

Full Length Research Paper

Senior manager overconfidence, managerial discretion and dividend policy: A study of Chinese listed companies

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The research attempts to link managerial overconfidence with dividend policy in an emerging market in China. In addition, it proposes and tests if managerial discretion factors such as duality, cash flow and market growth, moderate that relationship by using 745 companies as our sample. The results show that, like in Western countries, senior manager over confidence and dividend policy are negatively related and that relationship is strengthened by duality and cash flow. However, the proposed market growth variable does not show significance in strengthening the relationship between over confidence and dividend distribution. The current study attributes that to the uniqueness of an emerging market. It also tests and finds that other unique factors, such as state ownership and political connection in China, weaken the overconfidence and dividend relationship. Scholars should carefully examine if models and concepts applicable in Western countries can also be used in emerging markets.

Key words: Overconfidence, dividend policy, managerial discretion, moderating effect.

INTRODUCTION

For public companies, to pay dividend to shareholders or to further invest their earnings for growth is one of the three key financial decisions that their senior managers have to consider all the time (Miller and Modigliani, 1961). However, scholars diverge in if and how dividend policy is related to a company's performance. For instance, while Miller and Modigliani (1961) propose for the irrelevance theorem of dividend, DeAngelo and DeAngelo (2006) contend that "payout policy matters". Further, studies on how dividend policy matters to a company have mostly focused on firm characteristics, such as firm size (Denis and Osobov, 2008). One apparent short-coming of such studies lies in the rationality assumption, which has been challenged recently by scholars (Cordeiro, 2009; Simon, 1987).

Humans are subject to irrationality and best described

as bounded-rational (Ariely, 2008; Simon, 1978). Such bounded rationality is often reflected in people committing cognitive biases when making decisions (Hammond et al., 2006). Managers have been found to be even more prone to those errors (Businetz and Barney, 1997; Cooper et al., 1998). Because managers' cognitive biases are often the culprits of bad decisions, and consequently costly to the focal company, scholars have called and sought for means to minimize those mistakes (Hammond et al., 2006; Li and Tang, 2010).

Our research relaxes the rationality assumption. We assume cognitive biases are prevalent among managers and such biases as overconfidence have a great impact on their decision making. Our contention is that whether to distribute dividend or reinvest the earnings is not only related to firm characteristics, but also dependent upon senior managers' cognition. Since how senior managers' cognitive biases influence a company's financial decisions has been underexplored, our paper attempts to link one of the biases: Overconfidence with dividend policy. In addition, we test if managerial discretion moderates the

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relationship.

Through our research, we intend to make a few contributions. First, we fill in a research gap by proposing a relationship between senior managers' overconfidence and dividend policy, which scholars have not paid much attention to. Second, our research answers the call by Hammond et al. (2006) to find ways to reduce the effects caused by managers' erroneous cognition. Specifically, we test if managerial discretion can moderate the above mentioned relationship (Li and Tang, 2010). Third, top managers of different countries may matter to a company's performance in different ways because of the variations in managerial discretion (Crossland and Hambrick, 2007). Since previous research has investigated the managerial discretion effect on performance in developed countries (Crossland and Hambrick, 2011), we expand the framework to an emerging market (Hambrick and Finkelstein, 1987).

LITERATURE REVIEW

Manager overconfidence and financial decisions

Of the many cognitive biases (Hammond et al., 2006), overconfidence has been well researched sometimes under different names such as hubris (Roll, 1986; Li and Tang, 2010), optimism (Heaton, 2002) and overconfidence (Businetz and Barney, 1997; Cooper et al., 1998). We adopt overconfidence in our research, but we acknowledge all the terms can be interchangeably used.

Overconfidence happens when the "individual's certainty about his or her own predictions exceeds the accuracy of those predictions" (Li and Tang, 2010). When people's predictions often deviate from reality, they are over-confident. Overconfidence can happen to anyone; however, executives have been found more inclined to commit such errors (Businetz and Barney, 1997; Hammond et al., 2006). First, senior managers who have climbed up the ladder to their current positions tend to fall into paradox of success, believing in themselves and their strategies because of their past success (Audia et al., 2000). Hence, they develop the illusion of control and evaluate their chance of success higher than that of others. Second, over-confidence is often regarded as equivalent to being capable (Gilovich et al., 2002). Thus, over-confident people are more likely to be promoted to the corporate suite.

Since executives as leaders of an organization are often the most powerful decision makers (Andrews, 1987; Yukl, 1998), they can make or break a company (Finkelstein and Hambrick, 1990). It is therefore not surprising that numerous papers have studied the consequences of executive activities and decision making behaviours (Anand et al., 2002; Priem, 1994). There are also studies connecting senior manager overconfidence with financial decisions. Such research can be mainly

classified into three categories. The first is how senior manager overconfidence influences investment. Cooper et al. (1998) find 68% of business owners believe their initial investment can yield better return with their competitors while the five-year survival rate is below 25%. They conclude that overconfident managers tend to invest more. The study by Malmendier and Tate (2005) examines 477 companies from 1980 - 1994, and discovers that overconfident CEOs are more sensitive to cash flow while making investment decisions. When a company has more internal funding, they are inclined to over-invest. Under-investment dominates when CEOs sense the market under-estimate the company's value. Heaton (2002) has similar findings showing that over-confident managers either over or under-invest.

The second area of research focuses on overconfidence and financing. Landier and Thesmar (2009) make an inquiry into how optimism affects financial contracting. They found that overconfidence leads to short-term debt financing because they reason they would succeed, and even if they fail, investors will cover them. Ben-David et al. (2007) show that firms with over-confident CFOs tend to invest more, use more debt, use lower discount rates, and they often invest long-term rather than short-term. They recommend the effect of overconfidence be included when modeling corporate decision making. Hackbarth (2008) notes that overconfident managers often under-estimate investment risks and prefer higher levels of debt. Such tendencies, however, can potentially reduce agency cost, and hence increases firm value.

The third stream of research studied the relationship between managers' overconfidence and firm value. Gervais et al. (2003), for instance, they argue that, unlike rational managers, overconfident decision makers are likely to make fast decisions even under the condition of extreme uncertainty. They find overconfident executives often take unnecessary risks potentially hurting shareholders' interests that result in firm value. Only moderate confidence can increase firm value through the alignment of managers and shareholders' interests. Their finding has been resonated in Weinberg's paper (2009), where he also finds the degree of confidence matters to managers' decision making, that is, extreme confidence, reduces firm value while moderate confidence is "advantageous".

In sum, scholars have called for investigation into the relationship between overconfidence and financial decisions (Ben-David et al., 2007). Researchers have studied how overconfidence is related to investment, financing and firm value. However, how dividend policy and overconfidence are related has been underexplored. Our paper fills this research gap.

Managerial discretion

Scholars have debated about whether executives matters

for a few decades (Crossland and Hambrick, 2011). While some contend that senior managers' influence on a company's performance is limited because they are subject to constraints from the external environment (Lieberson and O'Connor, 1972), other researchers assert that they do make a difference (Thomas, 1988). To reconcile the two views, Hambrick and Finkelstein (1987) develop a theoretical framework of managerial discretion to answer how and when do managers matter. Managerial discretion, also called "latitude of action", exists because executives vary in how much discretion they may have, and consequently, they exert more or less influence on a company's performance and strategic behavior (Hambrick and Abrahamson, 1995).

According to Hambrick and Finkelstein (1987), managerial discretion is the function of a company's external environment, organizational structure and personal factors. At the individual level, factors leading to managerial discretion include tolerance of ambiguity, locus of control, cognitive complexity, professional aspiration, power base, political acumen and commitment (Hambrick and Finkelstein, 1987). Each of the seven factors can potentially increase or decrease managerial discretion. For example, Mitchell et al. (2009) propose that if a successor to a firm has an internal locus of control, that is, if he/she has a strong belief that events are under his/her control, he/she tends to exhibit more control while making decisions and therefore has more managerial discretion. Of all the individual sources of managerial discretion, power base has received the most attention (Hambrick and Finkelstein, 1995; Mitchell et al., 2009). Organizational tenure, for instance, is often linked to executive power. It is often assumed that the longer an executive has been employed at a company, the more power the manager has in their bargaining position, and hence, the more discretion they command. Finkelstein and Hambrick (1989) find that tenure is related to executive compensation in a curvilinear shape because executive power "accrues for a while and then diminishes, due to the CEO's reduced mobility" in the market. Halebian and Finkelstein (1993) discover that powerful CEOs may hurt a company's bottom line because they may "restrict the flow of information", eventually limiting other members' contribution to decision making.

Organizational factors associated with managerial discretion include, but not limited to, firm age, size, resources, capital intensity and corporate governance such as ownership structure (Berman et al., 2005; Hambrick and Finkelstein, 1995; Li and Tang, 2010). Firm size, for instance, can give the executive's prestige because large companies often connote more responsibilities and higher complexity of their tasks, enhancing an executive's discretion (Hambrick and Finkelstein, 1995). Finkelstein and Hambrick (1989) discover that firm size is positively related to CEO's compensation because CEOs have greater leverage of how they can get paid. Li and Tang (2010) argue that firm resources, especially

intangible ones, allow CEOs more discretion. They find RandD intensity, measured by the ratio between RandD expenditures and sales, encourages a company to engage risk taking activities.

Of the three levels of managerial discretion, environmental factors have been most intensively studied (Crossland and Hambrick, 2011). Most of the variables are industry characteristics. Hambrick and Finkelstein (1987) list the following as environment level determinants of managerial discretion: Product differentiability, market growth, industry structure, demand instability, quasi-legal constraints, powerful outside forces and capital intensity. Hambrick and Abrahamson (1995) reason that when demand is highly reliable, the uncertainty lessens and there is little room for managerial interpretation and discretion. Li and Tang (2010) contend that a complex market is often full of uncertainty and restrictions and increase executives' discretion. Such discretion is found to enhance risk taking activities.

To sum up, there has been a growing body of research on managerial discretion at all three levels. Recently, scholars have started to make inquiry into how national factors may influence managerial discretion (Crossland and Hambrick, 2011). However, managerial discretion research in emerging markets has been rare with a few exceptions (Li and Tang, 2010). We intend to expand the stream of research by examining managerial discretion in a new context: an emerging market (Alam, 2011).

Theoretical development

Dividend policy and managerial overconfidence

Why do companies distribute dividend to shareholders? Scholars have debated about this issue for centuries (Baskin, 1988). Even though scholars have developed many theories to explain the motivations behind corporate dividend policy (Ben-David, 2010), it is still a puzzle (Black, 1976). All the theories investigating this phenomenon can be broadly classified into two categories based on the assumptions: Do firms act rationally or irrationally?

The rational approach views managers as rational. Hence, managers use dividends as a function to reduce agency cost or as a device of signal to solve the information asymmetry problem. However, reviews of empirical research have not shown strong support for the assumption. Allen and Michaely (2003) and Frankfurter and Wood (2006) concludes there is no consistency between agency and signalling theories and empirical evidence.

This paper assumes that managers, investors, or both behave irrationally. In addition, even though scholars have investigated behavioural irrationality from three angles, investor sentiment, investor biases and managerial biases, we focus on the relationship between one of the

managerial biases, overconfidence and dividend policy.

Previous research investigating the relationship between overconfidence and financial decisions has studied investment, financing decisions and firm values. However, there are only a few exceptions to examine how managerial overconfidence affects dividend policies. This stream of research contends whether to distribute dividends or not depends on how managers perceive of the company's future, because dividend policy is a decision about investing earnings so as to grow the company if needed. When executives are overconfident about their future growth, they prefer to invest their earnings to boost growth for the company rather than pay dividend to the shareholders (Deshmukh et al. 2009). Overall, empirical studies have lent support to the argument. For instance, Cordeiro (2009) finds that over confident managers tend to pay fewer dividends.

Another line of research predicts that dividend policy varies across company's life cycle. Specifically, firms distribute few dividends in early years because managers believe future opportunities should be explored with the earnings. During later years, shareholders receive more dividends because of the lack of profitable opportunities. Therefore, paying out dividends can lessen the possibility of wasting the hard-earned cash (Denis and Osobov, 2008). Since China's capital market is still at its infant stage and most of the listed companies are at their early stage of development, Chinese executives are more optimistic about their future outlook. The managers may be even less likely to pay dividends to investors. We have the following hypothesis.

H₁: In China, senior manager overconfidence in listed public companies is strongly negatively related to dividend distribution.

The moderating effect of managerial discretion

As discussed earlier, managers in different contexts may have more or less discretions when delivering decisions (Hambrick and Finkelstein, 1987). The levels of factors can potentially lead to managerial discretions: Individual, organizational and environmental.

Individual level (Chair-CEO duality)

According to agency theory (Drew and Kaye, 2007; Jensen and Meckling, 1976), shareholders (principals) and managers (agents) have conflicting interests where the agents who are hired to manage principals' businesses may behave to maximize the benefit for themselves rather than for the shareholders. Hence, agency problems arise (Chrisman et al., 2005; Eisenhardt, 1989; Liang et al., 2009). On one hand, shareholders intend to use agents' talents and skills to generate good

returns for their investment. On the other hand, principals also have to minimize the agency problem possibly caused by moral hazard, adverse selection and hold-up (Gomez-Mejia et al., 2001). To solve the agency problems, principals employ certain governance mechanisms to make sure that the interests of both principals and agents can be aligned. One of such mechanism is chair-CEO duality when a firm's CEO is also the chair of the board. However, a dual role can be a potential threat to a company's decisions and performance.

Duality often means more power for a company's executives. A CEO who also serves as the chairman of the board may be able to employ his/her power to advance his/her own agenda without considering the needs of shareholders. Since managers' stock options often depend on if and how the company grows, senior managers are more inclined to invest the earnings for future growth. This may be truer in China because; a) China presents many investment opportunities; b) shareholders are not concentrated; c) running a Chinese company is of a more complex matter because of the emergence of new issues in an emerging economy. Research has shown that when a board's vigilance is weak, check-balance does not exist and hence, senior managers can exert more power to make decisions benefitting them more, such as not issuing dividends. We hence propose:

H₂: In China, duality strengthens the relationship between managerial overconfidence and dividend distribution.

Organizational level (Financial resources)

When a company grows and becomes larger and larger, the executive's prestige is often enhanced because such companies often connote success and hence, executives are often given growing responsibilities and their tasks become more complex. Previous research has found that the size of a company is often related to an executive's discretion because of the resources the executives control (Hambrick and Finkelstein, 1995). Another study by Li and Tang (2010) finds that firm resources, especially intangible ones, may allow CEOs more discretion. Agrawal and Knoeber (1996) discover that, when managers have growing resources, they have more managerial discretion.

However, all resources are not equally disposable to managers. For example, cash is king because equipment and other physical resources are not as liquid as financial resources such as cash (Barney, 1986). Also, profit is not equivalent to cash. Research has shown some very profitable small businesses fail over long term because they cannot manage their cash flow efficiently (Scarborough and Zimmerer, 2006). When executives have large financial resources such as cash reserve, and they believe there are good opportunities for better future return, they are likely to invest the money into future

projects to take advantage of the opportunities, due to having better discretion over cash. Chinese are well known because they often put more values on cash than on other assets, and saving more. Research has shown Chinese save cash to mitigate future uncertainty (Shimek and Wen, 2008). In other words, cash boosts Chinese's outlook into future. Executives in China tend to be more confident about the future and invest more rather than distributing dividend to shareholders. Hence, we hypothesize the following:

H₃: In China, a company's financial resources strengthen the relationship between managerial overconfidence and dividend distribution.

Environmental level (market growth)

External environment plays an important role in a company's decisions and performance (Dess and Beard, 1984). Executives may behave differently in different environments, for example, dynamic vs. stable, because in a stable environment, they are constrained by routines and rules, and hence, have less discretion compared with when the environment they face is dynamic (Hambrick and Finkelstein, 1987). Li and Tang (2010) discover that market uncertainty, complexity, and munificence are associated with managerial risk taking assuming different industries provide managers different level of discretion. Halebian and Finkelstein (1993) find the effect of team size on firm performance is significant in the computer industry, but not in the natural gas industry. As stated earlier, various industry characteristics have been examined regarding managerial discretion, such as product differentiability and market growth. Our focus is on market growth. Industry life cycle theory makes the prediction that firms at the growing stage tend to distribute few dividends because executives have a rosy picture about future investment opportunities (Denis and Osobov, 2008). Market growth has also been associated with managerial discretion (Liebersohn and O'Connor, 1972). Porter (1980) also is in agreement with the reasoning that high growth industries allow managers more discretion. Since most of the listed companies in China are still developing and growing, their executives are likely to believe they can have better return with future earnings for them and shareholders and therefore, opt to not pay dividends to investors by investing earnings to the future.

H₄: In China, market growth strengthens the relationship between managerial overconfidence and dividend distribution.

National level (State ownership and political appointment)

While Crossland and Hambrick (2011) are in agreement

with scholars that industry characteristics should be carefully studied, they advocate more for examination of national level factors and their effect on managerial discretion. They study 15 countries and find that managers in US enjoy the greatest discretion of all countries, while executives in Japan the smallest. Crossland and Hambrick (2007) also find managers may have various degrees of discretion because of the national political and social systems. However, neither study includes an emerging market even though emerging economies apparently have rather different institutional systems (Khanna et al., 2005). Our research fills a research gap by expanding the above research stream to an emerging country, China.

China has embarked on a journey to reform its economic system for over thirty years. One of the achievements China has gained while undergoing a series of reform is to build a socialist market economy, and it has seen a bundle of success. A 2010 report shows the top 500 private businesses in China paid more taxes and created more jobs than state-owned companies. However, state owned enterprises still play a more dominant role in China's economic development (Li and Tang, 2010). For example, many state owned businesses own shares of many listed companies and managers of many public companies hold positions in government agencies. All these unique characteristics of Chinese listed companies deserve further examination.

State ownership

Crossland and Hambrick (2011) propose and find individualism is positively related to autonomy and hence more managerial discretion. It is not surprising managers in Korea and Japan, two countries of collectivism orientation, are under many more constraints and enjoy the least discretion. China is in a similar situation and state ownership limits its managers even more; managers have even less discretion (Li and Tang, 2010) because managers of state-owned enterprise often have to realize not only company objectives, but also governmental objectives. For example, government may be more concerned with maintaining employment rather than maximizing profitability (Clark, 2003). With such conflicts, executives lose their discretion, and at the same time, they may lack the motivation to pursue future profitable opportunities. Rather, they choose to make employees and shareholders satisfied by distributing dividends.

H₅: In China, state ownership weakens the relationship between managerial overconfidence and dividend distribution.

Political connection

In China, the government usually appoints CEOs and

other senior managers for the state owned businesses. Hence, executives in Chinese listed companies often hold dual roles, with one as managers serving the interests of shareholders, and another as government officials to satisfy governmental goals. Executives in such positions undergo two sources of constraints and lack discretion when making decisions. In addition, when such executives choose between financial performance and social/political objectives, they often are inclined to prefer the latter. Fan et al (2007) find Chinese listed companies with a political connection are outperformed by those whose CEOs do not hold a governmental position, because a political connection may force executives to achieve social objectives rather than economic targets. A study on French companies shows political connection of CEOs and government officials tends to place more emphasis on job creation places rather than interest of the shareholders (Schoar and Thesmar, 2004). We reason executives of Chinese listed companies with political connection may find the option of distributing dividends more attractive than future growth of the company. Therefore we hypothesize:

H₆: In China, political connection weakens the relationship between managerial overconfidence and dividend distribution.

METHODS

Data collection

We collected our data from several sources. Financial variables, such as dividend policy, mainly come from Wind Information Company Limited's database. Wind Information is located in Shanghai and is regarded as a leading provider of accurate, timely and complete financial data of Chinese financial market. Their coverage of financial information ranges from stocks, bonds to macro-industry and foreign exchanges. We obtained other data regarding state ownership, duality and political connection from websites of Shanghai Stock Exchange and Shenzhen Stock Exchange, where annual reports of listed companies can be found. We ensured our data was accurate by double-checking Sina Finance's database, which has been confirmed to be rather reliable (Zeng, 2010; Zeng and Lin, 2011).

We collected all the variables from companies that were listed in the years of 2007 through 2009 based on the following criteria: First, since new companies behave differently from established ones in such policies as dividend distribution (Walter et al., 2007), we excluded those companies listed for less than three years to ensure our results are more stable and reliable. Second, we also removed all the companies on the ST and PT lists. Those companies either were being given special treatments or on the verge of being delisted. Third, since financial firms are also quite different from other companies regarding financial decisions, they were also eliminated. Fourth, we ran a descriptive analysis, and did not include values three standard-deviations away from the mean.

Our final sample consists of 257 observations from 2007, 230 from 2008 and 258 from 2009. We ran an analysis of variance (ANOVA) test of firm size and age for the three years. We did not observe differences across the three years. Therefore, we collapse the data into one dataset containing 745 total observations.

Measures

Dependent variable (DIV)

In China, companies distribute dividends in mainly four forms: Cash, stock, mutual funds and the combination of the three. We adopt cash dividend as the dependent variable because it is the most dominating means for dividend distribution. In addition, accounting practice treats only cash dividend as the real dividend due to the reason cash is ready to be allocated for further investment. We calculated our dependent variable as dividend per share (DIV).

Independent variables

1. Managerial overconfidence (OC): Since overconfidence can be "individual's certainty about his or her own predictions exceeds the accuracy of those predictions" (Li and Tang, 2010), we measured managerial overconfidence by calculating the difference between the forecast profit and the actual company performance. Lin et al. (2005) used similar measurements.
2. Chairman-CEO Duality (Duality): When the CEO of a company also serves as the chairman, we assigned a value of 1; otherwise, the value is 0.
3. Cash reserve (CF): It is the ratio of cash flow and total shares.
4. Industry growth (Growth): We followed Keats and Hitt (1988) by averaging the sales over a five years period in the industry.
5. State ownership (State): If the company is wholly state-owned or controlled, we assigned a value of 1; otherwise, the value is 0. Li and Tang (2010) used the same measure.
6. Political appointment (Political): When a CEO of a company is politically appointed it received a value of 1; otherwise, the value is 0. We followed the procedure by Li and Tang (2010).
7. Control variables: Since dividend policy is related to ownership concentration (OwnCon), return on equity (ROE), firm leverage (LEV) and firm size (Size) (Eije and Megginson, 2006; Li and Tang, 2010), we controlled these variables to reduce confounding effects. We computed ownership concentration as the percentage of the largest shareholder of the total shares and firm size as the natural log of company's total assets to ensure normal distribution.

Data analyses

We first provided descriptive results, such as means and standard deviations and calculated the correlations. We then ran three regression models using SPSS. The first model includes all four control variables. We then added the independent variables to Model One. The third model contains all control, independent variables, and the interaction terms to test for moderating effects.

Model 1: $DIV = \beta_0 + \beta_1 \text{OwnCon} + \beta_2 \text{ROE} + \beta_3 \text{LEV} + \beta_4 \text{Size} + \beta_5 \text{Duality} + \beta_6 \text{CF} + \beta_7 \text{Growth} + \beta_8 \text{State} + \beta_9 \text{Political} + \varepsilon$.

Model 2: $DIV = \beta_0 + \beta_1 \text{OwnCon} + \beta_2 \text{ROE} + \beta_3 \text{LEV} + \beta_4 \text{Size} + \beta_5 \text{Duality} + \beta_6 \text{CF} + \beta_7 \text{Growth} + \beta_8 \text{State} + \beta_9 \text{Political} + \beta_{10} \text{OC} + \varepsilon$.

Model 3: $DIV = \beta_0 + \beta_1 \text{OwnCon} + \beta_2 \text{ROE} + \beta_3 \text{LEV} + \beta_4 \text{Size} + \beta_5 \text{Duality} + \beta_6 \text{CF} + \beta_7 \text{Growth} + \beta_8 \text{State} + \beta_9 \text{Political} + \beta_{10} \text{OC} + \beta_{11} \text{Duality} \times \text{OC} + \beta_{12} \text{CF} \times \text{OC} + \beta_{13} \text{Growth} \times \text{OC} + \beta_{14} \text{State} \times \text{OC} + \beta_{15} \text{Political} \times \text{OC} + \varepsilon$.

RESULTS

Table 1 presents descriptive statistics and correlations for all the variables. For the dependent variable, the average

Table 1. Descriptive statistics and correlations of study variables^a

Variable			1	2	3	4	5	6	7	8	9	10
DIV	0.11	0.15										
Size	5.38	0.46	0.23**									
OwnCon	55.83	14.34	0.23**	0.10**								
LEV	47.11	18.34	-0.14**	0.43**	-0.05							
ROE	15.30	13.77	0.34**	0.18**	0.16**	0.10**						
Growth	0.42	0.49	-0.06	-0.01	-0.02	0.09*	-0.07					
CF	0.66	1.31	0.27**	0.27**	0.12**	0.16**	0.24**	0.01				
Duality	0.37	0.48	0.04	-0.03	0.05	-0.058	0.03	-0.04	-0.03			
State	0.58	0.49	0.04	0.12**	-0.03	0.088*	-0.08*	-0.13**	0.05	-0.11**		
Political	0.19	0.39	0.09*	0.12**	-0.07	0.024	0.10**	0.05	0.03	0.05	0.15**	
OC	20.45	205.46	-0.36**	-0.17**	-0.10**	0.03	-0.16**	0.03	-0.13**	0.03	-0.05	-0.09*

^an=745; *, P < .05; **, P < .01.

dividend per share paid is 0.105, while for developed countries; the number is about twice higher. Indeed, scholars should examine emerging markets. For the key independent variable, managerial overconfidence, we found that the mean is 20.4. Overall, Chinese executives are overconfident; they often paint their performance with a rosy picture. Another interesting finding is that the largest shareholder holds about 56% of the total company shares. It reflects the unique ownership structure of most Chinese companies, especially when the firm is owned or controlled by government.

Table 2 shows the results of three regression models. Model 1 includes all four control variables related to dividend distribution as previous research has predicted (Eije and Megginson, 2006; Denis and Osobov, 2008; Li and Tang, 2010). We predicted managerial overconfidence can decrease dividend distribution. Model 2 supports our prediction. Hence, H₁ is confirmed that managerial overconfidence is negatively related to dividend policy. We hypothesized that duality, financial resources and market growth all strengthen the negative relationship between managerial overconfidence and dividend distribution. It can be seen from Model 3 that there is support for duality and financial resources, but not market growth. The support for two of the hypotheses indicates when a CEO is also the chairman of the company, the company tends to issue less dividend, and when the company has more cash reserve, it is more likely to pay fewer dividends to its shareholders. H₅ and H₆ propose state ownership and political appointment weakens the relationship between managerial overconfidence and issuing dividend. Both hypotheses received strong support. When a company is owned by the government, overconfident managers issue more dividends. And when a CEO is politically appointed, he/she often distributes more dividends. Figures 1- 4 depict the interaction effects of managerial overconfidence and discretion on dividend distribution.

DISCUSSION

Upper echelons theory posits senior managers are the most important players of an organization (Hambrick and Mason, 1984; Priem, 1994). The stream of research has shown that indeed top executives of a company can influence its strategies and performance (Crossland and Hambrick, 2011; Wu et al., 2005). However, few studies have examined if executives have similar powers in emerging markets (Li and Tang, 2010). Further, the relationship between executive cognition, especially cognitive biases and firm financial decision has been even more underexplored (Ben-David, 2010). Our research fills in such a research gap by investigating if senior manager overconfidence is related to a company's dividend policy in an emerging market, China. We also answer a call to find means to minimize executives' cognitive biases (Hammond et al., 2006; Li and Tang, 2010).

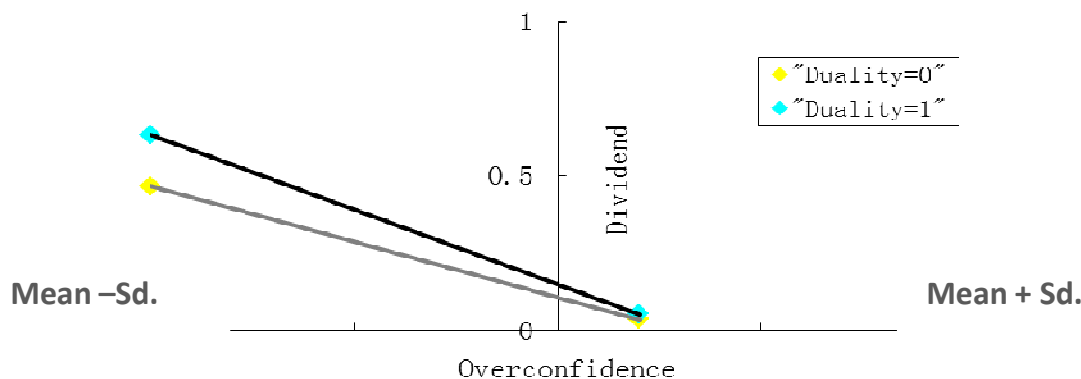
Dividend policy is one of three important financial decisions corporate executives have to consider so as to boost a company's performance (Ben-David, 2010). However, scholars have heatedly debated on if rational or abounded rational behaviour determines the existence of dividends (Miller, 1986; Ben-David, 2010). Miller (1986), for instance, contends behavioural and rational theories can explain dividend decisions at two different levels with micro suitable for behavioural while macro for rational.

We joined the scholarly discussion and examined the micro-behaviour of the executives (agents) on dividends policy. Specifically, we studied if senior manager overconfidence influences dividend distribution. We found a negative relationship between the two variables. The more confident the executives are about their company's future outlook, the less likely they pay dividends. Our findings are consistent with the results of a few other scholars (Deshmukh et al., 2009; Cordeiro, 2009). Our research lends support to Miller's contention (1986). We

Table 2. Regression results of firm dividend distribution.

Variable	Model 1		Model 2		Model 3	
Size	0.244***	(0.006)	0.206***	(0.006)	0.206***	(0.005)
OwnCon	0.129***	(0.005)	0.114***	(0.005)	0.122***	(0.005)
LEV	-0.296***	(0.005)	-0.267***	(0.005)	-0.258***	(0.005)
ROE	0.262***	(0.005)	0.234***	(0.005)	0.190***	(0.005)
Growth	-0.008	(0.010)	-0.005	(0.010)	-0.009	(0.009)
CF	0.172***	(0.005)	0.157***	(0.005)	0.093***	(0.005)
Duality	0.024	(0.010)	0.034	(0.010)	0.042	(0.009)
State	0.046	(0.010)	0.037	(0.010)	0.023	(0.009)
Political	0.036	(0.013)	0.022	(0.012)	0.033	(0.012)
OC			-0.241***	(0.005)	-0.359***	(0.012)
OC × Growth					0.038	(0.010)
OC × CF					-0.244***	(0.006)
OC × Duality					-0.124***	(0.012)
OC × State					0.024*	(0.011)
OC × Political					0.224***	(0.010)
Constant	0.093***	(0.010)	0.093***	(0.010)	0.092***	(0.009)
R ²	0.271		0.325		0.394	
Adjusted R ²	0.262		0.316		0.381	
F Value	30.346***		35.344***		31.542***	

n=745. *, P < .05; **, P < .01; ***, P < .001

**Figure 1.** Moderating effect of chair-CEO Duality.

made a unique contribution in that our scientific inquiry lies in an emerging market. Behavioral factors play an important role in dividend policy not only in developed countries, but also in emerging markets such as China. It confirms behavioural theories can be universally applied to explain financial decisions. We call for more and further scholarly investigation on how cognitive biases may affect important financial decisions (Ben-David, 2010).

Our study has also identified a few factors at four levels, individual, organizational, industry and national moderating the relationship between over-confidence and

dividend policy. To reconcile the debate among scholars regarding if executives matter to a company's performance, Hambrick and Finkelstein (1987) argue that the question to ask is when and how executives have a great impact on a firm. Since the inception of managerial discretion by Hambrick and Finkelstein (1987), more and more scholars have started to make inquiry into how managers are constrained by other factors, but studies on emerging markets are hard to find (Li and Tang, 2010). We used China as our research context and studied how five factors of managerial discretion either strengthen or weaken the proposed relationship between senior

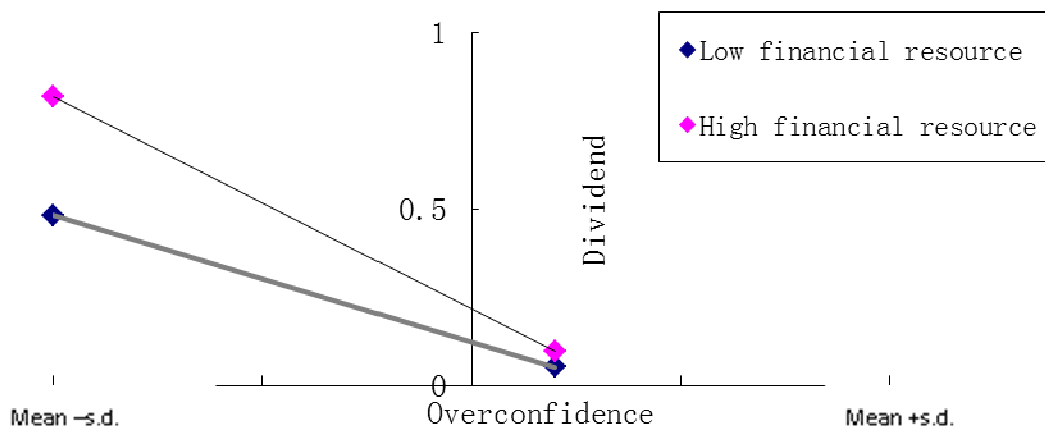


Figure 2. Moderating effect of financial resources.

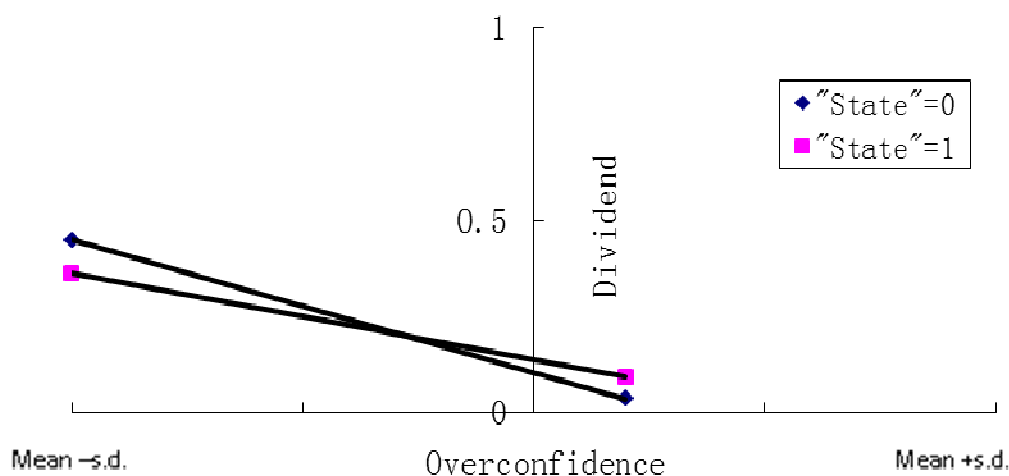


Figure 3. Moderating effect of state ownership.

manager overconfidence and dividend policy.

Specifically, at the individual level, we have found executive duality strengthens the proposed relationship. When a CEO also serves as the chairman of the board, he/she has more discretion in his/her hand in order to enhance his/her image and long term return (Chrisman et al., 2005). Distributing dividends can potentially harm a company's long term outlook. Executives holding both positions therefore, are less likely to issue dividends.

At the organizational level, when a company has more cash to disburse, its executives have more power and discretion when making decision (Scarborough and Zaimmerer, 2006). We found that big cash flow portion enhances executives' outlook about their company's future and executives with much cash in hand issue fewer dividends than those companies that do not have much cash reserve, believing their cash can be used for better future opportunities and returns.

We also predicted industry level factors such as market

growth strengthens the relationship between overconfidence and dividend distribution. However, we did not find statistical support. We reason this finding may be due to our way of how we operationalized the concept. The average of five years of sales may be a reliable indicator for market growth, though it may not be applicable in China. China has experienced exponential growth in almost all the industries in the past three decades. The variation between industries may be minimal.

Finally, we studied two national level variables, state ownership and political appointment and tested if they moderate the relationship between overconfidence and dividend policy. The statistical analyses support our hypotheses. State ownership weakens the proposed relationship because executives in a state owned enterprise are constrained by the state government's objectives, which often emphasize on employment and social benefits rather than profitability and shareholders' welfare (Clark, 2003). Political connection leads

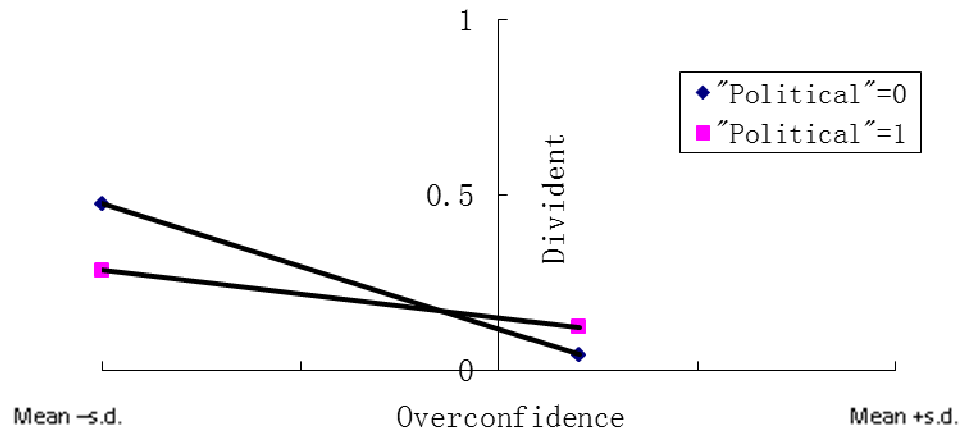


Figure 4. Moderating effect of CEO political connection.

executives to care for more of their promotion instead of a company's future outlook. Hence, political appointment leads to more dividend distribution (Fan et al., 2007).

To sum up, our research is in line with previous studies concerning managerial discretion (Crossland and Hambrick, 2007, 2011; Li and Tang, 2010). The above findings tend to agree with previous research that duality and financial resources can grant executives more power and hence, they have more leverage over their decisions no matter whether the companies are located in an emerging market or not (Agrawal and Knoeber, 1996; Hambrick and Finkelstein, 1995). No matter where the firms are operating, they need a governance structure and financial resources to meet the expectations of their customers and eventually their shareholders (Barney, 1986; Gomez-Mejia et al., 2001; Li and Tang, 2010).

However, our research also extends managerial discretion research; we included a few factor unique to the Chinese context. For example, state owned enterprises are still the dominating force in China's economic development and many state owned businesses are managed by managers who also hold positions in the government (Fan et al., 2007). We found political connection and state ownership both lead to more dividend distribution when the top managers are over confident. We have contributed to the literature by examining the unique factors in an emerging market where it has been ignored in the past (Haleblian and Finkelstein, 1993). We also discovered our prediction regarding market growth is not supported. Specifically, industry market growth does not strengthen the relationship between over confidence and dividend policy. We attribute that to the uniqueness of the emerging market. All emerging economies, BRIC for instance, have experienced tremendous growth in the past decades, and they are predicted to have even more opportunities to grow. Thus, variables such as industry growth rate may not be a good indicator to make predictions for such markets, even though similar studies in Western countries may find significant results. We

therefore, call for caution when applying research results in developed countries to emerging markets.

Implications for practice

Our research has a few practical implications. First, since dividends may hinder a company's opportunity exploitation behaviour while political connection enhances such an action, the board of directors of a company intending to grow the firm may want to recruit executives who do not have such connections. That same strategy applies to those state owned enterprises. Second, because managerial over confidence may affect a company's dividend policy, it is recommended senior managers should be aware of their confidence level so there will not be biases when making decisions.

Limitations and future research

The current study is not without limitations. First, our research was conducted in China. Since it may be different in many ways from other emerging economies, the findings may not be generalizable to other countries. We call for future research to test our theory in other nations. Second, we limited the managerial discretion variables to only five. There are other variables, such as munificence and dynamism, determining how senior managers distribute dividend. Scholars may give the phenomenon a more comprehensive investigation.

Conclusions

In this paper, we found senior manager over confidence is related to dividend policy. We also discovered several managerial discretion factors either strengthen or weaken the relationship. Our study and findings contribute to the financial decision and managerial discretion literature

because we tested theories developed in Western countries to an emerging market. The uniqueness of our findings calls for further investigation into emerging markets.

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