easier way— gaining benefit through illegal but in secret ways. The tendency of paying cash dividend decreases legitimately.

As a case in point, Northcom Group Co., Ltd. are merged by Shandong Qixing Iron Tower Co.,Ltd. whose traditional business builds tower and provides intelligent parking service. The ultimate controller of Northcom Group Co., Ltd. changed. After that, the new group decided to explore the 1400 MHZ wireless fidelity service, but it needed to invest a large amount of money to build assets related to this business. Meanwhile, the new top management team signed an agreement with the original ultimate controller in which the team promised to gain a very high level of profit. So, in the first three years, they made a lot of constructions and provided service to the customers who wanted to pay by accounts payable, expecting the company can gain profit quickly. However, constructions in process took up a lot of money with increasing debts, but the new service could not earn enough real cash, leading to a broken cash flow. In the fourth year, auditors found that the company started to transfer up to 4.6 billion benefit by related party transactions. And they had not paid cash dividend since the ultimate controller changed[9].

TABLE II. BENEFIT EXPROPRIATION AND TOP MANAGEMENT GROUP MEMBERS' REPLACEMENT AFTER THE ULTIMATE CONTROLLER CHANGED

variate	sample	minimum value	Maximum value	average	median	Standard deviation	deflection	kurtosis
Occupy 1	66	0.0000	28863.31	1007.009	0.0000	3675. 907	5.4119	34.6435
Occupy2	66	0.0000	33779.08	1638.63	0.0000	5176. 344	4. 5017	22.2434
Occupy 3	66	0.0000	0.2421	0.0081	0.0000	0. 0331	5.8118	5. 9694
Occupy 4	66	0.0000	0.9145	0.0222	0.0000	0. 0985	7. 6851	6. 9559
Dir-ratio	66	0.0000	1.0000	0.2871	0.2000	0. 2821	0. 9961	0. 1971
Ceo-ratio	66	0.0000	1.0000	0.3651	0.3333	0.3116	0. 5737	-0. 6502
control	66	0.0000	0.6818	0.2572	0.2554	0. 1542	0. 1835	-0. 2209

2.4.2 The major clients' instability-The ultimate controller's changing always is related to the major

clients' changing. Some of the major clients originally chose this company mainly because they considered the ultimate controller as a guarantor. But in a long time after

changing, most of clients tend to wait and see, so the total sells may decrease significantly. In addition, the company need to keep a healthy cash flow in this situation. Therefore, hardly can the company pay cash dividend.

3 THE INTERACTION RELATIONSHIP BETWEEN CASH DIVIDEND PAYMENT AND AUDITING

Since company system enterprises occur, agency problem has become the core of the corporate governance.

The first-type agency problem is between shareholders and top management team. This kind of problem can be solved by incentive mechanism and the supervision mechanism, and to be more specific, cash dividend payment and auditing are two ways among the supervision mechanism. Shareholders retain auditors to find out the accounting errors and financial frauds. At the same time, top management team pays cash dividend to prove that they take the responsibility of agency by agreement as it is shown in the statements.

The second-type agency problem is between large shareholders and minority shareholders. This kind of problem is caused by cash dividend payment, but can be eased by auditing.[9]

Above all, auditing and cash dividend payment can complement each other when aiming to reduce the agency cost. Moreover, auditing is concerned with corporate governance situation, financial frauds, capital safety and sustainable business capability. Although it does not take the responsibility directly, it can reduce the negative effects of ultimate controller's changing by ensuring the authenticity and legitimacy of financial information disclosure. Investors can get actual information through statements before investing money, so the agency costs decrease, promoting cash dividend payment. Hence, auditing can urge the company to pay cash dividend indirectly. Meanwhile, cash dividend payment situation is a sign when auditors make their professional judgment before working. No cash dividend paid for a long time can reflect some serious problems that may exist in the company and that need to be investigated deeply in further auditing process.

All in all, for the investors: firstly, the ultimate controller's changing needs to be taken into consideration before investing, otherwise the ones who expect to get money back quickly may disappointed. Secondly, reading statements inspected by auditors is a great way to supervise the company to pay reasonable cash dividend. Thirdly, according to cash dividend payment policy and the ultimate controller's changing, they can choose a proper CPA firm (for example, for the company that does not pay cash dividend as expected or has it ultimate controller changed, the invests may argue to retain a famous CPA firm with lower risk tolerance). For auditors, cash dividend payment situation can be seen as a clue to make professional judgement which contributes to the further work. So far, although professional judgement is made during the whole auditing work, cash dividend payment situation is not put stress on. In the future, more researches can be done in that field.

4 CONCLUSION

The ultimate controller's change will bring about the disputes of share transfer, complicate the pyramid-shaped shareholding structure, decreasing the effectiveness of corporate internal governance and reducing profit. In addition, auditing and cash dividend payment are substitutes for each other and auditing can increase the tendency of cash dividend payment indirectly. After analyzing roughly, some suggestions from the perspective of both auditors and investors are raised. Auditors can consider the ultimate controller's change and cash dividend payment situation when making professional judgement. Meanwhile, the investors can urge the company to pay cash dividend according to the financial data ensured by auditors; they can also make investment decision after searching for the information about the ultimate controller's changing, moreover, choosing CPA firm is also concerned with cash dividend payment and ultimate controller's stability. In general, it is reasonable to say that after the ultimate controller change, the listed company is unwilling to pay cash dividend.

This paper is based on several typical examples rather than statistical researches. Regressive analysis is applied to study further. Besides, other aspects about ultimate controller that effect the cash dividend payment tendency can be considered in my next paper, such as the number of them.

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