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Research on the Relationship between Cash Dividend Distribution and Earnings of Listed Companies under the Semi Mandatory Dividend Policy

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Abstract: The semi mandatory dividend policy links refinancing eligibility with cash dividend levels, forming a unique dividend regulatory system arrangement in China's capital market. Previous studies have mostly focused on the cash dividend promotion effect or "regulatory paradox" of policies, but have rarely examined the nature changes of the relationship between cash dividends and earnings after policy intervention from a theoretical perspective. This article constructs a three-dimensional analytical framework of "institutional constraints earnings function dividend decision-making", demonstrating that the core theoretical consequence of the semi mandatory dividend policy is that cash dividends have transformed from autonomous signals driven by earnings quality to compliance tools driven by financing qualifications, thereby triggering functional differentiation of earnings - real earnings have become the "qualification threshold" for dividend payments, and manipulable earnings have become the "regulatory variable" to avoid supervision. This article further analyzes the differential governance effects of policies in different earnings quality ranges from the perspective of agency costs, revealing the theoretical tension of the coexistence of "incentive distortion" and "governance premium". The research aims to provide a theoretical explanation for the decline of earnings information content under regulatory dividend policies, and to provide a theoretical basis for differentiated dividend regulation.

1. Introduction

Since the China Securities Regulatory Commission initially linked refinancing qualifications with cash dividend behavior in 2001, relevant policies have undergone a gradual strengthening process from "soft constraints" to "quantitative thresholds" [1]. In 2006, the "Measures for the Administration of Securities Issuance by Listed Companies" explicitly stated for the first time that "the accumulated profits distributed in cash or stock in the past three years shall not be less than 20% of the average annual distributable profits realized in the past three years." In 2008, this proportion was increased to 30% and limited to cash form [2]. The unique feature of this institutional design is that regulators do not directly mandate all listed companies to distribute dividends, but embed the

dividend level into the review criteria for refinancing qualifications, forming an indirect regulatory structure of "financing access type". Compared to the mandatory dividend system in countries such as Brazil and Chile, the constraints of the Chinese model are concentrated on the group of listed companies with external financing needs, and only have a signal demonstration effect on companies without refinancing plans [3].

In an unregulated situation, the correlation between cash dividends and earnings is mainly established through three theoretical channels. The signal transmission theory holds that management uses dividend changes to transmit private information about the sustainability of future earnings to the market, and the level of dividend payments thus becomes a screening device for earnings quality [4]. The agency cost theory points out that cash dividends suppress overinvestment and on-the-job consumption by reducing the cash flow that management can freely dispose of, and the effectiveness of this governance effect depends precisely on the authenticity of earnings - if earnings themselves are manipulated, dividend payments based on earnings lose their functional basis for constraining agency problems. The residual dividend theory further defines dividends as the surplus after deducting investment projects with positive net present value from earnings, and the relationship between dividends and earnings depends on the investment opportunity set and life cycle stage of the enterprise [5]. The above theories share an implicit premise: dividend decisions are autonomous judgments made by management based on earnings information, rather than passive responses to external compliance requirements.

The intervention of the semi mandatory dividend policy has broken the above premise. When the eligibility for refinancing depends on historical dividend records, the driving factor for dividend decisions shifts from "whether profits are sufficient to support distribution" to "whether distribution is sufficient to unlock financing channels" [6]. This raises a theoretical question that has been relatively overlooked in existing literature: Has policy changed the nature of the relationship between cash dividends and earnings, rather than just the strength of the relationship? Previous empirical studies have mostly tested whether policies have increased the willingness or payment level of cash dividends, but have not asked a more fundamental question: whether the information content carried by cash dividends has undergone a qualitative change after policy intervention? If dividends are no longer primarily driven by earnings quality, but by financing demand, then the applicability of dividend signal theory in the Chinese institutional context needs to be re examined. This chapter lays the institutional and problem foundation for subsequent analysis.

2. Functional differentiation of earnings and logical transformation of dividend decision-making

2.1 Dual role of surplus: from "distribution source" to "compliance tool"

In classical dividend theory, earnings are the financial source and signal carrier of dividend distribution, with a single function: the higher the quality of earnings, the more abundant the sustainable cash flow for distribution, and the stronger the credibility of the signal of dividend payment. However, within the framework of the semi mandatory dividend policy, the surplus obtained a second identity - the accounting base for refinancing eligibility. The policy calculates the dividend ratio based on the denominator of "annual distributable profit", so that the reported earnings directly determine how much cash dividends a company needs to pay to meet regulatory thresholds. This institutional design has resulted in a subtle yet important consequence: earnings are no longer just a constraint on whether dividends can be distributed, but also become a measurement benchmark for how much must be distributed. The root of functional differentiation lies in the fact that regulators need an observable and verifiable quantitative standard to enforce rules, and

accounting earnings precisely provide this standard; But the manipulability of accounting earnings makes this standard itself a managed object.

2.2 Threshold Effect of Real Earnings and Passivation of Dividend Payment

When a company has a need for refinancing and its real earnings are exactly or slightly above the policy threshold, dividend payments exhibit a unique passive characteristic. The management does not decide whether to allocate based on the sustainability judgment of earnings, but rather deducts the allocation amount based on the financing schedule. This means that the relationship between dividends and earnings may experience a non-linear break near the threshold: companies whose earnings just cross the threshold are forced to pay dividends that are disproportionate to their actual financial elasticity, while companies whose earnings are far below the threshold may abandon their refinancing plans and maintain low dividends completely unconstrained by policies. The policy has thus created a 'compliance interval' - within this interval, the sensitivity of dividend decisions to earnings quality significantly decreases for companies, while the sensitivity to financing constraints significantly increases. This theoretical inference is consistent with existing research findings: policies do indeed encourage companies with refinancing needs to increase their cash out levels, but this increase may not necessarily reflect an improvement in earnings quality.

2.3 The 'moderation effect' of manipulable earnings: the incentive for earnings management to avoid regulation

The deeper consequence of functional differentiation lies in the structural changes in the motivation for earnings management. If the management intends to meet the dividend threshold for refinancing with the lowest possible cash outflow, a rational strategy is to manipulate the reported earnings downwards, thereby lowering the base of "annual distributable profits". This means that the semi mandatory dividend policy may not induce traditional upward earnings management (to increase stock prices or salaries), but rather downward earnings management in specific contexts. Previous studies have noted the correlation between policies and earnings management, but mostly attribute it to upward manipulation that caters to dividends. From a theoretical logic perspective, the motivation for downward manipulation is particularly significant in companies with urgent financing needs and tight cash flow [7]. This possibility reveals an inherent tension in policy design: regulators use surplus as a yardstick to measure dividend sincerity, while the regulated can precisely reduce costs by managing the yardstick itself. As a result, earnings have transformed from "objects of signal transmission" to "tools of strategic regulation", and the information chain between dividends and earnings has fundamentally broken at this link.

2.4 Conversion of dividend decision-making logic from "signal driven" to "compliance driven"

Based on the above analysis, the theoretical consequences of the semi mandatory dividend policy can be summarized as a shift in decision-making logic: within the effective range of policy constraints, the main driving factor for cash dividends shifts from "management's confidence in future earnings" to "management's demand for refinancing qualifications". This transformation does not mean that the signal transmission function has completely disappeared, but rather that the content of the signal has changed - dividends no longer primarily convey information about earnings prospects, but rather information about corporate financing plans and regulatory compliance status. For external investors, the incremental information about earnings quality contained in dividend announcements after policy intervention should theoretically be lower than

the level before policy intervention. This proposition provides an institutional explanation for the weakening of dividend signaling effects in China's capital market.

3. Theoretical tension of policy effects from the perspective of agency costs

3.1 Theoretical basis for policies as external governance mechanisms

The normative starting point of the semi mandatory dividend policy is to alleviate two types of agency conflicts. Firstly, in companies with dispersed equity, management tends to retain free cash flow to expand control for personal gain, and cash dividends constitute a constraint on management's abuse of cash flow. Secondly, in companies with concentrated equity, controlling shareholders may seek personal gain through related party transactions or capital occupation, and mandatory cash outflows at least ensure that small and medium-sized shareholders receive a portion of distributable profits based on their shareholding ratio. From this perspective, policies have the function of "alternative governance": in an institutional environment where legal protection is not yet perfect, regulatory rules are used to compensate for the deficiencies in the internal mechanisms of corporate governance. If the policy effectively reduces agency costs, even if the information correlation between dividends and earnings is weakened, the policy may still generate net social welfare improvement.

3.2 Boundary conditions for governance premium

However, the realization of governance effects depends on specific conditions. When the quality of corporate earnings is high and financing constraints are loose, the required dividend payments by policies will not constitute a substantial burden, but instead reduce agency costs by constraining free cash flow, which is the source of the "governance premium". Wang Chunfei and Guo Yunnan's research found that semi mandatory dividend policies have a more significant governance effect in companies with higher agency costs, and there is indeed a certain governance premium. However, in companies with poor information disclosure quality and high financing constraints, the governance effect is significantly weakened. The theoretical implication of this discovery is that the effectiveness of policies is not uniformly distributed, but highly dependent on the existing earnings information environment of enterprises. Enterprises with poor earnings quality may find it difficult to use their reported earnings as a reliable distribution base, which could result in policy constraints being undermined or distorted.

3.3 Mechanism of incentive distortion

When companies with strong financing constraints and poor earnings quality face policy constraints, the risk of incentive distortion is most prominent. These types of enterprises face a dilemma: if they do not distribute dividends to the threshold, they will lose their eligibility for refinancing; If the dividend reaches the threshold, the internal cash flow will further dry up. Under this constraint, companies may adopt two strategic responses. One is to adjust the reported earnings to a level that precisely meets the minimum dividend requirements through accrual or real activity manipulation, while the actual dividends paid may be indirectly returned through external borrowing or subsequent refinancing funds, forming a cycle of "borrowing dividends financing to replenish blood". Secondly, when there is no actual need for refinancing, companies may actively choose not to distribute dividends to avoid policy constraints, resulting in a negative incentive of "no financing, no dividends". Previous studies have observed that policies have not induced "cash out dividends" in private placement companies, but this does not mean that incentive distortions do

not exist. Instead, it may indicate that distortions are manifested in earnings management in a more covert form rather than the dividend policy itself. The key theoretical judgment is that when policies bundle dividends with financing qualifications, dividends are no longer purely governance tools, but also become a component of financing strategies, and their governance functions are inevitably diluted by instrumental logic.

3.4 Asymmetric Policy Effectiveness and Complexity of Theoretical Evaluation

The analysis from the perspective of agency costs reveals an important fact: the semi mandatory dividend policy is not a choice between "effective" and "ineffective", but produces opposite effects in different groups of enterprises. For mature enterprises with high earnings quality and severe agency conflicts, policies may play a positive governance supplement role; For growing companies with low earnings quality and urgent financing needs, policies may induce earnings management and dividend alienation. This asymmetry means that evaluating policy advantages and disadvantages based on the "average treatment effect" is theoretically insufficient. The core issue of policy evaluation should shift from "whether the policy has increased the dividend level" to "under what conditions the policy has improved the matching relationship between dividends and earnings, and under what conditions it has disrupted this matching".

4. Integration of theoretical frameworks and policy implications

4.1 "Institutional Constraints - Earnings Function - Dividend Decision making" Analysis Framework

Integrating the analysis of Chapters 2 and 3 can extract a theoretical framework for understanding the relationship between dividends and earnings under a semi mandatory dividend policy. The core logic of this framework is that institutional constraints change the functional positioning of earnings, thereby altering the driving logic of dividend decisions, ultimately resulting in a state dependent relationship between dividends and earnings. In the ineffective policy constraint range (no refinancing demand or profits far below the threshold), the relationship between dividends and profits still roughly follows the prediction of classical theory; In the effective range of policy constraints (with refinancing demand and surplus approaching the threshold), surplus serves as both a source of distribution and a compliance base. The sensitivity of dividend decisions to earnings quality decreases, while the sensitivity to financing demand increases; In the policy constraint distortion range (tight financing constraints and poor earnings quality), earnings management becomes a strategic choice to avoid regulation, and the information correlation between dividends and earnings is broken [8]. The theoretical contribution of this framework is that it advances policy effects from the level of "horizontal changes" to the level of "changes in relationship properties", providing a more refined analytical tool for understanding the micro transmission mechanism of regulatory dividend policies.

4.2 Re examination of the Applicability of Dividend Signal Theory and Agency Cost Theory in China

The above analysis provides corrective implications for the applicability of two classic theories in the context of the Chinese system. In terms of signal theory, its core assumption - that dividend changes transmit management's private information about future earnings - requires additional conditions under a semi mandatory dividend policy: when dividend changes are mainly driven by compliance with financing qualifications rather than earnings expectations, the "separation

equilibrium" nature of dividend signals is weakened, and low-quality enterprises can imitate the dividend behavior of high-quality enterprises at a lower cost (through earnings management or external financing support), thus reducing the credibility of the signal. In terms of agency cost theory, the governance function of cash dividends is based on the authenticity of dividend payments; When dividend payments themselves may be a product of strategic compliance, their constraint effect on free cash flow is partially offset. This does not negate the effectiveness of the theory, but rather suggests that the application of the theory must include the institutional environment as an endogenous variable in the analysis.

4.3 Theoretical basis for differentiated regulation

The ultimate direction of theoretical analysis is the improvement direction of policy design. Since there are systematic differences in policy effects among enterprises with different earnings quality and financing constraints, the regulatory model centered on a unified dividend ratio threshold lacks sufficient theoretical basis. The theoretical basis of differentiated regulation is that regulators should adjust the constraint condition from "whether the dividend ratio meets the standard" to "whether the dividend behavior matches the quality of earnings". Specifically, for enterprises with high earnings quality and abundant cash flow, policies do not need to intervene excessively, and market reputation and equity financing cost mechanisms are sufficient to incentivize them to distribute reasonable dividends; For enterprises with questionable earnings quality but genuine financing needs, regulatory focus should shift from dividend thresholds to transparency in disclosing earnings quality and dividend funding sources, enabling investors to identify "real dividends" and "compliant dividends". Both studies have pointed out that the current policy should moderately "loosen" the linkage between refinancing qualifications and cash dividends, while using the standardization of dividend information disclosure as an alternative regulatory tool. The theoretical basis of this approach is precisely the core proposition argued in this article: the fundamental issue of policy is not the level of dividends, but whether the information correlation between dividends and earnings is distorted by institutional design.

5. Conclusion

This article argues that the semi mandatory dividend policy has substantially changed the relationship between cash dividends and earnings. The policy bundles refinancing qualifications with dividend levels, transforming cash dividends from autonomous signals driven by earnings quality to compliance tools driven by financing qualifications. As a result, earnings are functionally differentiated: real earnings become the "qualification threshold" for dividend payments, and manipulated earnings become the "moderating variable" to avoid regulation. As a result, the relationship between dividends and earnings exhibits a state dependent characteristic, and the information content of dividend signals is systematically diluted within the effective range of policy constraints. The perspective of agency costs further indicates that policy effects have asymmetry, with governance premiums and incentive distortions coexisting, and their boundaries depend on earnings quality and financing constraints. Based on this, the regulatory model of unified dividend ratio threshold lacks sufficient theoretical basis, and differentiated regulation should shift the focus of constraints from "whether the dividend ratio meets the standard" to "whether the dividend behavior matches the quality of earnings". The theoretical contribution of this article lies in advancing the study of policy effects from the level of "horizontal changes" to the level of "changes in the nature of relationships".

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