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## Corporate governance and dividend pay-out policy in Germany

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### Abstract

A new explanation of why dividends may be informative is put forward in this paper. We find evidence that dividends signal the severity of the conflict between the large, controlling owner and small, outside shareholders. Accordingly, dividend change announcements provide new information about this conflict. To test the rent extraction hypothesis and discriminate it from the cash flow signaling explanation, we utilize information on the ownership and control structure of the firm. We analyze 736 dividend change announcements in Germany over the period 1992–1998 and find significantly larger negative wealth effects in the order of two percentage points for companies where the ownership and control structure makes the expropriation of minority shareholders more likely than for other firms. The rent extraction hypothesis also has implications for the levels of dividends paid. We find larger holdings of the largest owner to reduce, while larger holdings of the second largest shareholder to increase the dividend pay-out ratio. Deviations from the one-share-one-vote rule due to pyramidal and cross-ownership structures are also associated with larger negative wealth effects and lower pay-out ratios. Finally, using Lintner's (American Economic Review 46 (2) (1956) 97–113) model of dividend determination we find corroborating results. The presence of a second largest shareholder with a considerable equity stake makes a crucial difference in the governance of the firm. Our results call for better minority shareholder rights protection and increased transparency in the course of European Capital Market Reform.

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