The Effect of Corporate Governance and Capital Structure on Dividend Payment: Evidence from Malaysia

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Abstract: - Previous studies have focused on organization lifecycle and dividends trend over different period of time and analyzed factors that influence dividends payout. Current literature, based on agency theory perspective, suggests that corporate governance and capital structure can also influence dividend payout. This study investigates the impact of corporate governance and capital structure on dividends payout of Malaysian listed companies for the year of 2009 and 2010. This study employs convenience sampling method due to the availability of corporate governance index data from Minority Shareholders Watchdog Group (MSWG). Other companies' financial information were collected from Thompson Financial Datastreamdata base. Pool regression methods are performed to analyze the data. The results of the study show that corporate governance has negative and strong effect on dividend payout as predicted. The effect of capital structure on dividend payout was negative but not significant. The findings from this research contribute to the additional dividend payout knowledge in the area of accounting and finance. The input would help the regulatory body to enhance the corporate governance mechanism to reduce agency cost and this would lead to the less amount of dividend to be paid to share holders. The study also contributes to the new period (2009-2010) of dividend payout study within Malaysian environment, which investigate the dividend payout behaviour of Malaysian companies during stable economic period.

Key-Words: dividend payout, Malaysia, corporate governance, capital structure

1 Introduction

Dividend policy is a set of company's rules and guidelines used to decide how much the company will pay dividend to its shareholders. It is an important financial management decision made by the board of directors and the management since it could influence the company'svalue. Thedecision on the amount of dividends is also important to potential investors who want to invest their money in the company. In Malaysia, dividends declared by financial institutions must be approved by Bank Negara Malaysia. However if a company is not regulated by Bank Negara Malaysia, it should refer to Section 365 of Malaysian Companies Act 1995 that stated "no dividend shall be payable to the shareholders by any company except out of profit or pursuant to section 60".

From different perspective, Alwi[3] advocates that dividends not only indicate firm's future perspective and performance, but also act as corporate governance mechanisms. Jirappon and Ning[14]further suggest that the level of dividend paid is depending on the level of corporate governance mechanism implemented in a company.

Corporate governance is defined as a process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability. The ultimate objective is to realize long term shareholder value and also taking into account the interest of other stakeholders [15].

Companies that implement good corporate governance mechanism would provide assurance to investors that they will receive sufficient return from their investment through payment of dividend [1]. LaPorta et al. [15] provides further elaboration on the role of corporate governance as a mechanism through which outside investors protect themselves against expropriation by the insiders. This expropriation is related to agency cost.

Dimensions of corporate governance mechanisms in a corporate sector include ownership structure, board structure, board activity which includes meeting and forming of committee, remuneration, transparency, disclosure, alliance and

ISBN: 978-1-61804-159-3

merger[1]. According to Shleifer andVishny[20] the main mechanisms by which corporate governance works are internal control and management compensation that is designed to align managers' incentives with the owners' goals. However, corporate governance may not always be effective. Factors like concentration of share ownership, capital structure and board structure determine the owners' incentives to incur the cost of installing effecting governance mechanisms.

Capital structure refers to the combination of fund in the form of debt and equity that use to finance a firm. Miller and Modigliani [18]proposed that one of factors that can influence value of the firm would be the ratio of debt over equity of firm. If proportion of firm's debt is high, the risk related with its future earning is increased and firm expect to earn higher rate of return. The debt to equity ratio reveals the extent to which company's management is willing to fund its operations with debt, rather than equity.

Corporate debt as an internal control mechanism can reduce agency conflict which was described by [11].Grossman and Hart [11] stress that the obligation that is associate with debts, reduced management discretionary control over corporate cash flow. Debts can force managers to forego for positive net present value projects. Debt could also restrict the payment of dividend.

Past studies in Malaysia have analyzed the cash dividends trend, both in the amount of payment and number of companies that pay dividends [9]. Those studies showed a downtrend in the amount and number of companies that pay cash dividends. The main reason was the macroeconomics factors. Those prior studies have covered period of studies from year of 1926 until 2006. The results were affected by Asian financial crisis in 1997 and this could be the main reason for declining dividends payout in that period.Other studies also focused on determinant factors such as growth, profitability, size and age and their results supported the relationships between dividends payout and the mentioned factors [6,8].

Most of the previous studies have restricted their sampling model to industrial or financial sector only. This study will use sample of firms from all industries in listed on Bursa Malaysia. This study tries to extend knowledge of how corporate governance and capital structure variable influence the payment of dividend. Previous studies have studies these variables separately. This study plans to fill the gap by focusing on corporate governance mechanism and capital structure to examine their effect on dividend payout of Malaysian listed companies.

Therefore, the objectives of this study are:

1- To investigate the relationship between corporate governance and dividend payout of Malaysian public listed companies.
2- To investigate the relationship between capital structure and dividend payout of Malaysian public listed companies.

This study employs convenience sampling method due to the availability of corporate governance index (CGI) data from Minority Shareholders Watchdog Group (MSWG). The findings of the study show that CGI has a negative and strong effect on dividend pay-out and dividend yield as predicted. The effect of capital structure on dividend pay-out and dividend yield was negative but not significant. The findings from this study contribute to the additional dividend pay-out knowledge in the area of accounting and finance. The input would help the regulatory body to enhance the corporate governance mechanism to reduce agency cost. The study also contributes to the new period (2009-2010) of dividend pay-out study within Malaysian environment, which investigate the dividend pay-out behaviour of Malaysian companies during stable economic period.

The next few sections provide detail discussion of the review of the literature and hypotheses development, research methodology and research findings. The section ends with the discussion of research conclusion and implication.

2 Literature Review and Hypothesis Development

2.1 Corporate Governance and DividendPayout

Dividend and corporate governance are tools that can control agency problem within firms. Firms that have strong corporate governance mechanisms can ensure investors that they would receive maximum return from their investment [4].Dividends payment is one of the mechanisms to improve corporate governance and reduce agency cost. According to La Porta et al. [15]corporate governance is betterin countries that have legal system to protectinvestors. Therefore, managers in these countries can distributeless dividends to shareholders and invest excess fund in different projects. Well governed firms have control over their excess cash which can have a positive effect on their future performance and dividendpay-out[7]. So far, studies that focused on corporate governance mechanisms and its relationship with dividends payout have shown consistent result, in which effective and strong corporate governance companies are able to pay fewer dividends [14]. When corporate governance is strong, dividend as one mechanism to reduce agency costs will be set at a minimum level. However, there is no study in Malaysia that investigated this issue. Therefore, a study needs to be carried out in Malaysia. Therefore the first hypothesis is stated as follows:

H1: There is a negative relationship between corporate governance level and dividends payout.

2.2 Capital Structure and Dividend Payout

Past studies show that the relationship between capital structure and payment of dividend can be positive or negative. The negative proponents argue that when there is less agency conflict between managers and investors, investors are aware that managers would not use the excess cash for their own self-interest. Therefore, firms that increase their debt can afford to pay lower dividend.

From another perspective, conflict between managers and investors is also less in companies that are financially stronger. An increase in debt would not send a negative signal to investors since they are willing to wait for future dividends pay out [10].In this case, the relationship between debt and dividends pay-out is expected to be negative [13]. Triantis et al. [21] showed that the firm's debt-equity ratio depends critically on the probability distribution of cash flow and on the firm's investment opportunities. Grullon et al. [12] found a small but statistically significant decline in the leverage ratio for dividend-increasing firms and vice versa. In this case, the reduction of dividend pay-out does not matter to investor as they are aware that managers are managing the company well and willing to receive dividend in the future [10].

However, firms that encounter high agency problem, any increase in debt will give a negative signal of possible opportunistic behaviour by management. Therefore, investors demand higher payment of dividend [5].Consequently, the relationship between capital structure and dividend pay-out is expected to be positive.

In conclusion, the results of previous studies show that the relationship between capital structure and dividend payout depends on the level of agency problem and firms performance. Since the relationship between these two factors can be positive and negative, the second hypothesis is stated as follows:

H2: There is association between capital structure and dividends payout.

3 Research Methodology

This study uses cross-sectional design to test the relationship between variables. The study used data of companies listed on the Bursa Malaysia for the period of 2009 to 2010. These periods of study are free from major economic crisis.

The study employs a convenience sampling method which is a type of non-probability sampling technique, based on the availability corporate governance index data issued by Minority Shareholders Watchdog Groups (MSWG)[1]. Specifically, data were obtained from 202 companies for these two years of study.Previous Malaysian studies have used similar sample size in their studies. Corporate governance index (CGI) is collected from MSWG. Other financially related data were collected from Thompson Financial Datastream database.

The dependent variable is the dividend payout ratio. It is anaccounting based ratio and is calculated as follows:

$$\text{Dividend payout} = \frac{\text{Dividend per share}}{\text{Earning per share}}$$

There are two independent variables; corporate governanceand capital structure. Corporate governance variableemploys corporate governance index issued by MSWG[2]. Capital structure is a ratio of total debt over total equity. The control variables in this study are size, profitability and growth opportunities. The regression model to investigate the influence of all variables to dependent variable is as follow:

[1] The Minority Shareholder Watchdog Group (MSWG) was established as a government initiative in the year 2000 as part of a broader capital market framework to protect the interests of minority shareholders through shareholder activism. It is one avenue of market discipline to encourage good governance amongst public listed companies with the objective of raising shareholder value over time. For further information please visit http://www.mswg.org.my/web/

[2] The calculation of CGI involves 5 stages: Stage 1 takes in to account the 121 key parameters stated in the Malaysian Code on Corporate Governance, Listing Requirements, and International Best Practices; In Stage 2the calculation of score include the 29 best practices; in Stage 3 the measure include the financial performance indicator (5-year average ROE and Market Capitalisation), in Stage 4, aspect of corporate responsibility (environment, community, marketplace and workplace) were taken into consideration, and in Stage 5, the measurement is based quality of disclosure in Annual Report and proper market conduct.

$$DP_{it} = \alpha_1 + \alpha_2 CGI_{it} + \alpha_3 CS_{it} + \alpha_4 ROE_{it} + \alpha_5 Size_{it} + \alpha_6 GO_{it} + \varepsilon_{it}$$

Where:

DP_{it}	=	Dividend per share divided by earnings per share offirm *i* at time *t*.
CGI_{it}	=	Corporate governance index of firm*i* at time*t*.
CS_{it}	=	Total debt divided common equity of firm*i* at time *t*.
ROE_{it}	=	Net income divided by total shareholder's equity of firm *i* at time *t*.
$Size_{it}$	=	Total sales of firm *i* at time *t*
GO_{it}	=	End year share price divided by book value per share of firm *i* at time *t*.
ε_{it}	=	Standard error.

4 Analysis and Findings

Table 1 presents a summary of the descriptive informationof variables.

Table 1: Descriptive Statistics

	Min	Max	Mean	Std. Dev.	Skewness	Kurtosis
DP	0.00	94.54	37.82	26.70	0.29	-0.79
DY	0.00	12.12	4.13	2.83	0.56	0.06
CGI	1.00	101.00	51.00	29.23	0.00	-1.20
CS	0.01	2.90	0.73	0.66	1.64	2.77
ROE	0.24	35.45	14.82	9.05	0.75	0.01
Size (RM)	88,682	16,467,100	3,053,199	4,266,300	1.97	3.01
GO	0.30	6.66	1.76	1.43	1.80	3.22

Table 2 presents results of Pearson's correlation to examine the multicollinearity problem among independent variables. The table shows that all Pearson's correlations coefficients values are not more than 0.7, which means there is no multicollinearity problem among independent variables.

Two regression analyses were performed to test the research model. Model 1 is based on the effect of only independent variables (corporate governance and capital structure) toward dividend pay-out. The second model (Model 2) includes the effect of independent and control variables (profitability, size and growth opportunities). Two additional regression analyses were also carried out to test the model separately each year. The results are tabulated in Table 3.

Table 2 Pearson's Correlation Test

	DP	DY	CG	CS	ROA	Size	GO
DP	1						
DY	.461**	1					
CG	-.226**	-.148*	1				
CS	-.154*	-.052	-.021	1			
ROA	.251**	.107	.179*	.017	1		
Size	.046	-.058	.275**	.074	-.049	1	
GO	-.442**	-.031	-.277**	-.008	.635**	.141*	1

**. * Significant at 17 and 5% level respectively

Overall, the research models are significant at 1% with the range of adjusted R^2 from 5.6% to 20.3%. In Model 1, the results show that corporate governance index has a negative relationship with dividend payout. The result is significant at 1%. It indicates that companies with strong corporate governance can pay lower dividend to their shareholders and reinvest the money in projects. The result supports hypothesis one.

Table 3 Regression Result

Variables	Model 1	Model 2	Year 2009	Year 2010
Constant	48.326*** (13.072)	35.708*** (6.293)	8.401*** (5.206)	2.689*** (3.550)
CG	-.228*** (-3.327)	-.189** (-2.774)	-.166* (-1.687)	-.305*** (-3.190)
CS	-.120* (-1.746)	-.123* (-1.830)	-.167* (-1.700)	-.147 (-1.531)
ROE		.219*** (3.216)	.209** (2.121)	.237** (2.479)
Size		.046 (.700)	.015 (0.151)	.015 (0.152)
GO		-.414*** (-6.283)	-.521*** (4.303)	-.034*** (5.030)
Adjusted R^2	5.6%	20.3%	18%	19.5%
F-Value	6.939	11.256	5.484	13.099
Sig.	.001***	.000***	.000***	.000*

***, **, * Significant at 1%, 5%, and 10% respectively
Value of variables coefficient is presented in the table, t-value is in bracket.

The results supports the previous work undertaken by Dittmar and Mahrt-Smith (2007) that suggest when corporate governance mechanism is high, investorsare willing to finance firms and expect to receive dividends in the appropriate time in the future. In strong and well governed firms, investors perceive that managers have control over their excess cash, therefore the CGI has a negative effect on dividend payment. Jirapon and Ning (2006) also find inverse association between dividends payout and shareholders right, indicating that firms pay higher (lower) dividends where shareholders rights are weak (strong). LaPorta et al. (2000) explained that firms with weak shareholders rights need to establish a reputation for not exploiting shareholders. Therefore, these firms, who have poor corporate governance mechanism(weak shareholder rights), the agency problem is high, and pay higherdividends than firms with strong corporate governance mechanism.

The results presented in Table 3 also show that capital structure has a negative effect on dividend payout. However the effect is just moderate (significant at 10%). Therefore the second hypothesis cannot be accepted.

The negative relationship is supported by the work of Faulkender et al. (2006) that argue that firms that the agency problem is low (for example in firms that have better financial performance)the disagreement between managers and investors are less. In a case of increase in debt, investors are willing to wait for future dividends payment. Therefore, therefore the relationship between capital structure and dividend pay-out is negative. Grullon et al. (2002), for example, has also found statistically significant decline in leverage ratio for dividend-increasing firms.

The results for separate regression analyses, based on different years of study (2009 and 2010),show consistent results. Corporate governance variable shows a negative and significant relationship with payment of dividend. On the other hand, capital structure variable show negative but insignificant relationship with dividend payment.

The overall results of control variables are almost consistent with past studies in which profitability is positively significant to influence dividend pay-out. Growth opportunity shows a negative direction and size does not show any significant direction.

4 Conclusion

Dividend is a distribution of a company's profit to its shareholders. The amount of dividend paid is based upon the number and types of shares they hold. Dividend pay-out is important because managers have to decide on the amount of cash that needs to be paid to shareholders by considering the financial and investment position of companies. Previous studies have focused on organization lifecycle and dividends trend over different period of time and analyzed factors that influence dividends payout. Current literature, based on agency theory perspective, suggests that corporate governance and capital structure can also influence dividend payout. Therefore, this study investigates the impact of corporate governance and capital structure on dividends payout of Malaysian listed companies for the year of 2009 and 2010. This study employs convenience sampling method due to the availability of corporate governance index data from Minority Shareholders Watchdog Group (MSWG). Other companies' financial information, such as capital structure and control variables, were collected from DATASTREAM data base. Pool regression methods are performed to analyze the data. The results of the study show that corporate governance has negative and strong effect on dividend payout as predicted. The effect of capital structure on dividend payout was negative but not significant.

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