DO COMPANIES HAVE DIFFERENT MOTIVATIONS TO USE DIFFERENT FORMS OF PAYOUTS?

Dr. Adam Lei and his co-authors, Dr. Huiha Li and Dr. Jin Yu, in a recent article in Managerial Finance, took an in-depth look at how dual-class firms compare to single-class firms in terms of their dividend payments and share repurchases.

SO YOU MAY BE ASKING, WHAT IS A DUAL-CLASS FIRM?

A dual-class firm has two classes of common stock shares: (1) superior shares with additional control and voting rights and (2) regular shares, also known as inferior shares, that do not have the same voting rights as superior shares. A superior voting share can have more than ten times the vote of a regular share. A single-class firm does not have superior shares. They only have one class of shares.

Prior studies on dual-class firms' payout choices show that dual-class firms have higher cash dividends and share repurchases than single-class firms. The evidence from this research shows that, when matched to single-class firms, dual-class firms have a higher probability of paying dividends in both share classes. In particular, dual-class firms are more likely to repurchase their superior shares. Why? Because buying back shares with superior voting rights allows the corporation to maintain its control.

WHAT MOTIVATES A COMPANY TO PAY DIVIDENDS OR REPURCHASE SHARES?

Conflicts of interest between shareholders and company management can be mitigated by dividend payments and share repurchases. How are these things connected? Dividend payments and share repurchases help eliminate conflicts of interest because when there are direct (through dividend payments) or indirect (through share repurchases) cash payments to shareholders, there is less opportunity for company management to use this cash to spend on activities that do not align with the shareholders' interest.

In regards to share repurchases, companies can also buy back stocks to maintain control of the company. Dual-class firms are more motivated to repurchase their superior shares because they can maintain their private benefits of control and defend against a hostile takeover. However, in certain instances, this may cause conflicts of interest in that while company management does not want another firm to take over, a takeover might have actually benefited the shareholders (if the stock price later increases as the result of said takeover).

The authors explain that firms can have more nuanced motivations to use different forms of corporate payouts than previously thought. Dual-class firms do not use share repurchases and dividend payments as simple substitutes for one another. Instead, the firms balance these two options to reduce possible conflicts of interest and maintain the benefits of control through the number of votes they possess.

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