Strategic Dividend Payouts in the Chinese Real Estate Sector: Navigating Regulatory Pressures and Shareholder Interests

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Abstract. In the context of heightened regulatory scrutiny within the Chinese real estate sector, this paper investigates the motives and implications of substantial dividend payouts by real estate enterprises. The backdrop is defined by the "Three Red Lines" policy, which aims to stabilize the economic turmoil by imposing strict financial constraints on these companies. This study delves into the reasons behind these large dividends, hypothesizing that such practices are used to project financial health and appease regulatory bodies, while also satisfying strategic interests of major shareholders. Findings suggest that while these dividends serve to reassure investors about a company's financial stability, they also exacerbate financial vulnerabilities, leading to increased risk of operational failures. This study contributes to the discourse by linking dividend policies with broader economic impacts and providing insights into how regulatory frameworks could be adapted to mitigate these risks, thereby fostering a more stable real estate market.

Keywords: Real Estate Dividends, Regulatory Impact, Financial Stability, Chinese Market, Shareholder Interests.

1. Introduction

Under the background of the national implementation of the "three red lines" policy, China's real estate market is undergoing great changes. The policy aims to control the excessive boom and expansion of risks in the real estate market, by clarifying the three red lines of land, capital and finance, and limiting the financing scale and debt level of housing enterprises. However, the implementation of this policy has also triggered a series of chain reactions. With the gradual decline of the bubble in the real estate market, some real estate enterprises are facing huge financial pressure, which leads to the phenomenon of thunder in some enterprises. This situation not only has a direct impact on the real estate industry, but also has a certain degree of impact on the related industry chain and the overall economy. At the same time, the concept of no expansion advocated by the state is gradually gaining popularity. Through optimizing the utilization of land resources and improving the efficiency of urban space utilization, urban renewal and transformation are becoming the main development direction of the current real estate market. This shift will not only help mitigate the risk of a bubble in the real estate market, but also help promote urbanization and improve the quality of life of urban residents.

The exploration of risk management and policy impacts in the Chinese real estate sector has been extensively studied. Chen explored the risk management issues of Chinese real estate companies, taking Sunac as an example. The article pointed out that the COVID-19 pandemic and international situation have had a huge impact on Chinese real estate companies, leading to huge debt repayment pressure, rising construction costs, and slow fund recovery. The author proposed suggestions such as opening new sources of revenue, paying attention to risk control, and strengthening internal control to help Sunac avoid "explosion"[1]. Similarly, Wang pointed out that risk management is crucial in the real estate industry through analyzing the Evergrande explosion event. Companies should establish a comprehensive risk management system, including market risk, policy risk, financial risk, and liquidity risk. Government policies have a significant impact on the real estate market, and companies should establish a policy tracking mechanism to actively communicate with government departments, keep abreast of policy developments, and adjust strategies accordingly. In addition, companies need to analyze the specific impact of policies on their operations and finances, develop

countermeasures to mitigate policy risks, and strengthen internal training and education to enhance employees' sensitivity and response capabilities to policy changes [2].

The "Three Red Lines" policy, as studied by Wang and Yang, has been pivotal in alerting firms to financial risks. Wang studied the effects of the "Three Red Lines" policy on real estate firms using case studies. The policy alerts firms to financial risks and encourages them to improve business strategies and financial structures. However, it has limitations that can affect normal operations and fail to detect hidden debts. The study suggests more positive and comprehensive policies to promote enterprise optimization, such as relaxing financing policies, limiting support loans, improving policy standards, accurately classifying enterprises, and focusing on non-green enterprises' non-high-quality projects [3]. Yang explored the impact of China's "Three Red Lines" policy on the real estate sector, implemented in August 2020. This policy limits financing capabilities to curb excessive borrowing and stabilize the economy. Yang's study shows that while the policy increased financial strain for some firms, it also pushed the industry towards healthier, sustainable practices. Yang suggests that companies adapt by optimizing financial management and exploring new business models [4].

On the topic of real estate's role in urban economic dynamics and commercial real estate development, Wang studied the link between real estate investment and urban economic growth, emphasizing the industry's significant impact as a leading, basic, and pillar industry. There's a mutual boost between the two: real estate investment drives urban growth and quality of life, while urban growth props up real estate. However, excessive investment can waste land and harm the environment. Therefore, the government must regulate to strike a balance for healthy real estate market development and urban economic growth [5]. Zhen discussed the "saving the delivery of buildings" and "stopping loans" issue in China's real estate market. The central government has paid high attention to the issue and increased the "saving the delivery of buildings" policy. Local governments have also strengthened their implementation efforts, and the effect of "saving the delivery of buildings" is expected to be more significant. The short-term risks of the stopping loans event are controllable, but its potential impact should not be underestimated. The event may lead to changes in China's real estate sales system [6].

In the commercial real estate sector. Li predicted a healthy future for China's real estate market, citing foreign housing enterprises' stock market advantages. Kaide Real Estate, with 30 years of experience in China, follows a long-term strategy for high-quality, sustainable growth. Future residential markets will prioritize customer needs, favoring companies with strong reputations, product capabilities, and delivery efficiency. Kaide is optimistic about the Greater Bay Area and Yangtze River Delta, particularly Guangzhou, Shenzhen, Shanghai, Suzhou, and Hangzhou [7]. Guo discussed the practice of urban renewal in Shanghai, focusing on the transformation of commercial real estate. It highlights the challenges faced by traditional department stores and the success of shopping malls that have adapted to changing consumer preferences. The author also discussed the integration of historical architecture and culture into commercial spaces, citing examples such as Zhangyuan, Panlong Heaven, and Dragon Hui [8]. Duan discussed the optimization of commercial real estate operation management from the perspective of value chain. It introduced the theory of value chain and its application in commercial real estate operation management. The author proposed several optimization measures, including value chain reconstruction, internal value chain process engineering, and value chain integration. The author concluded that the optimization of commercial real estate operation management based on the value chain can help enterprises adapt to market changes, improve resource allocation, and enhance their competitiveness [9]. Ye discussed the development issues and strategies of commercial real estate in third-tier cities in China. It analyzed the background, advantages, problems, and solutions for the development of commercial real estate in these cities. The author emphasized the importance of long-term planning, risk prevention mechanisms, and talent introduction in the development of commercial real estate in third-tier cities [10].

As mentioned above, while previous research has focused extensively on the impacts of regulatory policies like the "Three Red Lines" on financial risk management in real estate, there is a gap in

understanding the specific reasons behind the large dividends paid by these enterprises. Therefore, this article plans to explore the motivations for substantial dividend payouts in the Chinese real estate sector, particularly considering stringent regulatory conditions. The aim is to ascertain how these payouts serve to manage company perceptions among investors and regulatory bodies, and how they align with the strategic interests of major stakeholders. This exploration is crucial for devising recommendations that ensure financial prudence while sustaining investor confidence.

2. Current Situation of the Real Estate Market

2.1. Tightening Regulatory Environment with the "Three Red Lines" Policy

In recent years, the Chinese government has implemented the "Three Red Lines" policy to rein in excessive leverage and risky behavior in the real estate sector. This policy sets limits on debt-to-asset ratios, cash flow, and net debt-to-equity ratios for real estate companies. Developers that exceed these thresholds face tighter financing restrictions. Only five real estate companies fully meet all three indicators, namely China Overseas Land & Investment, China Resources Land, Longfor Group, Poly Developments and Holdings, and Gemdale Corporation. On the other hand, eight real estate companies have touched all three red lines, including China Evergrande Group, Greenland Holdings, Sunac China Holdings, and Tahoe Group.

2.2. Industry Consolidation and "Thunderstorms"

As a result of the "Three Red Lines" policy and tighter financing conditions, the real estate industry has witnessed a wave of consolidation. Weaker players, unable to meet the new financial standards or facing liquidity issues, have struggled to survive.According to the "House Finance" account on Toutiao, as of August 14, 2023, among the top 100 real estate companies in 2020, 42 have already experienced explosions, accounting for more than 40%, including Evergrande, Sunac, Greenland, Shimao, CIFI, Zhongnan Real Estate, Sunshine City, Zhenro Holdings, etc. Among them, 40 are private real estate companies, and 2 are mixed-ownership companies, Greenland Holdings and Sino-Ocean Group. According to the WeChat official account "Household Not Speculation Technology Prosperity", as of October 4, 2023, among the top 100 real estate companies, 50 have already experienced explosions, with an explosion rate of 50%.

3. Reason for the Large Dividends of Real Estate Enterprises

3.1. Projection of Financial Health to Investors

In an environment marked by stringent regulatory policies, particularly the "Three Red Lines," real estate companies in China have strategically increased their dividend distributions to demonstrate robust financial health and operational stability to investors. This approach is especially vital during periods of regulatory tightening and market volatility, as seen with giants like Evergrande.

The implementation of significant dividends primarily serves as a market signal, portraying the company as financially stable and operationally efficient. This is crucial for companies under the constraints of the "Three Red Lines" policy, which limits debt levels and financial operations. By announcing and distributing generous dividends, these companies reassure investors of their financial health, despite potential liquidity issues or declining profitability.

For example, Evergrande's dividend strategies during liquidity crises are designed to sustain investor confidence. While this creates an impression of financial stability, it also masks the financial strains and operational challenges the company faces. Thus, the strategic distribution of dividends is not only a method of returning profits to shareholders but, more importantly, a way to manage perceptions and expectations in a scrutinized market.

This strategic choice is crucial in the real estate sector, where investor confidence and market reputation significantly impact a company's ability to attract financing and sustain operations.

Consequently, substantial dividend payouts are a key element of a broader strategy to navigate market uncertainties and regulatory constraints.

3.2. Demonstrating Economic Health to Regulatory Bodies

The regulatory landscape, significantly shaped by the "Three Red Lines" policy, along with prevailing market conditions, has greatly influenced the dividend strategies of real estate companies. The need to navigate these regulatory constraints while maintaining market confidence has led companies to adopt aggressive dividend policies.

Substantial dividend payouts in this context are not just a method for returning profits to shareholders but also a strategic response to regulatory and market challenges. By distributing dividends, companies signal their resilience and adaptability, qualities crucial for maintaining investor interest and confidence in a tightened regulatory environment.

Furthermore, these dividend strategies are seen as an effort to align with regulatory expectations, showcasing a commitment to financial prudence and risk management. This is particularly relevant for companies nearing or exceeding the thresholds set by the "Three Red Lines" policy. Here, substantial dividends are used to demonstrate to regulators and the market that the company remains committed to shareholder value, even as it navigates financial and operational constraints.

This strategic navigation requires a delicate balance. On one hand, substantial dividends affirm the company's commitment to shareholder returns and financial health. On the other hand, they necessitate careful financial management to ensure that such policies do not compromise the company's ability to comply with regulatory standards or to capitalize on growth opportunities. Thus, dividend policies become a critical part of a broader strategy aimed at steering the company through the complexities of the regulatory environment and market volatility.

3.3. Satisfying Major Shareholders and Strategic Interests

Another dimension underpinning the substantial dividend payouts among real estate companies in China relates to the interests of major shareholders, including top executives and primary investors. These individuals or entities often wield significant influence over company policies and strategic decisions, including those pertaining to dividend distributions.

In the case of companies like Evergrande, where a relatively small group of shareholders controls a significant portion of the company, dividend policies are frequently tailored to meet their expectations and financial interests. This dynamic is particularly evident when profits decline or financial pressure increases. Here, the decision to proceed with substantial dividend payouts can be viewed as a deliberate strategy to ensure the continued support and commitment of key stakeholders.

This approach, while beneficial in securing the loyalty and backing of major shareholders, raises pertinent questions about its long-term sustainability and alignment with the company's broader financial and operational goals. Specifically, it underscores the potential conflict between short-term shareholder interests and the long-term health of the company. For instance, prioritizing generous dividend payouts in times of financial duress can strain the company's liquidity, limit its ability to invest in growth opportunities, and increase its vulnerability to market and regulatory pressures.

Furthermore, this strategy highlights the intricate balance that companies must navigate between rewarding shareholders and ensuring the company's financial stability and growth prospects. The focus on satisfying major shareholders through dividends must be weighed against the imperative to maintain a prudent financial posture, especially in a sector characterized by high capital expenditure and significant regulatory scrutiny.

4. Recommendations and Outlook

4.1. Enhanced Regulatory Oversight on Dividend Policies

To effectively address the issue of excessive dividend payouts, particularly by companies facing liquidity constraints, it is crucial to establish a robust regulatory framework. This framework should

include the introduction of regulations that cap dividends at a reasonable percentage of net profits or free cash flow, ensuring that dividends are paid from actual earnings rather than through accruing debt. Additionally, enhancing monitoring mechanisms to ensure compliance with financial regulations, such as the 'three red lines' policy, is essential. This could involve more frequent financial disclosures and audits, especially for companies that are near or have crossed these red lines. Establishing clear and stringent penalties for companies that breach dividend payout regulations is also necessary, which could include fines and restrictions on future borrowing to enforce compliance and prevent financial instability.

4.2. Corporate Governance and Transparency Enhancement

Improving corporate governance and enhancing transparency in financial reporting among real estate companies are critical steps towards ensuring that decisions regarding dividends are made with consideration for the long-term health of the company and the interests of all stakeholders. Implementing governance frameworks that mandate the inclusion of minority shareholder representatives in dividend-related decision-making processes would ensure a more balanced approach to dividend payouts. Requiring detailed disclosures regarding dividend decisions in annual and quarterly reports, including the rationale for the dividend and its impact on the company's financial health, is also vital. Additionally, regularly engaging with all stakeholders, including creditors and investors, to provide updates on financial health and dividend policies should be part of a broader strategy to maintain open lines of communication with the market and build trust, which is crucial for the stability and growth of the real estate sector.

4.3. Policy Refinement and Market Confidence Strengthening

Refining the 'three red lines' policy to balance risk management with the growth needs of real estate companies is necessary. Introducing flexibility in the application of this policy, where the criteria are adjusted based on a company's financial stability and risk profile, could prevent undue strain on companies while still controlling high-risk financial behaviors. Encouraging companies to develop internal risk management frameworks that are robust and capable of quickly adapting to policy changes and market conditions is also essential. Conducting regular reviews of real estate policies and their impacts on the market ensures that these policies remain relevant and effective in the face of changing market dynamics and economic conditions, thereby strengthening market confidence and contributing to the long-term sustainability of the real estate sector. This approach will protect the interests of both companies and investors, fostering a more stable economic environment.

5. Conclusion

This study has unearthed critical insights into the practice of large dividend payouts among Chinese real estate companies, underpinning its prevalence as a strategic tool used for multiple corporate objectives. The main findings reveal that substantial dividends are often projected to signal financial robustness to investors and regulatory bodies, particularly during periods of tightened financial regulations. However, such strategies, while bolstering short-term investor confidence, may undermine long-term financial stability by straining cash reserves needed for operational and growth initiatives.

The implications and outlooks suggest that there is a pressing need for refined regulatory oversight to curb the risks associated with indiscriminate dividend payouts. Enhanced transparency in financial disclosures and improved corporate governance can also play pivotal roles in aligning dividend policies with both shareholder interests and corporate longevity. Looking ahead, policy refinements should aim to balance risk control with the developmental needs of real estate enterprises, thereby supporting sustainable growth in the sector and stabilizing the broader economic landscape. This

balanced approach would ensure the health of the real estate market and by extension, contribute positively to urban economic dynamics.

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