

Dividends and Corporate Shareholders

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Corporations uniquely have a tax preference for cash dividends. Nevertheless, dividends do not increase following trades of large-percentage blocks of stock from individuals to corporations. Moreover, although one-third of firms have corporate blockholders, 68% of these firms pay no dividends, and ownership is not clustered at levels that increase the tax benefits of dividends. These findings are not driven by the investing firms' tax rates or by agency problems. Instead, operating companies expand the target firms and pursue joint ventures. Dividends are lower with these investors. Financial investors are not attracted to dividend-paying firms and tend to be passive. (*JEL* G30, G32, G35)

An unusual provision of the tax code taxes corporations, but only corporations, at a lower rate on dividends than on capital gains. Because of this provision, Black (1976) concludes that corporations are the only investors with a tax preference for dividends, a view which is now widely accepted. Ross, Westerfield, and Jaffe (2005, p. 522), for instance, write that corporations "prefer to invest in high-dividend stocks, even without a preference for current income." Brealey, Myers, and Allen (2006, p. 432) similarly write that "only corporations have a tax reason to prefer dividends."

Corporations' tax preference for dividends could have several effects. For example, corporations could tilt their stock holdings toward high-dividend-paying stocks in a classic dividend-clientele scenario. If corporations hold large-percentage blocks of stock, they could also use their voting power to initiate or increase dividend payments. In either case, the tax-preference hypothesis predicts a positive relation between dividend payments and corporate stock ownership.

We thank an anonymous referee, Vladimir Atanasov, Alex Edmans, Laura Field, John Graham, Yaniv Grinstein, Simona Mola, Jeffrey Pontiff, Clifford Smith, Michael Weisbach, and seminar participants at Boston College and the Annual Meeting of the American Finance Association for helpful comments. After this paper went to press, Michael Barclay died in a small plane crash. We lost a close friend of twenty-five-years standing, and the finance profession lost a leading light. (January 10, 1957–August 16, 2007) Mike truly leaves the world a better place than he found it. Many will miss him. Send correspondence to Clifford G. Holderness, Finance Department, Fulton Hall, Boston College, Chestnut Hill, MA 02467. E-mail: clifford.holderness.1@bc.edu.

Given the special tax status of corporate shareholders, it is surprising that no one has investigated the relation between corporate stock ownership and dividend policy. That is what we do in this paper. Because corporations do not have to report their stockholdings below 5% of a firm's common stock, our investigations are limited to corporate shareholdings at or above this threshold. We employ two distinct data sets to analyze the relation between corporate stock ownership and dividend policy. First, we investigate trades of large-percentage blocks of common stock in which the sellers are individuals and the purchasers are corporations. Because individual sellers are tax averse to dividends while the corporate purchasers have the opposite preference, the tax-preference hypothesis predicts that dividends should increase following these block trades. Moreover, because we are examining the same firms before and after a block trade, these investigations should control for other determinants of dividend policy. Our second set of investigations examines dividend policy at 376 randomly selected CRSP- and Compustat-listed corporations. We examine these firms in 1995 and revisit them in 1998, 2001, and 2004.

Contrary to the tax-preference hypothesis, we do not find a positive relation between dividends and corporate stock ownership in either sample. Following large-block trades in which the purchasers are corporations and the sellers are individuals, the portion of firms paying dividends actually decreases. The random sample paints a similar picture. Although we find that one-third of all firms have corporate blockholders, 68% of the firms with such large shareholders pay no dividends. Moreover, the fractional ownership of these corporate blockholders is not clustered at levels that would increase the tax benefits of cash dividends.

We investigate several explanations for why corporate blockholders are not associated with higher dividends. We reject the possibility that corporate blockholders have low marginal tax rates, which would diminish the tax benefits of dividends for them. To the contrary, corporate blockholders tend to have high marginal tax rates. The data also reject the possibility that agency problems at the blockholder firms contribute to suboptimal dividend policies. Using two accepted measures of the quality of firms' corporate governance mechanisms, we find that potential agency problems at the corporate blockholders are no different than they are in public corporations generally.

We obtain insights into why there is no tax effect by dividing the corporate blockholders into operating investors and financial investors. Although subject to the same tax on dividends, these two types of investors appear to have different motivations for making block investments. Operating blockholders appear focused on establishing joint ventures or pursuing operating synergies. We find that dividends are lower but capital expenditures are higher at firms with operating blockholders. Although this result is contrary to the tax-preference hypothesis, it does not imply that taxes are irrelevant. Holding all other factors constant, corporate investors clearly would prefer to receive their returns in the most tax-efficient fashion. Thus, a sufficiently powerful econometric test might

be able to detect a corporate tax preference for dividends at the margin. When operating companies make strategic investments, however, all other things are not equal. In particular, our results show that operating blockholders find it more profitable to pursue strategic interactions with their target firms than to use their influence to alter dividend policy or pursue simple dividend capture strategies.

The literature has paid less attention to financial blockholders even though evidence we present shows that they are more common than operating blockholders. One would think that because financial blockholders do not have the operational and synergistic considerations of operating blockholders, they would focus more on dividend policy. We find this not to be the case, however. Dividend policy at firms with financial blockholders is indistinguishable from the dividend policy at firms with no corporate blockholders of any type. In part, this seems to reflect the passivity of financial blockholders. Compared with operating blockholders, their blocks are smaller; they hold them for shorter periods of time; and they are less likely to have board of director representation. If financial blockholders are exercising their rights as shareholders, they are not doing so with dividend policy. Moreover, whatever criteria financial corporations use to choose their block investments, dividend policy does not appear to be one of them.

These findings have relevance for several areas. Most obviously, our evidence rejects the hypothesis that corporate investors are attracted to dividend-paying firms. This complements the emerging literature that finds dividend clienteles for some type of investors but not for others. Our evidence is thus inconsistent with several theory papers, including Shleifer and Vishny (1986) and Allen and Michaely (2003), positing that corporate block investors are attracted to dividend-paying firms.¹ Our findings also help to fill out an emerging picture of how large shareholders influence dividend policy. Perez-Gonzalez (2003) finds that changes in the tax rate on dividends have a significant effect on payout policy when a firm's largest shareholder is an individual. In contrast, to the extent that corporate blockholders intervene to shape dividend policy, it is operating blockholders, and they are associated with lower dividends. Lastly, our findings highlight a richness with corporate blockholders as there appear to be important differences between operating and financial corporate blockholders.

The paper is organized as follows. Section 1 starts with a brief overview of the tax treatment of dividends for corporate shareholders. Next, we review theoretical articles that posit a positive relation between corporate block ownership and dividend policy, and we summarize what little empirical evidence exists on corporate shareholders and dividends. Section 2 investigates dividend changes after block trades, focusing on those trades in which a corporation buys a block from an individual. Section 3 starts with a cross-sectional analysis of a

¹ These theories have yet to be tested. As Allen and Michaely (2003) write, "whether indeed large shareholders are attracted to firms that pay dividends . . . is an unresolved empirical issue that is worthy of pursuing."

random sample of firms. We then analyze dividend policy in a series of panel regressions. Section 4 investigates why dividends are not higher in the presence of dominant corporate shareholders even though they would pay lower taxes. Here we explore differences between operating and financial blockholders. A brief conclusion follows.

1. Background

1.1 Dividends, taxes, and corporate shareholders

The Internal Revenue Code differentiates between dividends received by individuals and dividends received by corporations. During the period of our analysis, individuals were fully taxed on any dividends they received.² Corporate shareholders, in contrast, have always been allowed to deduct from their taxable income at least 70% of any dividends they receive.³ If a corporation owns 20% or more of the common stock of the distributing company, the dividend deduction increases to 80%. When a corporation owns at least 80% of the stock of another corporation, the dividend deduction is total.

The effective marginal tax rates for capital gains are reversed for individual and corporate shareholders. Individual taxpayers are taxed at a lower rate on long-term capital gains than on ordinary income. Corporate shareholders, in contrast, face a lower effective marginal tax rate on dividends than on capital gains. Because corporations are allowed to exclude most, if not all, of their dividend income, they are taxed at a rate of approximately 35% on capital gains but only 10.5% (or less) on dividends. It is this difference between the tax status of corporate and individual shareholders that has long intrigued financial economists.

1.2 Theoretical papers on corporate shareholders and dividends

Corporations' unique tax preference for dividends is a key component in several prominent theoretical papers. Shleifer and Vishny (1986) model a large shareholder that monitors management. There is a potential free-rider problem because the large shareholder incurs all of the monitoring costs but reaps only part of the benefits. In their model, dividends can act as a side payment for these monitoring services if the large shareholder values dividends more highly than small shareholders. Shleifer and Vishny note, but do not pursue empirically, that large shareholders are often other corporations and should thus have a tax preference for dividends.

² After our sampling period, in 2003, the tax code was changed to lower the tax rate on dividends received by individuals. Before this change, any dividends received by individuals were taxed at the individual's normal marginal tax rate with a maximum rate of 35%. After the change, dividends received by individuals are now taxed at a rate of 15%. Chetty and Saez (2005) study these changes. The taxation of dividends received by corporations is not affected by these changes.

³ Prior to December 22, 1987, corporations could deduct 80% of any dividends received if they owned less than 20% of the stock of another corporation.

Corporations' presumed tax preference for dividends is also central in Allen and Michaely (2003). They develop a model reflecting the fact that individuals face higher taxes on dividends than on capital gains; tax-exempt institutions are indifferent between dividends and capital gains; and corporations prefer dividends to capital gains. Under these assumptions, they show that an equilibrium evolves in which individuals hold low-dividend-paying stocks, institutions hold medium-dividend-paying stocks, and corporations hold high-dividend-paying stocks.

Finally, Allen, Bernardo, and Welch (2000) develop a model in which managers pay dividends to encourage sophisticated investors to hold large-percentage blocks of stock. Firms pay dividends in this model both because dividends serve as a signal of value (by attracting the attention of sophisticated investors who are not tax averse to dividends) and because the large-block shareholders who are attracted by the dividend payments help mitigate the agency conflicts between diffuse owners and managers. Although Allen, Bernardo, and Welch focus on a clientele of tax-exempt institutions who are indifferent between dividends and capital gains, their model predicts that both firms' dividend policies and large-block shareholders' investment decisions are materially affected by the blockholders' dividend tax status.

All of these models reflect the narrow provision of the tax code that treats corporate shareholders differently than other shareholders for the taxation of dividends received. The implications of these models, however, are broad and fall into four categories. First, the models make a classic tax-clientele prediction that corporations will hold high-dividend-paying stocks. Second, the models have implications for the determinants of dividend policy because firms may institute or increase dividends to attract corporate shareholders. Third, the models are relevant also for the determinants of a firm's ownership structure; they imply that corporate shareholders are more likely to be found in firms that pay dividends than in those that do not pay dividends. Fourth, the models suggest that one way corporate blockholders use their voting power and receive private benefits is through dividend policy.

1.3 Existing empirical evidence

Early empirical tests of tax-based dividend clienteles focused on their asset-pricing implications. For example, Elton and Gruber (1970) find that ex-dividend day stock returns are decreasing in a stock's dividend yield, which they interpret as evidence supporting tax-based dividend clienteles. Elton and Gruber note that investors in the highest yield stocks exhibit a preference for dividends over capital gains, a preference they attribute, at least partially, to corporations' tax preference for dividends. Litzenberger and Ramaswamy (1979) also find evidence of dividend clienteles when they estimate an after-tax version of the CAPM. Following these early papers, debate over the existence of dividend clienteles continued unresolved, largely because it was difficult to obtain the stock ownership data needed to test for clienteles directly.

As more stock ownership data have become available, researchers have been able to test for tax-based dividend clienteles directly. The emerging evidence is mixed. Most of these papers focus on individual or institutional shareholders and ask whether such investors gravitate to holding stocks with certain dividend characteristics. A few papers examine the impact of large-percentage, noncorporate shareholders on dividend policy. There is little evidence on either the stockholdings of corporate shareholders or the impact of such shareholders on dividend policy.

Scholz (1992) and Graham and Kumar (2006) find evidence consistent with tax clienteles among small individual (retail) investors. The preference for dividends among these investors seems to decline with income, which makes sense as increasing marginal tax rates for individuals reduce after-tax dividends. Individual investors are in a different tax situation than corporate shareholders, and these small investors obviously do not have the voting power to change dividend policy.

Brav and Heaton (1998) and Binay (2001) find evidence of dividend clienteles among institutional investors. Michaely, Thaler, and Womack (1995) and Grinstein and Michaely (2005), however, find no evidence that the level of dividends affects institutional ownership, which they interpret as evidence against a tax-clientele effect. Institutional investors will be either tax averse or tax neutral toward dividends, depending on the tax status of their beneficiaries. Corporate shareholders, in contrast, have a tax preference for dividends. In addition, institutional shareholders individually seldom own large-percentage blocks of stock, but, by design, the corporate shareholders we study always own at least 5% of the common stock and occasionally own majority blocks.

There has been less research on the relation between dividend policy and large-percentage shareholders. Perez-Gonzalez (2003) examines a broad sample of public corporations during the mid-1990s. He finds that when tax law changes cause dividends to be less tax disadvantageous relative to capital gains, dividends increase in those firms in which the largest shareholder is an individual as opposed to an institution. Firms in which corporations are the largest shareholder are excluded from his analysis. The author interprets these findings as evidence of a clientele effect for large-percentage individual shareholders; he also concludes that such blockholders influence dividend policy directly.

Eckbo and Verma (1994) study dividend policies at Canadian corporations and in so doing look at corporate shareholders. Their model proposes a game between corporate shareholders and managers in which corporate shareholders always desire higher dividends than do managers. In the model, corporate or institutional shareholders can ask for a vote on dividend policy if management does not agree to their demand for higher dividends. The dividend that is ultimately paid depends on the voting power of the corporate shareholder and how far apart managers and shareholders are on the proposed dividends. Eckbo and Verma find that the voting power of the corporate shareholders influences dividends, with dividends increasing as corporate voting power increases.

For several reasons, Eckbo and Verma's results are unlikely to apply to the United States. The tax laws in Canada on intercorporate dividends differ from those in the United States. Moreover, in Canada minority shareholders have the right to object to dividend policy. In contrast, dividend policy in the United States is left to the discretion of the board of directors under the business judgment rule. Perhaps most significantly, in Canada the nature of corporate blockholders is typically different from the nature of corporate blockholders in the United States. In Canada many corporate blockholders are holding companies for individual blockholders.⁴ In the United States these would be Chapter S corporations and thus subject to individual tax treatment.

One paper that does present data on corporate shareholders and dividends in the United States is Holderness and Sheehan's (2000) study of organizational and legal constraints on majority shareholders. As part of their analysis, they look at dividend policy on the theory that high payouts to shareholders may increase the frequency of external financing, which in turn could trigger external monitoring of a majority shareholder. They do not find any significant differences in payout policy between the corporate majority shareholder firms and their paired firms. Holderness and Sheehan do not study shareholders who own large but less-than-majority blocks of stock, nor do they examine changes in dividend policy after trades of majority blocks of stock.

2. Block-Trade Analysis

The tax-preference hypothesis assumes at its core that corporate shareholders place a higher value on cash dividends than do other types of shareholders, especially individual shareholders. Corporate shareholders can not have a lower tax preference for dividends than individual shareholders, and corporate shareholders will have a greater preference for dividends to the extent their marginal tax rate is greater than zero. Accordingly, dividends should increase after a corporation buys a large-percentage block of common stock from an individual, either because management wants to curry favor with the new blockholder or because the new blockholder uses its voting power to alter dividend policy to suit its own tax situation. Because we are examining the same firm before and after it changes from an individual to a corporate blockholder, we should be holding constant other factors that affect dividend policy. Consequently, if dividend policy changes after a block trade, it should, in part at least, reflect the tax preferences of the new corporate blockholder.

⁴ An example is Thomson Corporation, one of the largest Canadian corporations with a market capitalization of \$22.5 billion. Sixty-five percent of its common stock is owned by Woodbridge Company, which is described in Thomson's proxy as a "private company that is the primary investment vehicle for Kenneth R. Thomson and other members of the family of the late first Lord Thomson of Fleet." Kenneth Thomson is a director but not an officer of Thomson Corporation.

2.1 Block-trade sample

We generate a sample of block trades by examining each entry of *The Wall Street Journal Corporate Index* for 1978 through 1997 for transactions that satisfy several criteria. First, we look for trades of at least 5% of the outstanding common stock of a company. It is important to understand that these are trades of existing blocks of stock. No stock is issued, so no funds flow to the (target) firms. Indeed, the (target) firms themselves are not directly involved in the trades. Second, we need to know the number of shares in the block from *The Wall Street Journal*, the Lexis-Nexis computer database, or from documents purchased from Disclosure, Inc., typically SEC form 13d filed by either the block purchaser or the block seller. This information is needed to confirm that the trade meets the 5% threshold. Third, we exclude block trades that are announced simultaneously with an offer to acquire the remaining shares in the firm. Using these criteria, we generate a sample of 186 block trades. This sample size compares favorably with earlier studies. Barclay and Holderness (1989) in the first block-trade paper study sixty-three block trades. Mikkelsen and Regassa (1991) analyze thirty-seven block trades. Allen and Phillips (2000) investigate operating interactions associated with 402 large-percentage equity investments by one corporation in another corporation. Only forty-two of these positions, however, were acquired in block trades.

The type of blockholder is central to our inquiry. We classify as corporate shareholders operating firms, banks, and insurance companies as all may claim the dividend exemption. (Later in the paper we partition the corporate blockholders into operating and financial.) We also classify private companies as corporate shareholders when press reports indicate that the company is an operating entity, as opposed to an investment vehicle. In contrast, we do not classify private investment vehicles, including Chapter S corporations (such as hedge funds), as corporations because under the Internal Revenue Code any dividends they receive must be passed through each year to their individual shareholders who, in turn, pay taxes on the dividends at their full marginal tax rate. By the same reasoning, we also do not classify mutual funds as corporations, but instead put them into a separate, noncorporate category.⁵

Using this classification, we identify fifty trades in which the block seller is an individual and the block buyer a corporation. If tax considerations are important, dividends should increase following these trades as corporations supposedly favor dividends while individuals disfavor them. We also have a few (15) block trades that go in the other direction, from corporations to individuals. Because our focus is on possible tax effects from corporate blockholders, not from individual blockholders, our analysis naturally focuses on the individual to corporate block trades. We do briefly discuss the corporate-to-individual block trades, however. There are 121 other block trades (from one corporation

⁵ Both dividends and capital gains received as a result of normal operations are taxed as ordinary income for financial corporations that engage in market making or other trading activities. To the best of our knowledge, none of the blockholdings in our samples fall into this category.

to another or from one individual to another). These block trades do not change the tax status of the blockholder and thus are not expected to affect dividend policy, but they are used for control purposes in some analyses.

Throughout the paper we measure dividend policy in four ways, all of which have been used by other researchers. One measure is a dummy variable that equals one if a firm pays cash dividends and zero if it does not. We also examine the level of dividends in three ways because any clientele effect should increase with the level of dividends. Dividend Yield is dividends per share divided by the stock price per share (Compustat annual data item 26 divided by item 199). Dividends/Assets is annual dividends divided by the book value of assets (Compustat annual data item 21 divided by item 6). Dividend Payout is dividends per share divided by earnings per share before extraordinary items (Compustat annual data item 21 divided by item 18). We also document changes in dividends per share after each of the fifty blocks trades. Because this measure is unscaled, it is not appropriate for cross-sectional analyses, either with the block-trade sample or later in the paper with the random sample.

Dividend Yield takes an investor's perspective by incorporating the stock price, thereby making it relevant for the various clientele models. The problem with this measure is that its variance is determined largely by the variance of the stock price, rather than from changes in dividends, which is our primary interest. The advantage of the second measure, Dividends/Assets, is that the book value of assets is relatively stable over time. Thus, changes in Dividends/Assets are more likely to result from changes in dividends. The last measure, Dividend Payout, indicates how much of a firm's earnings are returned to shareholders in the form of dividends. This variable should help control for changes in a firm's financial condition that might trigger a change in dividend policy, such as financial distress, as opposed to a change in the tax situation of a firm's dominant shareholder.

2.2 The situation before the trades

We start by examining dividend policy before the block trades to put any posttrade changes into perspective. If dividends were abnormally high before the trades, they could remain unchanged after the trades even if corporations prefer dividends to capital gains. That is to say, an assessment of dividend policy associated with block trades needs to consider both the pre- and posttrade level of dividends and not just the change in the level of dividends.

Before the block trades the sample firms seem to have typical dividend policies as summarized in the "Before" column of Table 1. Their average Dividend Yield is 1.7% (median 1.1%), and they are paying out 15% (median 2%) of their earnings in the form of dividends. Slightly more than half (58%) of the firms are paying dividends. These figures are similar to the dividend policies of similar firms in the same year. Here we alternatively compare the sample firms both to similar-sized firms and to firms from the same industry (Fama-French 38 industry classification). For example, the average Dividend

Table 1
Changes in dividend policy associated with fifty trades of large-percentage blocks of common stock between 1978 and 1997 in which the block seller is an individual and the block purchaser is a corporation (but not the corporation that issued the stock)

	Before	After	<i>p</i> -value of difference
Portion Paying Dividends	58%	41%	0.04
Dividend Yield	0.017 (0.011)	0.009 (0.00)	0.01 (0.01)
Dividends/Assets	0.0064 (0.003)	0.0058 (0.00)	0.66 (0.07)
Dividend Payout	0.15 (0.02)	0.10 (0.00)	0.21 (0.08)
Block Size	0.28 (0.27)	NA	NA

Portion Paying Dividends is the percentage of firms paying dividends in at least one of the two years either before or after the trade. Dividend Yield is a firm's average (median) annual cash dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 199). Dividends/Assets is a firm's average (median) annual dividends (Compustat annual data item 21) divided by book value of assets (Compustat annual data item 6). Dividend Payout is a firm's average (median) total annual cash dividends (Compustat annual data item 21) divided by its accounting income before extraordinary items (Compustat annual data item 18). The average and median for each variable are computed for the two years before the block trade (Before) and the two years following the trade (After). Data from the year of the trade do not enter into these calculations. Block Size is the average (median) portion of the firms' common stock involved in the trade. All trades involve at least 5% of the firm's outstanding common stock. The third column is the *p*-value from a standard *t*-test for the hypothesis of no difference between averages or the *p*-value for a Wilcoxon rank-sum test on the difference between the before and after medians. Data from *The Wall Street Journal*, CRSP, and Compustat.

Yield is 1% less and the median Dividend Yield is the same as it is for similar-sized firms in the same year. The average payout of the block-trade firms is slightly above what similar-sized firms were doing in the same year, but their median payout is the same (not reported).⁶ When we compare the sample firms with firms from their same industry, the findings are similar.

Thus, there is no evidence of a clientele effect in which corporations are buying blocks in high-dividend-paying firms. There appears to be an opportunity for the corporate purchasers to use their considerable voting power, which averages 28% of the common stock (median 27%), to institute or increase dividends after their arrival.

2.3 Changes in dividend policy after corporations buy large blocks

Table 1 also documents how dividend policy changes after a corporation buys a large-percentage block of stock from an individual. Although the tax-preference hypothesis predicts an increase in dividends following such trades, especially given that dividends were not abnormally high before the trades, we find no evidence of this. If anything, there appears to be a modest decline in dividends. The portion of firms paying dividends drops from 58% before the trades, when there is a dominant individual shareholder, to 41% after the trades (*p*-value of 0.04 on the difference), when there is a dominant corporate shareholder.

⁶ To make these comparisons for each year of our sample we divide all active Compustat firms into five equal-sized groups based on total asset value. We then determine the median dividends/assets, the median dividend yield, and the median dividend payout for each quintile. Then we place each of our firms into the appropriate size quintile for each year studied, which are the two years before and the two years following the trade. Finally, we subtract the appropriate median (average) figure from the block-trade firm's dividend/assets, dividend yield, and dividend payout.

Similarly, all three measures of the level of dividends decline following the trades. Here we compare the two-year averages before or after the trade, excluding the year of the trade. Thus, we are examining a five-year window. The declines in the mean and median Dividend Yield, the measure of the level of dividends that is probably the most relevant for the clientele models, are both statistically significant. The median declines in Dividend Payout and Dividends/Assets are likewise statistically significant.

Because we have only fifty trades, we can check each trade for changes in dividends per share. Following most of the block trades, 72% of the sample (36 of 50 trades), there is no change in dividends per share. There are dividend decreases after nine trades (18% of the sample), but there are dividend increases after only five trades (10% of the sample).⁷ Thus, five different measures of dividend policy provide no support for the posttrade increase in dividends predicted by the tax-preference hypothesis. If anything, the evidence suggests a posttrade decrease in dividends. And this was from a pretrade level for dividends that was not unusually high.

2.4 Robustness checks

The data in Table 1, although seeming to reject a tax effect, cannot reject more involved explanations that would be consistent with the tax-preference hypothesis. We now address three of these explanations. We also examine block trades that go from corporations to individuals.

2.4.1 Do dividends increase with larger fractional blocks? Table 1 does not account for the fractional size of the blocks. A reasonable argument would be that dividends increase only if the corporate block purchasers have sufficient voting power. Moreover, the tax benefits of dividends for corporate shareholders increase with fractional ownership, first at 20% and again at 80%. Because all of the trades are included in Table 1, it is possible that dividend changes among the larger block trades may be obscured by the smaller block trades.

There is no evidence of this. For instance, the firms halting dividend payments after the trades have corporate-owned blocks that average 31% of the common stock (median 28%). Three of the firms that halt dividend payments have majority corporate shareholders. An analysis of the level of dividends paints a similar picture. When we regress our measures of the change in the level of dividends on the percent of common stock in the block, the coefficient for the fractional block size is negative (but insignificant), which provides no evidence that larger corporate block purchasers use their greater influence to increase dividend payments or that dividends increase as the associated tax benefit for corporate shareholders increases.

⁷ To check the robustness of these results, we check dividends per share for each of our block-trade firms for three calendar years after the trade. In this one-year extension from the analyses reported above, one firm increases its dividend and another firm decreases its dividend. Thus, our finding of no overall posttrade increase in dividends and arguably a decrease appears robust to the window of analysis.

2.4.2 Do dividends increase once we account for the decline in the portion of firms paying dividends? The data in Table 1 encompass twenty years, and for each block trade we examine dividends over a five-year span. Fama and French (2001) document that the proportion of firms paying dividends has decreased over the past twenty years. This raises the possibility that although dividends may decrease following block trades, the decreases may be smaller than expected because of the corporate purchasers. A smaller-than-expected decrease could be viewed as an effective increase.

To investigate whether our results are affected by the general decline in the proportion of firms paying dividends, we replicate all of our analyses after adjusting for changes in dividend payments by similar-sized firms in the same year. Results from this difference-in-difference approach paint the same picture of dividend decreases after corporations purchase blocks in other firms, with some of the decreases being statistically significant. For instance, adjusted Dividend Yield (the Dividend Yield for our sample firm minus the average Dividend Yield for similar-sized firms in the same year) goes from -1% before the trade to -1.5% after the trade (p -value of 0.07 on the difference). The adjusted Dividend Payout likewise declines (p -value of 0.20). Median figures for both adjusted Dividend Yield and adjusted Dividend Payout also decline. In no instance do we find evidence of a statistically significant increase.

2.4.3 Were other determinants of dividend policy changing at the same time as the block trades? By examining the same firm before and after the block trade, we should control for most of the cross-sectional determinants of dividend policy. It is possible, however, that other factors that influence dividend policy were changing at the same time as the block trades. Indeed, it is possible that such changes triggered the block trade itself. For instance, assume that corporate blockholders systematically buy blocks in firms with decreasing profits. If dividends subsequently decrease, it might have little to do with the tax preference of the new blockholder but more to do with the firm's financial difficulties. We address this issue here through panel regressions with fixed effects for firms and in the next section of the paper through an analysis of the dividend policies at a random sample of publicly traded firms.

In Table 2 we regress each of our measures of dividend policy on factors identified in the literature that affect dividend policy. We control for Firm Size (the natural log of the book value of a firm's assets), return on assets (earnings before interest, taxes, and depreciation scaled by the book value of a firm's assets), and the firm's market-to-book ratio. To test for whether the new blockholder is associated with changes in dividend policy, we specify dummy variables to identify when the firms have corporate blockholders. Nothing in Table 2 suggests that the changes in dividend policy are being driven by changes in other variables. Moreover, the Corporate Buyer dummy, which is our primary focus, is negative in three of the four regressions (although only

Table 2

Panel regressions using fixed firm effects of dividend policy at fifty firms in which a corporation buys a large-percentage block of common stock between 1978 and 1997

	Dividend Dummy	Dividends/Assets	Dividend Yield	Dividend Payout
Corporate Buyer Dummy	-0.371 (0.31)	0.0007 (0.60)	-0.004 (0.12)	-0.048 (0.24)
Firm Size	0.640 (<0.01)	0.0007 (0.11)	0.002 (<0.01)	0.033 (0.01)
Ebitda/Assets	8.689 (<0.01)	0.013 (<0.01)	0.013 (0.03)	
Market to Book	-0.0007 (0.96)	-0.00001 (0.80)	0.0003 (0.83)	0.0005 (0.76)
Intercept		0.002 (0.37)	0.003 (0.45)	-0.0002 (0.99)
Adjusted R ²		0.11	0.10	0.04
F-statistic or chi-square <i>p</i> -value	<0.01	<0.01	<0.01	0.04

The data use the two years before the block trade and the two years after the trade. The dependent variable in the first regression is whether the firms paid dividends. The dependent variable in the second regression is Dividends/Assets, which is a firm's total gross dividends (Compustat annual data item 21) divided by the book value of its assets (Compustat annual data item 6). The dependent variable in the third regression is a firm's gross cash dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 199) ("Dividend Yield"). The dependent variable in the last regression is a firm's total gross dividends divided by its accounting income before extraordinary items (Compustat annual data item 18) ("Dividend Payout"). Firm Size is the natural log of the book value of the firm's assets. Market to Book is the ratio of a firm's market value of equity divided by the book value of its assets. Ebitda/Assets is a firm's earnings before interest, taxes, and depreciation divided by the book value of its assets. The Corporate Buyer dummy takes the value of one in the two years after the block trade. All trades involve at least 5% of the firm's outstanding common stock. *p*-values in parentheses test whether regression coefficients are different from zero. Data from *The Wall Street Journal*, CRSP, and Compustat. 1978–1997.

one is marginally significant), which is opposite from the prediction of the tax-preference hypothesis.⁸

2.4.4 Block trades from corporations to individuals We have fifteen trades in which the block seller is a corporation and the block buyer is an individual. When we replicate the analyses of Table 1 with this small sample, median measures of dividends stay constant (at zero) while averages decline slightly. These declines, however, are never statistically significant. When we replicate the Table 2 regressions with the dummy variable now taking the value of one for an individual buyer, the estimated coefficient on this variable in all four regressions is negative. The significance levels range only from 0.14 (for the logit regression) to 0.30 (for the payout regression).

Putting the issue of statistical significance to the side, the declines in dividends following the corporate-to-individual block trades are consistent with a tax effect. The question is whether this tax effect is driven by the corporate sellers, the individual buyers, or both. To address this issue, we need to examine the dividend policies of the firms before the trade. We do this both relative to similar-sized firms and relative to firms from the same industry. Both comparisons show that dividends were typical of other firms before the trades. For example, the median yield (measured all three ways) is exactly the median yield for the industry; the average yield is either slightly above or below the industry average (depending on the measure) and that difference is never statistically

⁸ We also run the same regressions by simply pooling all observations for all years. The results are qualitatively the same as in Table 2.

significant. The size-adjusted figures paint a similar picture. For example, the median Dividend Yield of the sample firms is the same as similar-sized firms and the average yield is only 0.12 percentage points higher. Given that the firms start from a normal level of dividends, the posttrade decline in dividends (the issue of statistical significance aside) suggests a tax effect for individual blockholders but not for corporate blockholders.

3. Random Sample Analysis

We now turn to our second set of investigations, dividend policy at a random or representative sample of public corporations. Investigations with this sample, which are equal in importance to those with the block trades, offer several advantages. Most important, it is possible that there is something unusual about firms that are the subject of a block trade. The trades may not be exogenous. An unidentified factor might both trigger a block trade and affect dividend policy after the trade. Perhaps without such factors dividends would have increased with the arrival of a corporate blockholder. There may also be something unusual about the block buyers. Along these lines, we note that only two of our block buyers are financial corporations, whereas casual observation suggests that financial blockholders are more common than this. The random sample also enables us to determine how often firms have corporate blockholders and how often those blockholders are either operating companies or financial corporations. If only a few firms have corporations as large-percentage shareholders, then the attention over the years on the unusual tax treatment of intercorporate dividend payments has been overblown. A random sample expands the number and range of observations for analysis. Finally, a random sample enables us to estimate the (unconditional) impact of any tax effect associated with large corporate shareholders on dividend policy.

3.1 The random sample

To generate a random sample of firms, we start with all firms listed on the March 1995 disk of Compact Disclosure, which includes all firms traded on the NYSE, Amex, and NASDAQ. We select 1995 because we want both recent data and a starting point for panel data. We randomly select one of the first ten firms listed in Compact Disclosure's alphabetical listing of firms and then select every tenth firm thereafter. This produces a list of 428 firms.

We then use proxy statements to obtain information on large-block ownership. We were able to obtain proxies for 376 of the 428 firms from the SEC's Edgar database, Lexis-Nexis's EdgarPlus database, or LaserDisclosure. These 376 firms constitute the sample for this part of the paper.⁹ The proxies are as close to 1995 (typically February or March of that year) as possible. We then revisit these firms using 1998, 2001, and 2004 proxies (to the extent that they are

⁹ There is no overlap between this sample and the block-trade sample.

still publicly traded). We thus have panel data with three-year intervals without replacement of firms that are acquired, go private, or declare bankruptcy.

From the proxies, we hand collect ownership data on all shareholders who own at least 5% of the common stock. In 1995, 129 of the 376 sample firms (34%) have at least one corporate blockholder that owns at least 5% of the stock. (We use the same blockholder classification as with the block trades.) There are 168 different Corporate Blocks in the 1995 sample, with some firms having more than one corporate blockholder. The average aggregate stockholdings of all corporate blockholders within a given firm when the firm has at least one corporate blockholder is 27% (median 19%). In seventy-one of these firms (19% of the total sample), the largest blockholder in the firm is a corporation. In these cases the average size of that block is 28% (median 22%).

We draw two conclusions from these summary statistics, which to our knowledge are the first reported data on the extent of corporate block ownership among public firms in general.¹⁰ First, corporate block ownership is more than a curious anomaly. Fully one-third of a representative sample of public firms has corporate blockholders. Second, as shown in Figure 1, there is no clustering of corporate ownership at 20%, which would increase the dividend exclusion from 70% to 80%, or at 80%, which would make the dividend exclusion total. There are only six blocks (4% of the sample) that fall between 20% and 25%, and only three blocks are greater than 80%. One would expect more clustering of corporate block ownership at (slightly above) 20% and 80% if tax incentives on dividends were a first-order consideration.

3.2 Basic findings

If tax considerations carry weight, many firms with corporate blockholders will pay dividends. As reported in Table 3, the opposite, however, is the case. Sixty-eight percent (68%) of the 129 firms with corporate blockholders pay no dividends in 1995 (p -value < 0.01 for a binomial probability test that firms with corporate blockholders are as likely to pay dividends as they are not to pay dividends). This figure is slightly higher but not statistically different from the percent of firms without corporate blockholders that do not pay dividends.

The tax-preference hypothesis also has implications for ownership structure. If the hypothesis is correct, firms paying dividends should be more likely to have corporate blockholders. The data reject this proposition as well. Only 33% of the 133 firms paying dividends have corporate blockholders (p -value < 0.01 for binomial probability test that firms paying dividends are as likely to have corporate blockholders as they are not to have such blockholders). In contrast, 35% of the firms that pay no dividends have corporate blockholders.

One limitation of these comparisons is that they do not account for the fractional size of the Corporate Blocks. Perhaps, for instance, 7% ownership

¹⁰ Field and Sheehan (2004) report data on corporate large-block ownership for a sample of IPO firms for the first two years in which they are public.

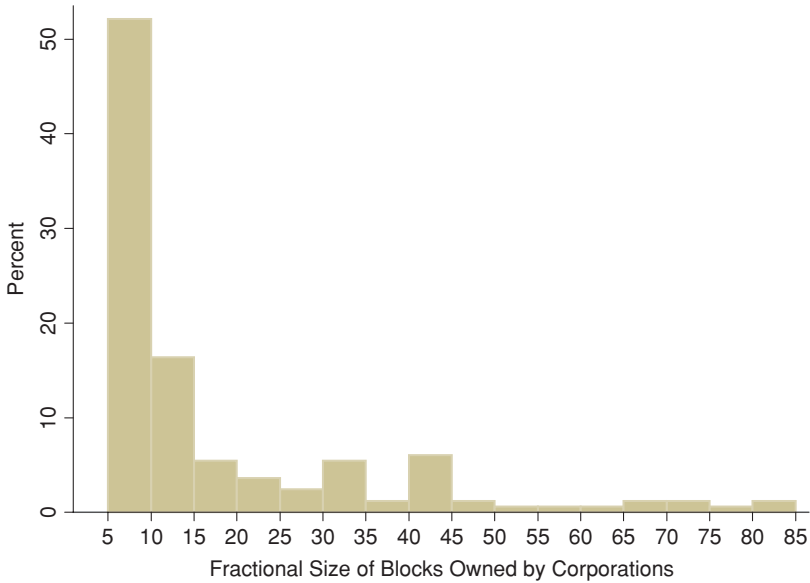


Figure 1
Fractional ownership of corporations that own large-percentage blocks of at least 5% of the common stock in a sample of 376 randomly selected firms
 This figure shows the fractional size of the 164 Corporate Blocks in these firms. Some firms have more than one corporate blockholder. Ownership data are from 1995 and come from annual proxy statements.

does not give a blockholder the power to influence dividend policy but 20% does. Fractional size is also important as the tax benefits of dividends increase as a corporation’s ownership reaches 20%; they increase again at 80%. The data, however, reject this line of reasoning. For instance, 70% of the fifty firms with corporate blockholders that own at least 20% of the common stock pay no dividends (p -value <0.01 for a binomial probability test that firms with corporate blockholders owning at least 20% are as likely to pay dividends as they are not to pay dividends). At the extreme, ten of the thirteen firms with majority corporate shareholders (77%) pay no dividends (p -value = 0.09) for a binomial probability test that firms with majority corporate blockholders are as likely to pay dividends as they are not to pay dividends).

Similarly, we find no evidence that firms paying higher dividends are more likely to attract corporate blockholders. For example, if we examine the top quartile of dividend payers (measured as dividends as a percentage of firm assets), only 33% have corporate blockholders (p -value of <0.01 that such high-dividend-paying firms are as likely to have corporate blockholders as they are not to have corporate blockholders). These findings are consistent with our earlier finding that corporations are not buying large-percentage blocks in firms with abnormally high dividends, nor do dividends increase after the arrival of a corporate blockholder.

Table 3
Summary statistics on the payment of cash dividends in a sample of randomly selected firms

	Firm has corporate blockholder	Firm has no corporate blockholder	<i>p</i> -value of difference between subsamples
Portion not Paying Dividends	0.68	0.64	0.71
Dividends/Assets			
Average	0.0071	0.0074	0.85
Median	0.00	0.00	0.55
Dividend Yield			
Average	0.010	0.009	0.72
Median	0.00	0.00	0.46
Dividend Payout			
Average	0.07	0.13	0.16
Median	0.00	0.00	0.16
	Firm pays dividends	Firm does not pay dividends	<i>p</i> -value of difference between subsamples
Portion Having Corporate Blockholders	0.33	0.35	0.71
Blockholder Ownership			
Average	7.0%	8.2%	0.50
Median	0.00	0.00	0.58

Dividends/Assets is annual dividend payment (Compustat annual data item 21) divided by the book value of assets (Compustat annual data item 6). Dividend Yield is a firm's annual cash dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 199). Dividend Payout is a firm's total annual cash dividends (Compustat annual data item 21) divided by its accounting income before extraordinary items (Compustat annual data item 18). Firms with corporate blockholders are the 129 firms in which at least one corporate shareholder owns at least 5% of the common stock. Firms paying dividends are those 133 sample firms that pay dividends. There are 376 total firms in the sample. Ownership data are from 1995 and come from annual proxy statements. Financial data are from 1994 and come from Compustat and CRSP. The *p*-values are either for a difference in the means test or for the Wilcoxon rank-sum test.

3.3 Multiple regressions

The preceding analyses do not control for factors other than corporate block ownership and fractional block size that might affect dividend policy. The question becomes: once we control for the determinants of dividend policy, does the existence of a corporate blockholder increase either the probability of a firm paying dividends or the level of dividends?

We address this question through a series of multiple regressions. We identify control variables from the literature. To control for Firm Size, we use log of book value of assets. To control for investment opportunities, we use the market-to-book ratio. To control for firm profitability, we use earnings before interest, taxes, and depreciation scaled by the book value of a firm's assets. Exploratory analyses reveal that dividends increase significantly with the age of a firm; accordingly, we control for firm age.¹¹ To control for industry effects, we use the Fama-French classification of thirty-eight industries. Finally, we control for individual block ownership because (in contrast to corporate shareholders) they have a tax preference for capital gains over dividends (Jensen, Solberg, and Zorn 1992; or Agrawal and Jayaraman 1994). In the first two regressions in

¹¹ Year of incorporation comes primarily from the Mergent On-Line Data Base. When that source does not have the information, we determine year of incorporation from the firm's Web site or from Lexis-Nexis and Factiva text searches.

Table 4, we use a dummy variable that equals one if a firm pays dividends and zero otherwise (logit regressions). The other (OLS) regressions utilize the same three measures of dividend policy used with the block trades (Dividends/Assets, Dividend Yield, and Dividend Payout).

Table 4 offers no support for the proposition that dividends are either more likely or higher in the presence of corporate blockholders. Instead, as with the block-trade analysis, there is weak evidence that dividends are actually lower in the presence of a corporate blockholder, which runs counter to the tax-preference hypothesis. The sign of the coefficient for corporate ownership is negative in seven of the eight specifications; in the last specification it is negative and marginally significant (p -value of 0.12).

3.4 Robustness checks

We conduct a wide range of investigations to check the robustness of the Table 4 results. Because two of our measures of dividend policy cannot be negative and are thus bounded below (Dividends/Assets and Dividend Yield), we replicate our results using a Tobit model. Because our OLS regressions do not produce normal, independent, and identically distributed error terms, we also replicate our results using quantile regressions based on median values. We use three alternative measures of corporate block ownership: the aggregate stock ownership of all corporate blockholders, the stock ownership of the firm's largest corporate blockholder, and a dummy variable that identifies when a firm's largest blockholder is a corporation. Because some of the regressions using these alternative measures of ownership may be unduly influenced by outliers, we conduct analyses in which we winsorize the dependent variables at the 5% and 95% level. Lastly, we use a variety of alternative measures for the other control variables.¹²

In the many regressions with these alternate methods and specifications, the fundamental result remains unchanged and is consistent with what we found with the block trades—there is no evidence of the predicted positive relation between dividend policy and corporate stock ownership.

3.5 Changes in dividend policy

Next we examine changes in dividend policy over time to determine whether firms initiate (halt) or increase (decrease) dividends after the arrival (departure) of corporate blockholders. We first note that there is no such relationship in the summary statistics. Twenty-nine firms from the random sample initiated dividends in 1998, 2001, or 2004. The average (median) corporate block ownership before the initiations was 4.2% (median zero), and the average corporate block

¹² For firm size, instead of log of book value of assets we use log of market value of equity and log of sales. For growth opportunities, instead of the market-to-book ratio we use the compounded three-year growth rate in sales and the three-year growth rate in assets. For firm profitability, instead of Ebitda scaled by firm assets we use Ebitda scaled by firm sales and return on assets (net income divided by assets). For firm age, instead of the number of years since incorporation we use the log of the number of years since incorporation.

Table 4
Regressions analysis of the dividend policies at a sample of randomly chosen firms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Dividend Dummy	Dividend Dummy	Dividend/Assets	Dividend/Assets	Dividend Yield	Dividend Yield	Dividend Payout	Dividend Payout
Corporate Blocks	-0.08450 (0.71)	-0.19990 (0.56)	-0.00006 (0.97)	-0.00020 (0.91)	0.00043 (0.85)	-0.00038 (0.89)	-0.05188 (0.30)	-0.07416 (0.12)
Individual Blocks		0.01487 (0.96)		-0.00209 (0.14)		-0.00200 (0.35)		-0.04249 (0.27)
Firm Size		0.60811 (<0.01)		-0.00004 (0.95)		0.00091 (0.27)		0.03706 (<0.01)
Market to Book		-0.19418 (0.34)		0.00037 (0.55)		-0.00124 (0.14)		0.01018 (0.21)
Ebitda/Assets		2.96516 (0.02)		0.01088 (0.06)		0.00218 (0.66)		
Age of Firm		0.03837 (<0.01)		0.00024 (<0.01)		0.00017 (<0.01)		0.00273 (<0.01)
Constant	-0.57396 (0.00015)	-5.10959 (<0.01)	0.00737 (<0.01)	0.00101 (0.77)	0.00929 (<0.01)	0.00293 (0.51)	0.12436 (<0.01)	-0.12419 (0.07)
Observations	376	369	376	369	376	369	376	372
Pseudo/adjusted R ²	0.152	0.433	<0.001	0.140	<0.001	0.243	0.005	0.172

The first two regressions are logit regressions in which the dependent variable takes a value of one if the firm paid dividends in 1994 and zero otherwise. The other regressions are OLS. Dividends/Assets is annual dividends (Compustat annual data item 21) divided by book value of assets (Compustat annual data item 6). Dividend Yield is a firm's dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 199). Dividend Payout is a firm's annual dividends divided by its accounting income before extraordinary items (Compustat annual data item 18). Corporate Blocks is a dummy variable that indicates the firm has at least one corporate shareholder that owns at least 5% of the common stock. Individual Blocks is a dummy variable that indicates the firm has at least one individual shareholder who owns at least 5% of the common stock. Firm Size is the natural log of the book value of the firm's assets. Market to Book is the ratio of a firm's market value of equity divided by the book value of its assets. Ebitda/Assets is a firm's earnings before interest, taxes, and depreciation divided by the book value of its assets. Age of Firm is the number of years since incorporation. All regressions included unreported industry dummy variables based on the Fama-French 38 industry classification. (*p*-values of Huber-White robust *t*-statistics in parentheses test whether coefficients are significantly different from zero.) Data from CRSP, Compustat, Mergent Data Base, and annual proxy statements.

ownership after the initiations was 3.2% (median zero). Conversely, fourteen firms halted dividends in 1998, 2001, or 2004. Corporate Blocks averaged 5% (median zero) before these stops and 4% (median zero) after the stops.

These summary statistics, obviously, do not account for other factors that might affect dividend policy. Accordingly, we now conduct panel regressions using data from all four years (1995, 1998, 2001, and 2004) with fixed effects within firms. This helps to control for omitted firm-specific factors that affect dividend policy and are constant over time. Of the original 376 sample firms, 284 were publicly traded in 1998; 202 were public in 2001; and 155 were still public in the last sample year of 2004. We continue to use the same four measures for dividend policy, but we use only those independent variables from Table 4 that change over time. Consequently, we do not use year of incorporation (firm age) or industry classification as they stay constant over time for a given firm and are thus subsumed within the firm fixed effect. The panel regressions are presented in Table 5.

The panel regressions fail to support the tax-preference hypothesis. The coefficients for changes in corporate ownership in all specifications are small, insignificant, and change sign depending on the specification. In general, the panel regressions do little to explain changes in dividend policy over time.¹³ This is consistent with a long line of research going back to Lintner (1956) showing that dividend policy within a firm tends to be sticky over time.

3.6 Do Firms change the mix of payouts for corporate shareholders?

Corporate blockholders' tax preference for dividends over capital gains could manifest itself in several ways. We find no evidence that cash dividends are higher in firms with corporate blockholders. Corporate blockholders, however, could cause firms to change the mix of payouts between cash dividends and share repurchases. To the extent that firms distribute cash, corporate blockholders will pay lower taxes on dividends than on the capital gains associated with share repurchases. Thus, tax-clientele considerations would hold that, all else equal, firms with corporate blockholders should distribute a higher fraction of their total payouts in the form of cash dividends.

To investigate the impact of corporate blockholders on the mix of payouts, we define a new variable called "payout mix," which is cash dividends (Compustat annual data item 21) minus stock repurchases (Compustat annual data item 115) divided by the book value of assets (Compustat annual data item 6).¹⁴ If the tax-preference hypothesis is correct, the payout mix should be higher in firms with corporate blockholders than in firms without corporate blockholders.

¹³ We conduct several robustness tests here. For instance, instead of using a dummy variable to identify firms with corporate blockholders, we use the aggregate stock holdings of all corporate blockholders. The results remain qualitatively the same throughout these various robustness tests.

¹⁴ Compustat annual data item 115 includes not only repurchases of common stock but repurchases of preferred stock as well. The inclusion of the latter, however, is usually only a small fraction of a firm's total repurchases and thus should not significantly affect the results. See Stephens and Weisbach (1998).

Table 5
Panel regressions with fixed effects within firms of the dividend policy at a group of randomly selected firms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Dividend Dummy	Dividend Dummy	Dividend/Assets	Dividend/Assets	Dividend Yield	Dividend Yield	Dividend Payout	Dividend Payout
Corporate Blocks	0.001082 (0.42)	0.000654 (0.49)	-0.000023 (0.56)	-0.000030 (0.50)	-0.000017 (0.77)	-0.000020 (0.77)	0.000061 (0.97)	-0.008436 (0.41)
Individual Blocks		0.000288 (0.64)		0.000004 (0.89)		0.000024 (0.42)		-0.063804 (0.40)
Firm Size		0.002314 (0.80)		-0.000928 (0.07)		-0.001216 (0.15)		-0.115345 (0.62)
Market to Book		-0.004670 (0.30)		-0.000518 (0.36)		-0.000526 (<0.01)		-0.069857 (0.20)
Ebitda/Assets		-0.001648 (0.27)		-0.000126 (0.50)		-0.000120 (0.08)		
Constant	0.408864 (<0.01)	0.379889 (<0.01)	0.007952 (<0.01)	0.014258 (<0.01)	0.009335 (<0.01)	0.016725 (<0.01)	0.300228 (0.29)	2.615821 (0.32)
Observations	1,020	969	988	969	990	969	988	980

Data are from 1995, 1998, 2001, and 2004. There are 376 firms for 1995, 284 firms for 1998, 202 firms for 2001, and 155 firms for 2004. All firms were randomly chosen in 1995 and are in the 1995 data set. The dependent variable in regression one is a dummy variable that takes the value one if a firm paid dividends and zero if it did not; the dependent variable in regression two is a firm's annual dividends (Compustat annual data item 21) divided by the book value of its assets (Compustat annual data item 6) ("Dividends/Assets"); the dependent variable in regression three is the last two regressions is a firm's dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 19) ("Dividend Yield"); the dependent variable in regression four is a firm's annual dividends divided by its accounting income before extraordinary items (Compustat annual data item 18). Corporate Blocks is a dummy variable that takes a value of one if a firm has a corporate blockholder and zero otherwise. Individual Blocks is a dummy variable that indicates the firm has at least one individual shareholder who owns at least 5% of the common stock. Firm Size is the natural log of the book value of the firm's assets. Market to Book is the ratio of a firm's market value of equity divided by the book value of its assets. Ebitda/Assets is a firm's earnings before interest, taxes, and depreciation divided by the book value of its assets. (*p*-values of Huber-White robust *t*-statistics in parentheses test whether coefficients are significantly different from zero.) Data from CRSP, Compustat, and annual proxy statements.

We find no evidence that corporate blockholders affect the mix of payouts between cash dividends and share repurchases. To the contrary, firms with corporate blockholders actually spend slightly more repurchasing stock than they do paying dividends. Furthermore, firms with corporate blockholders have a slightly greater propensity to repurchase shares than to pay cash dividends. We also conduct multiple regression analyses to control for other variables that could affect the mix of payouts, including Firm Size, q -ratio, firm profitability, and firm age. Our variables of interest are either a dummy variable to denote firms with corporate blockholders or the percentage of stock held by all corporate blockholders within a firm. Neither variable is statistically significant.¹⁵

4. Why Isn't There a Tax Effect on Dividend Policy?

The evidence both from the block trades and from the random sample points to the same conclusion—dividends are not higher in the presence of a large-percentage corporate shareholder even though these shareholders have a unique tax preference for dividends. We now investigate several possibilities for this finding. The first two possibilities implicitly assume that tax considerations are paramount. We then divide our sample of corporate blockholders into operating firms and financial firms. Here we test for the possibility that different types of corporate blockholders may have different objectives in making block investments, and for some investors taxes on dividends may be of second-order importance.

4.1 Tax rates of the corporate blockholders

The claim that corporations are the only investors with a tax preference for dividends is based on the corporate statutory tax rate of 35%. If a corporation's effective marginal tax rate is sufficiently low, because of loss carry-forwards or high deductions, from a tax perspective it will be indifferent between dividends and capital gains. There is evidence that some corporations, indeed, have low tax rates. Our failure to find a tax effect on dividend policy would be understandable if low-tax-rate corporations tend to own blocks in other corporations.

To investigate this possibility, we need an estimate of the marginal tax rates of corporate blockholders. Graham (1996a and 1996b) develops an algorithm for estimating the effective marginal tax rates of public corporations. We use

¹⁵ We conduct a wide range of multiple regression analyses and robustness checks, including alternative regression methods, alternative definitions of variables, and the trimming of outliers. These analyses help address the regularity that repurchases are more frequent when firms have more volatile cash flows and when recent stock-return performance has been poor; see Jagannathan, Stephens, and Weisbach (2000). These regression analyses and robustness tests do not change the fundamental finding that corporate blockholder firms do not reduce stock repurchases to maintain cash dividends. We also find no change in the mix of payouts with the block-trade sample after the arrival of a corporate blockholder.

Table 6

Summary statistics on the marginal tax rates of corporations that own large-percentage blocks in a random sample of other corporations (corporate blockholders) compared with corporations generally

	Corporate blockholders	All other corporations	<i>p</i> -value of difference
Average marginal tax rate	30%	17%	<0.01
Median marginal tax rate	35%	13%	<0.01
Proportion of firms with zero marginal tax rate	0.03	0.09	0.02

The tax rates come from John R. Graham, <http://faculty.fuqua.duke.edu/~jgraham/taxform.html>, and are described in Graham (1996a and 1996b). These tax rates take into account any interest deduction that a corporation may have (that is, they are “marginal tax rates two” from Graham). The observations are from 1995, 1998, 2001, and 2004. There are 122 observations for the corporate blockholders and 26,198 observations for other corporations. The *p*-values in the last column are for either a difference in the means test or the Wilcoxon rank-sum test.

his database (the Graham Database) to determine whether the corporate blockholders in our random sample have low marginal tax rates.¹⁶

Table 6 reports the marginal tax rates for our corporate blockholders and compares them with the marginal tax rates for the other companies in the Graham Database. The corporate blockholders have an average marginal tax rate of 30% (median 35%), which is obviously high in an absolute sense and also relative to other public corporations. Furthermore, few corporate blockholders have marginal tax rates of zero, the rate at which they would be indifferent between dividends and capital gains.

We conduct several investigations into the robustness of these findings. First, because some of our corporate blockholders are not in the Graham Database, primarily because they are either foreign or private, we want to determine if there is a selection bias in data availability. There is no statistically significant difference in dividend policy between the firms whose corporate blockholders are in the Graham Database and the firms whose corporate blockholders are not in the Graham Database. When we replicate the regressions of Table 4 with a dummy variable to indicate those firms with missing tax-rate data, the dummy variable is insignificant and changes sign with the regression specification. We also examine each of the four sample years separately; in every year the marginal tax rates of the corporate blockholders are close to 35% and are significantly higher than they are for the entire sample.

We also investigate whether dividend policy varies with the marginal tax rate of the corporate blockholders. In particular, we want to determine if dividends increase as the marginal tax rate of the corporate blockholder increases, as would be predicted from the tax-preference hypothesis. We do not find this, nor do we find any systematic relation between the corporate blockholders’ marginal tax rate and dividend policy.¹⁷ This is not surprising because there

¹⁶ <http://faculty.fuqua.duke.edu/~jgraham/taxform.html>.

¹⁷ The sign of the coefficient for the blockholders’ marginal tax rate is generally insignificant in a wide range of investigations, including replication of the cross-sectional regressions of Table 4 and the panel regressions of Table 5. In the few instances where the blockholders’ marginal tax rate is significant, the sign of the coefficient

is little cross-sectional variation in the blockholders' tax status; 75% of the corporate blockholders have marginal tax rates clustered around 34%. Thus in summary, we find that the specific tax status of corporate blockholders cannot explain the absence of a tax effect. If anything, the high tax rates of corporate blockholders should make tax considerations even more important.

4.2 Agency problems at the corporate blockholders

The high tax rates summarized in Table 6 suggest that managers of the corporate blockholders should be attuned to ways to reduce their firms' tax payments. But perhaps agency problems at the corporate blockholder firms mean that their managers care more about building an empire through block investing than reducing their firms' tax bills. This explanation would be consistent with our findings of relatively low dividends (Table 3), high marginal tax rates (Table 6), and large-block investments.

To address this explanation for the lack of a tax effect on dividend policy, we need a measure of potential agency problems at the corporate blockholder firms. Two indices have been developed recently to do this. The first index is developed by Gompers, Ishii, and Metrick (2003) (the Governance or "G Index"). The G Index is constructed by adding one for each corporate governance feature that restricts shareholders' rights, such as poison pills and staggered voting for directors, and subtracts one for features that increase shareholder rights, such as cumulative voting. The higher the index, the weaker are the rights of shareholders to discipline management and the greater, therefore, are the potential agency problems.

A limitation of the G Index is that it treats as equal in impact all features that either enhance or erode shareholder rights, such as staggered boards and cumulative voting. In fact, some lead to greater managerial entrenchment. Accordingly, Bebchuk, Cohen, and Ferrell (2004) develop an alternative index (the Entrenchment or "E Index"). The E Index uses the same source material as does the G Index (publications from the Investor Responsibility Research Center) but considers only those six factors that the developers of the index find are the most important for managerial entrenchment.¹⁸ Like the G Index, a higher score for the E Index signifies greater managerial entrenchment and hence greater agency problems. (The G Index ranges from 0 to 24; the E Index ranges from 0 to 6.)

Table 7 summarizes both indices for the corporate blockholder firms and compares them with other firms. We see that the corporate blockholders are

is negative, which is opposite from what the tax-preference hypothesis would predict. In those few firms with multiple corporate blockholders, we define the blockholders' marginal tax rate in three alternative ways: a simple average, an average weighted by the blockholders' ownership stakes, and the blockholders' maximum marginal tax rate. All three measures produce similar results.

¹⁸ The six are restrictions on the power of shareholders to amend by laws, supermajority voting for mergers, staggered elections for directors, poison pills to discourage insurgent large-percentage shareholders, and golden parachutes for top management.

Table 7

Summary statistics of two measures of potential agency problems at corporations that own large-percentage blocks in a random sample of other corporations (corporate blockholders) compared with corporations generally

	Corporate blockholders	All other corporations	<i>p</i> -value of difference
G Index of Corporate Governance			
Average	9.3	9.0	0.20
Median	9.0	9.0	0.32
Observations	157	7,185	NA
E Index of Corporate Governance			
Average	2.0	2.4	<0.01
Median	2.0	2.0	<0.01
Observations	156	6,353	NA

The G Index of Corporate Governance comes from Gompers, Ishii, and Metrick (2003). The E Index of Corporate Governance comes from Bebchuk, Cohen, and Ferrell (2004). For both indices, a higher score indicates fewer shareholder rights and thus greater potential agency problems. The observations are from 1995, 1998, 2001, and 2004. The *p*-values in the last column are for either a difference in the means test or the Wilcoxon rank-sum test.

similar to other firms. For instance, there is no significant difference between the blockholder firms and other firms in either the average or median G Index. The blockholder firms, however, have a slightly lower average and median E Index, suggesting fewer agency problems; these differences are statistically significant.

We also investigate the corporate blockholders' market-to-book ratio on the theory that a low market-to-book ratio would be consistent with significant agency problems. (Of course, a low market-to-book ratio could reflect other considerations, such as bad luck.) The corporate blockholder firms have market-to-book ratios that are slightly above but statistically indistinguishable from the median figures for their industries (not reported).¹⁹

Thus, there is no evidence that agency problems at the corporate blockholder firms are any different from agency problems at public corporations generally. We, however, lack a benchmark for judging how good or bad agency problems are at the typical public corporation. Perhaps managers of public corporations can largely do what they want. If this were the case, it would be reasonable that managers could ignore the consequences from following a suboptimal dividend policy with respect to their companies' block investments.

One way to address this point is to determine if there is any relationship between the governance indices and dividend policy. We conduct a wide range of investigations, including simple regressions of each of our four dependent variables with the blockholders' agency rating, replication of the cross-sectional regressions of Table 4, and replication of the panel regressions of Table 5 using both the G Index and the E Index. In no instance is the coefficient for the blockholders' agency index statistically significant.²⁰

¹⁹ We use the Fama French 38 industry classification for these calculations.

²⁰ We also conduct robustness tests to determine whether there is a selection bias in the firms for which we have agency ratings for their corporate blockholders. We do this by defining a dummy variable that takes a value of one if the blockholder data is missing and zero otherwise. In a broad set of tests, the dummy variable is insignificant and changes sign with the specification.

Finally, we conduct regression analyses simultaneously using both the blockholders' governance ratings and their marginal tax rates along with a variety of other control variables (such as Firm Size). There is no resulting evidence of a positive relation between either or both of these variables and dividend policy. We also explore whether the interaction of a high marginal tax rate and strong shareholder rights is associated with higher dividends (as a way to reduce taxes). To do this we define a new variable that is the product of a firm's corporate blockholders' marginal tax rate (for firms with multiple corporate blockholders, we use the blockholders' average marginal tax rate) times 24 minus the blockholders' G Index (for firms with multiple corporate blockholders, we use the blockholders' average G Index). The coefficient for this new measure is always insignificant and is often negative in sign, which is opposite to what the tax-preference hypothesis would predict. In short, in a wide range of analyses controlling for both blockholder characteristics and recognized determinants of dividend policy, there is no support for the tax-preference hypothesis.

4.3 Operating versus financial corporate blockholders

Although there is a consistent tax treatment for dividends received by corporations, the nature of the corporations that own large-percentage blocks in other corporations is anything but homogeneous. The literature on intercorporate investments has stressed the operating interactions that often arise when one firm invests in another firm (for example, Allen and Phillips (2000) or Fee, Hadlock, and Thomas (2006)). Indeed, forty-eight out of fifty of our block trades fit this mold. One of the strongest regularities among the block trades is that the purchasing corporations are in the same or a related business as the target firms (36 trades or 72% of the sample). In addition, 60% of the block purchasers become publicly involved in firm management. Often representatives of the block purchaser join the target's boards of directors; in some instances, representatives of the block purchaser assume top management positions at the target. In 38% of the block trades there are public announcements of joint efforts by the block purchaser and the firm to expand operations, often in the form of a joint venture. Only two of our trades fit the mold of the nonoperating or financial buyer. Interestingly, one of these trades involves the only posttrade initiation of dividends in the entire block trade sample.²¹

Although the literature has focused on operating corporate blockholders, some corporate blockholders are financial organizations. Indeed, in our random sample financial blockholders are more common than operating blockholders. The two types of corporate blockholders could have different motivations in

²¹ Kleer-Vu Industries never paid a dividend for the thirty-four years during which its founder, Benjamin Osher, served as chief executive officer and owned 27% of the firm's common stock. Shortly after Mr. Osher sold his block of stock to Denitex International Corporation, however, Kleer-Vu initiated dividend payments and subsequently increased them in each of the next two years. It also declared a special dividend two years after the trade. At the time of the dividend initiation and subsequent increase, Denitex's representatives constituted a majority of the directors at Kleer-Vu. Kleer-Vu fabricates and sells plastic products. Denitex describes itself in SEC filings as being engaged "in securities investing."

making block investments. Financial investors are unlikely to have the expertise to affect firm operations, and they are unlikely to enjoy the private benefits (such as synergies in production) that are often a consideration for operating blockholders. Hence, financial blockholders may be more concerned with dividend policy.

To investigate such possibilities, we divide the random sample into firms with financial corporate blockholders and firms with operating corporate blockholders. The financial blockholders are either banks (41 in the 1995 random sample) or insurance companies (54 in 1995). (Recall that mutual funds, pension funds, and personal investment vehicles are put in separate categories and are never classified as corporate.) All other corporate blockholders are classified as operating blockholders (69 in 1995). The two categories of financial and operating investors are mutually exclusive and exhaustive of the corporate blockholders.²²

Table 8 reports that firms with operating blockholders have lower dividends than firms with financial blockholders, no matter how dividends are measured. Dividends at firms with operating blockholders are also lower than they are at firms with no corporate blockholders of any type. Even with the small sample sizes, many of these differences are statistically significant. Thus, with operating corporate blockholders dividends are opposite to the direction predicted by the tax-preference hypothesis.

This suggests that other considerations may be more important for operating investors. Although there are likely a variety of such considerations, it is reasonable to hypothesize that capital expenditures at the target firm might be one of them. Indeed, we see in Table 8 that capital expenditures are higher in firms with operating blockholders than firms with financial blockholders or firms with no corporate blockholders of any type. All of these differences are statistically significant. The differences also seem to be economically significant. Both the mean and the median capital expenditures (as a percentage of firm assets) are approximately twice as high in firms with operating blockholders.²³

The block-trade sample fits this pattern as well. Dividends decline after a corporation buys a large-percentage block from an individual. (Recall that all but two of the trades involve operating buyers.) At the same time, capital expenditures increase, although the increase is not statistically significant. In contrast, when a block goes from a corporation to an individual, both average and median capital expenditures decline, and these declines are statistically significant (p -values of 0.01 on both parametric and nonparametric tests).

These findings suggest that operating corporate block investors conclude that funds are better spent pursuing investment opportunities at the target firm than increasing dividends, the negative tax implications notwithstanding. Although this may not be an optimal tax policy for the corporate blockholders,

²² Eleven firms have both operating and financial corporate blockholders. These firms are excluded from the Table 8 comparisons, but they are included in the Table 9 comparisons.

²³ We also conduct analyses with a variety of control variables. The results confirm that dividends are lower and capital expenditures are higher in firms with operating as opposed to financial blockholders.

Table 8
Capital expenditures and dividend policy in a sample of randomly chosen public firms

	Firms with operating corporate blockholders	Firms with financial corporate blockholders	<i>p</i> -value of difference between operating and financial	Firms without corporate blockholders	<i>p</i> -value of difference between operating and firms without corporate blockholders	<i>p</i> -value of difference between financial and firms without corporate blockholders
Capital Expenditures						
Average	0.27	0.14	0.03	0.14	<0.01	0.77
Median	0.19	0.09	<0.01	0.10	<0.01	0.31
Portion Paying Dividends	0.27	0.41	0.12	0.37	0.19	0.46
Dividends/Assets						
Average	0.002	0.009	0.02	0.008	0.05	0.71
Median	0.00	0.00	0.06	0.00	0.08	0.49
Dividend Yield						
Average	0.005	0.10	0.13	0.10	0.19	0.97
Median	0.00	0.00	0.08	0.00	0.08	0.61
Dividend Payout						
Average	-0.06	0.17	0.03	0.13	<0.01	0.26
Median	0.00	0.00	<0.01	0.00	<0.01	0.38

Financial blockholders are banks and insurance companies. All other corporate blockholders are classified as operating blockholders. Columns two and three compare the forty-five firms with operating blockholders with the seventy-one firms with financial blockholders. Column four adds the comparison with all firms in the random database of 376 firms that have no corporate blockholders of any type. Capital Expenditures are annual capital expenditures (Compustat annual data item 128) plus research and development expenditures (Compustat annual data item 46) divided by the book value of assets (Compustat annual data item 6). Dividends/Assets is annual dividends (Compustat annual data item 21) divided by the book value of assets (Compustat annual data item 6). Dividend Yield is a firm's annual cash dividends per share (Compustat annual data item 26) divided by its end-of-year stock price (Compustat annual data item 199). Dividend Payout is a firm's total annual cash dividends (Compustat annual data item 21) divided by its accounting income before extraordinary items (Compustat annual data item 18). Ownership data are from 1995 and comes from annual proxy statements. Financial data are from 1994 and comes from Compustat and CRSP. The *p*-values are for either a difference in the means test or the Wilcoxon rank-sum test.

it apparently facilitates the investments. And the managers of the corporate blockholders apparently believe that this will be more beneficial for their firms than a policy of high dividends, lower taxes (at least on the dividends received by the corporate shareholders), but lower investments.²⁴

Financial blockholders are different. Our priors were that these investors would be more focused on the tradeoff between dividends and capital gains because the ancillary considerations present with operating blockholders will be less important, if they are relevant at all. The unusual tax treatment of dividends received by corporations should therefore push dividends to be higher. Yet firms with financial blockholders have indistinguishable dividend policies from firms that have no corporate blockholders of any type (last column of Table 8).

We are able to rule out several possible explanations for this surprising finding. The explanation does not appear to rest with the tax rates of the financial blockholders, as they are somewhat higher than the operating blockholders' (35% versus 29%). Similarly, financial blockholders have corporate governance ratings that are indistinguishable from operating blockholders. The explanation also does not seem to rest with investment opportunities. As noted in Table 8, capital expenditures at firms with financial blockholders are similar to what they are at firms without corporate blockholders. Finally, the explanation does not rest with acquisitions of the firms, which would be one way for the blockholders to receive cash tax free. Neither of the two financial blockholders in the block-trade sample subsequently acquired their firms. And among the 228 financial blockholders in the four years of the random sample, only four eventually acquired their firms.²⁵

There are, however, some notable differences between financial and operating blockholders that might offer insights into why dividends are not higher in the presence of financial blockholders. We see in Table 9 that financial blockholders tend to hold considerably smaller fractional blocks than do operating blockholders, and they are less likely to own the largest block in a firm. Furthermore, although 69% of the operating blockholders have board representation, only 12% of the financial blockholders have such representation. To be sure, some of this difference can be attributed to the smaller fractional blocks of the financial investors. But when we conduct a probit regression that takes a value of one if a blockholder has board representation and zero otherwise and we control for the fractional size of the block, the rank ordering of the block, and Firm Size, the dummy variable for financial blockholders is negative and significant.²⁶

²⁴ A case in point from the block-trade sample involves A&P. Tengelmann Corporation bought 42% of the stock of A&P from the family of the company's founder. Eventually, Tengelmann acquired majority control of the company and by numerous press accounts totally controlled A&P. Among its other actions, Tengelmann increased the number of specialty stores, centralized control, and moved the firm's headquarters. Tengelmann also stopped the payment of dividends at A&P.

²⁵ In contrast, 14 of the 139 operating blockholders eventually acquired their firms.

²⁶ To cite one example of this tendency, in 1995 there are thirty-one instances in which the largest blockholder is a financial corporation. Yet only 26% of these blockholders have board representation. By comparison, 83% of

Table 9
Comparisons of the block ownership and corporate activities of operating corporate blockholders versus financial corporate blockholders (banks and insurance companies) at randomly selected public corporations

	Operating blockholders	Financial blockholders	<i>p</i> -value of difference
Block ownership			
Average	28%	10%	<0.01
Median	20%	8%	<0.01
Position of block within firm			
Largest	59%	31%	
Second largest	24%	32%	
Other	17%	37%	
Average	1.7	2.4	<0.01
Median	1	2	<0.01
Ownership of other blockholders in firm			
Average	18%	24%	0.07
Median	16%	22%	0.07
Blockholders with board representation	69%	12%	<0.01

There are sixty-nine operating blockholders and ninety-eight financial blockholders. All blockholders own at least 5% of the common stock. The *p*-values in the last column are for either a difference in the means test or Wilcoxon rank-sum test. Data are from 1995 and come from annual proxy statements.

There is also evidence that financial blockholders hold their blocks for shorter periods of time compared with operating blockholders. Thirty-seven of the 1995 firms with corporate blockholders (of either type) have no corporate blockholders in the next sampling year of 1998. Thirty-three of these firms had only financial or only operating blockholders in 1995. Of these 33 firms, 26 (79%) had financial blockholders but only 7 (21%) had operating blockholders in 1995.

Our findings thus paint a consistent picture of financial blockholders who have less voting power than do operating blockholders, and what voting power they do have they exercise less often. In addition, they hold their blocks for shorter times, which would make the tax consequences of dividend policy less important. Finally, there is no evidence of a clientele effect as dividend policy does not appear to be a factor in the decision of financial corporations to take large positions in other companies.

A full investigation of these findings is beyond the scope of this paper, but we raise two avenues for future investigation. First, financial blockholders may also be debt holders. In this case, their involvement in management could cause them to lose priority in bankruptcy. Second, as Roe (1994) explains, much of the federal securities legislation of the 1930s was intended to stop financial institutions from influencing corporations. Although these restrictions have been loosened over the years, it is possible that financial institutions have not yet developed the expertise or the inclination to influence major decisions at public corporations. In any event, it will bear watching to see if financial institutions become more assertive over time with their rights as shareholders, in dividend policy as well as in other aspects of firm management.

the operating blockholders with a similarly positioned block have board representation; more than half of these blockholders have multiple representatives.

5. Conclusion

The effect of taxes on firms' dividend policies has been debated for many years. Corporate shareholders play a special role in this debate because they are the only investors with a tax preference for dividends over capital gains. In this paper, we investigate whether the special tax status of corporate shareholders affects either their investment decisions or the dividend decisions of the firms in which they invest. Black (1976) dismissed the possibility that corporate shareholders would affect payout policy because he thought that corporate block ownership was rare. Data we report in this paper show, to the contrary, that corporate block ownership is not rare; approximately one-third of all publicly traded corporations have corporate blockholders.

The issue, thus, becomes an empirical one: are corporations attracted to high-dividend-paying firms, or do they attempt to influence dividend policy once they purchase a block? We offer two sets of empirical investigations to answer these questions, to test the tax-preference hypothesis. If the tax treatment of dividends for dominant shareholders is a first-order consideration, dividends should increase after a corporation buys a large-percentage block of stock from an individual. We find this not to be the case. In most instances when such a trade occurs, dividend policy remains unchanged; when dividend policy does change, it is more likely to decrease than to increase. We also examine dividend policy at a representative sample of publicly traded corporations. This analysis confirms the block-trade analysis. Corporate blockholders are more than two times as likely to be found in firms that pay no dividends as they are to be found in firms that pay dividends. Similarly, two-thirds of firms that pay dividends have no corporate blockholders. Equally telling is the fact that the ownership of corporate blockholders is not clustered at the levels (20% and 80%) at which the tax benefits of cash dividends increase.

We also investigate why corporate blockholders do not push for higher dividends to leverage their special tax status. Operating corporate blockholders appear to be more interested in improving the target firms' operating performance. To the extent these blockholders affect dividend policy, it apparently is to lower dividends. Corporate blockholders that are financial companies are different. They are more passive than their operating brethren, and their choice of where to invest does not appear to be influenced by a firm's dividend policy. There is also no evidence that financial blockholders use their voting power to increase dividends.

Although the findings reported in this paper are inconsistent with textbook discussions and theoretical models of the corporate tax preference for dividends, our findings are consistent with recent survey evidence on managers' priorities for setting dividend policy. Brav et al. (2005) report that top financial officers do not consider the tax situation of large shareholders when setting dividend policy. Nor do they set dividend policy to attract large shareholders. Instead, firms focus on their operating decisions; dividend increases are considered only

after investment and liquidity needs have been met. Although some researchers are skeptical of survey results, the empirical evidence in this paper confirms that taxes, at least in the context of corporate shareholders, do not have the influence on dividend policy that many over the years have assumed.

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