

# THE IMPACT OF OWNERSHIP STRUCTURE ON DIVIDEND POLICY: EVIDENCE OF MALAYSIAN LISTED FIRMS

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**Abstract:** *Drawing on the existence evidence indicating that corporate ownership in emerging market is predominantly concentrated and controlled by large-block shareholders, this study attempts to investigate the effect of ownership structure on dividend payout decision of Malaysian listed firms. The study employs a panel data analysis of 141 firms listed on Bursa Malaysia for the financial year from 2009 to 2013. The sample is subdividing into concentrated and dispersed ownership counties. Multiple regression analysis is used to estimate the association proposed in the hypotheses. The results support the hypothesis that ownership is positively and significantly related to dividend payout decision. This finding is consistent with the view that dividend payout policy is a solution to reduce agency conflict between managers and shareholders. The findings also advocate that profitability is positively and significantly related to dividend payout. This finding supports the assertion that highly profitable firms distribute higher dividend to their shareholders. Finally, firm size and leverage are found to be negatively related to dividend payout at very strong and relatively weak level of significance respectively.*

**Keywords:** *Dividend policy, ownership structure, controlling shareholders*

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## Introduction

Literature on dividend policy has evolved since the scholarly work by Modigliani and Miller (1961). Drawing on the evidence of the dividend irrelevance theory in the perfect market engaged with rational investors, many researchers over the world have sought to identify the determinants of dividend policy (Modigliani & Miller, 1961). These determinants include investment opportunities (Abor & Bokpin, 2010; Pruitt & Gitman, 1991), firm size (Fama & French, 2002; Abor & Bokpin, 2010), profitability (Amidu & Abor, 2006; Abor & Bokpin,

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2010) and capital structure (Al-Kuwari, 2009; Allen & Michaely, 1995). A more recent constituent of literature has focused on the effect of ownership structure on dividend payment (Harada & Nguyen, 2011; Mehrani, Moradi & Eskandar, 2011).

While empirical evidence on the determinants of dividend policy has largely focused on developed economies with mixed results (Abor & Bokpin, 2010), the impact of ownership structure, in particular, concentrated ownership on the firms' dividend policy in emerging markets such as Malaysia remains largely unexplored. More than 60 percent of listed firms in emerging market particularly in Malaysia are very much concentrated and these firms predominantly owned by inherited families (Claessen, Djankov & Lang, 1999). Previous study reveals that concentrated ownerships are strongly associated with pyramidal structures that are likely to increase the risk of expropriation between minority and controlling shareholders (Claessens, Djankov and Lang, 2000). Literature has shown that financial leverage and dividend policy play vital role in reducing agency costs, arising from conflicts between managers and shareholders. Debt is used as a monitoring tool to observe managers while dividend payout policy is used to prevent self-interest activities by the controlling shareholders (La Porta et. al. 2000).

Other firm-specific characteristics such as firm size, risk level, investment opportunity, profitability and leverage have also been found to be related to dividend payout policy (Abor & Bokpin, 2010; Amidu & Abor, 2006; Al-Kuwari, 2009). Since it has been a universal consensus that there is no single driven explanation for dividend policy (Abor & Bokpin, 2010), this study incorporates some other variables such as firm size, profitability and leverage to empirically test the effect of these variables on dividend policy in different contexts of corporate landscape, specifically in Malaysia.

## **Literature Review**

### **Dividend Payout Policy**

Principally dividend is the distribution of profits to shareholders due to their ownership of shares in a company. The main purpose of distributing dividends to shareholders is to reduce the free cash flow that can reduce conflicts of interest between managers and shareholders, thus preventing managers from engaging in value-destroying activities that may harm the shareholders' wealth (Jensen, 1986). Prior literature also reveals that dividend payout policy has been used to convey management private information as well as to signal the company's future prospects, hence enable the investors to make appropriate decision for their future investment (Abor & Bokpin, 2010). Furthermore, researchers in the field have agreed with universal consensus where there is no absolute explanation for the dividend policy, thus it becomes an important corporate issue that interacts in parallel with the financial and investment decisions made by a firm.

### **Ownership and Dividend Payout Policy**

The ownership structure, an important determinant in the dividend decision-making process, is defined by the distribution of equity with regard to votes and capital, but also by the identity of the equity owners. The relationship between ownership structures and dividend policy in Malaysian firms is complex due to its variety of owners. Kumar (2012) stated that

the association between ownership structure and dividend payout policy in India differs across different group of owners and at different level of shareholding.

Despite incorporating different ownership, no significant difference is shown by countries of the same economic and institutional development such as, a higher level of ownership concentration in East Asian corporations (La Porta et. al., 2000), widely held corporation ownership for UK and Ireland's financial and large firms (Faccio & Lang, 2002), state control in Malaysia, Indonesia, Singapore and Thailand whereas most Japanese and Koreans corporations have widely dispersed ownership (Claessens et. al., 1999).

The studies in United Kingdom by Bank, Cheffins, and Goergen (2004), Renneboog and Trojanowski (2005), Goergen, Renneboog, and Da Silva (2005) concluded that ownership structure positively impacted dividend policy. On the other hand, Renneboog and Trojanowski (2006) noted that German companies changed dividend payout because there was a large block of shareholding, voting power and control in the hand of block holder and their coalitions have negatively impacted the dividend payout ratios. Short, Zhang, and Keasery (2002), concluded that there was a negative relationship between the inside ownership and the dividend payout policy in their study in UK.

Roy (2015) focused on the effect of the adoption of corporate government practices on the dividend payment in order to identify the effect of presence of family blocks on the dividend payment policy. Indeed, the presence of corporate government variables has significantly impacted the dividend policy. The presence of growth opportunities in the company has also positively related to dividend payment. Thus, this hypothesis was developed;

*H<sub>1</sub>: There is significant association between ownership structure and dividend payout policy.*

### **Firm Size and Dividend Payout Policy**

A study showed that size, age and profitability of the firms were major determining factors of corporate dividend policy in Jordan (Malkawi, 2007). Eriotis (2005) advocated that high dividend payout companies were typically ten times bigger in size than the non-paying companies. Similarly, Farrelly et. al. (1985) revealed that most high dividend payment Canadian firms are remarkably larger in size. Commonsensically, since larger firms have wider opportunities to enter capital market and consequently able to raise fund at much lower cost without utilizing internal funding, resulting in bigger cash flow coupled with greater ownership structure, they are able to generate larger profit and pay higher dividend to their shareholders. Ho (2003) opined that out of all the regressed variables of profitability, size, liquidity, leverage, risk, asset mix and growth, the dividend policies are affected positively by size in Australia and liquidity in Japan and negatively by risk in Japan only. Furthermore, size was found to significantly affect the DPS as compared to either the current, past or future net earnings (Al-Twajry, 2007).

Conversely, Mehdi, Mahdi & Shahnaz (2010) debated that firm size does not affect dividend distribution and was agreed by Afza and Mirza (2010) who discovered that only ownership structure and cash flow to be significant. Demsetz and Lehn (1985) also learned that firm size was negatively correlated with ownership structure. The research conducted by Azeem,

Akbar and Usman (2011) proved that the dividend policy and firm size was not positively associated. Thus, this hypothesis was developed;

*H<sub>2</sub>: There is significant association between firm size and dividend payout policy.*

### **Profitability and Dividend Payout Policy**

Profitability is constantly described as the main indicator of dividend payments in most studies (Glen & Singh, 2004; Anil & Kapoor, 2008). Many studies show an increase in profits caused a dividend pay appreciation [see Amidu & Abor (2006), Gill et. al. (2010) and DeAngelo et. al. (2006)]. Amidu and Abor (2006) examine the factors that affect the dividend payout policy of listed firms in Ghana. The result shows a significant positive relationship between dividend payout ratio and profitability, cash flow, and tax. It is in line with Imran's (2011) in the case of Pakistan engineering firms who found that firms with higher sales and profits have sufficient cash and other resources to distribute more cash dividends amongst shareholders. The logical reason is since dividends are usually paid from annual profits, profitable firms are willing to pay higher dividends and therefore a positive relationship is expected between dependent and independent variables. This however contradicts the study by Elmi and Muturi (2016) which shows that the results did not show significant effect between profitability and dividend payments. Profitability has a positive but insignificant impact on dividend payments by commercial firms and services. This implies that changes in profits are not expected to have a significant impact on dividend payments. This is the case when a company decides to pay a certain dividend payment. However, when company profits are reduced, the company reduces its dividend payout though not much. Therefore, this hypothesis was developed:

*H<sub>3</sub>: There is a significant association between profitability and dividend payout policy.*

### **Leverage and Dividend Payout Policy**

The ownership structure and the company's financial capital have an important impact on financial stability. One way for a company to maximize its value is by optimizing the combination of debt and equity holding to finance its assets generating cash flow for the company. Muhammad Usman (2012) suggests that financial leverage is a financial activity involving raising funds from outsources and incurring costs to improve it. Asad and Yousaf (2014) examine the impact of leverage on dividend payment pattern of Pakistani manufacturing firms. By using 44 companies from five different sectors from the year 2006 to 2011 found that leverage has significant negative impact on dividend pattern of sampled firms. Zeng (2003) advocates that if financial leverage is used as a default time indicator and has a positive relationship with the cost of finance, thus paying dividends can increase the financial difficulty of a firm due to its high leverage ratio. The results show that there is an inverse relationship between these two variables. It was reinforced by the same results reported by Fenn and Liang (2001), which shows that there was an inverse direction in the relationship between the two variables. Nash et. al. (2003) also supports the argument arising from the inclusion of debt agreements to minimize dividend payments by bondholders.

In addition, Ozdagli (2009) shows that there is a significant relationship between dividends offer by companies related to financial leverage. In fact, the leverage level of the company will reflect changes in returns to their investors. The higher the leverage levels of the company, the lower the return to the shareholders as companies have to bear the costs to pay their financing costs. However, Al-Kuwari (2009), emphasized that the relationship between financial leverage and company dividend payments was positive when the optimum capital structure was able to pay a high dividend compared to other companies. Thus, this hypothesis was developed:

*H<sub>4</sub>: There is a significant association between financial leverage and dividend payout policy.*

## **Data and Methodology**

### **Sample and Data Collection**

The sample comprises the Bursa Malaysia listed companies excluding financial related companies. Financial and corporate data are obtained from Bloomberg's database and annual report of the companies. This study utilizes panel data of 141 companies for five-year windows period from the year 2009 to 2013. Sample represents 4 major sectors classified by the Bursa Malaysia namely, industrial product (37 percent), followed by trade and service (26 percent), and consumer product sector (21.3 percent) while property sector contributes 15.7 percent. Although there is some concentration in certain sectors, this study does not control the effect of this concentration. Following Claessens et. al. (2002) this study categorizes a firm as a closely held firm if the top five largest shareholders hold with a minimum control threshold of 20 percent.

### **Measurement of Variables and Model Specifications**

Prior research on dividend has examined association between several variables and dividend payment. For instance, dividend is found to be associated with firm size, profitability, efficiency and leverage (Nendi et. al., 2013; Harada & Nguyen 2011; Lace et. al., 2013). This study employs a panel data analysis of 705 firms-year observations for the year 2009 to 2013. Pooled ordinary least square regression (POLS) is used to test the hypotheses developed in the study. Following existing literature, this study uses dividend model employed by Harada and Nguyen (2011) with some modifications of the variables. In addition to firm ownership, this study also includes several other hypothesized variables such as firm size, profitability and leverage. Therefore, the following is the model employed to test the hypotheses developed in the study.

$$DPR = \beta_0 + \beta_1 \text{Ownership} + \beta_2 \text{Firm Size} + \beta_3 \text{ROA} + \beta_4 \text{DR} + \varepsilon$$

Where:

- $\beta_0$  = intercept of the equation
- $\beta$  = a regression coefficient
- DPR = a fraction of dividend to net income
- Ownership = percentage of equity hold by top 5 substantial shareholders
- Firm Size = log of total assets
- ROA = return on assets
- DR = long term debt to total assets
- $\varepsilon$  = error term

## Result and Discussion

### Descriptive Analysis

Table 4.1 provides descriptive statistics for the variables used in the study. As shown in Table 4.1, there are 106 closely held firms (about 75 percent of the total sample firms), while the remaining is firms with dispersed ownership. These figures reflect that businesses in Malaysia are dominated by large-block shareholders. Descriptive analysis shows that concentrated and dispersed ownership firms encompass a wide range of dividend payout ratio ranging from 0.63 percent to 190.52 percent and 3.02 percent to 201.36 percent respectively. The average dividend ratio is reaching almost 52 percent for closely held firms as compared to 43.57 percent for widely held firms. With respect to ownership structure, following the table 4.1 the study finds that, on average the percentage equity holdings by top five substantial shareholders for closely held firms is 49.89 percent. The result also indicates the ownership structure of the companies is widely dispersed at 4.35 percent and highly concentrated at 99.89 percent shareholdings. With regard to firm size, the sample firms also cover a wide range of firms, some moderately small and some relatively larger ranging from RM35.85 million to RM71495.5 million. In average, the total asset is worth RM2509.3 million and RM2923.9 million respectively for concentrated and dispersed ownership companies. Return on assets (ROA) ranging from -12.2 percent to 38.67 percent with a mean of 7.67 percent for closely held firms and 8.41 percent for dispersed ownership firms. On average, firms with concentrated ownership employ slightly less debt in their capital structure (20.96 percent) relative to dispersed ownership firms (26.38 percent). This finding provides evidence that closely held firms are less levered because the managers cum owners of these firms are more risk-averse since debt leads to possibility of bankruptcy.

**Table 4.1: Descriptive statistics**

Variables	Concentrated Ownerships Firms (106 firms)				Dispersed Ownership Firms (35 firms)			
	Min	Max	Mean	Std. Dev	Min	Max	Mean	Std. Dev
<b>DPR</b>	0.0063	1.9052	0.5146	0.3334	0.0302	2.0136	0.4357	0.3409
<b>Ownership</b>	0.2019	0.9989	0.4989	0.1587	0.0435	0.1915	0.1406	0.0461
<b>Firm Size</b>	56.8	43195.8	2509.3	5695.8	35.85	71495.5	2923.9	9803.6
<b>ROA</b>	-0.122	0.346	0.0767	0.0655	-0.0457	0.3867	0.0841	0.0698
<b>DR</b>	0.026	1.1872	0.2096	0.1857	0.0002	3.5509	0.2638	0.4507

## Correlation Matrix

Table 4.2 presents the correlation matrix of the variables employed in this study. The higher value correlations of coefficient show the stronger relationship between variables. Based on table 4.2, it shows the dividend payout ratio is negatively correlated with ownership structure, firm size and ROA. However, debt ratio is found to have positive relationship with dividend payout ratio which is resulted at 0.0402. Correlation matrix shows that independent variables are not highly correlated. For this reason, there is no multicollinearity problem found in the study.

**Table 4.2: Correlation matrix of the independent variables**

Variables	DPR	Ownership	Firm Size	ROA	DR
<b>DPR</b>	1.0000				
<b>Ownership</b>	-0.0351	1.0000			
<b>Firm Size</b>	-0.0231	0.0699	1.0000		
<b>ROA</b>	-0.0037	0.0371	-0.1198	1.0000	
<b>DR</b>	0.0402	-0.0717	-0.0440	-0.0144	1.0000

## Empirical Regression Results

The primary results of the study are presented in Table 4.3. The regression analysis is used to test the hypotheses developed in the study. Recall that Hypothesis 1 predicts a significant association between ownership and dividend payout policy. The results reported in Table 4.3 show the association between dividend payout and the hypothesized variables derived from the extant literature. The adjusted R- square is about 14.02 percent which implies that the hypothesized variable and other firm-specific variables explain about 14.02 percent variation in dividend payout ratio of the sample firms.

**Table 4.3: Pooled Ordinary Least Squared (POLLS)**

DPR	Coef .	Std. Dev	T	P> t	95% Coef.	Interval
<b>Ownership</b>	.4175043	.0675729	6.18	0.000	.2848335	.5501752
<b>Firm Size</b>	-.0370131	.0086304	-4.29	0.000	-.0539579	-.0200684
<b>ROA</b>	.5251304	.1865639	2.81	0.005	.1588359	.8914249
<b>DR</b>	-.0718528	.04292	-1.67	0.095	-.1561208	.0124151

As shown in Table 4.3, dividend is positively and significantly related to ownership (coefficient = 0.417;  $p < 0.01$ ). The result supports Hypothesis 1 which predicts that dividend payout is significantly related to firms' ownership. The finding of this study is consistent to the widely-held view in the dividend and corporate ownership literature that shows closely held firms is associated with high agency problem, hence they pay higher dividend to shareholders to reduce conflict of interest between managers and shareholders (Jensen, 1986). The regression result also shows that dividend payout is negatively and significantly associated with firm size (coefficient = -0.037;  $p < 0.01$ ). The finding suggests that larger and diversified firms are more likely to have better knowledge of market and thus they are more

likely to have better investment opportunities. Therefore, larger firms pay low dividend, since dividend and investment denote competing possible uses of firm's free cash flow (Abor & Bokpin, 2010).

Another variable that is found to have strong positive association with dividend payout is return on assets (ROA), a proxy for profitability (coefficient = 0.525;  $\rho < 0.01$ ), suggesting that highly profitable firms pay higher dividend. The strong positive association between dividend payout and profitability is also consistent with findings previously reported elsewhere. Intuitively, Amidu and Abor (2006) and Anil and Kapoor (2008) argue that firms with higher profitability have higher internal resources available to pay high dividend to their stockholders. Leverage is found to be negatively and significantly associated with leverage (coefficient = -0.071;  $p < 0.1$ ). The result is consistent with those found in the literature which majority argues that firms which employ larger portion of debt in their capital structure have high tendency to pay lower dividend due to the needs to serve debt obligation (Rozelf & Michael, 1982)

### **Conclusion**

Despite the prominent form of business organization in emerging economies, many studies have examined the influence of ownership structure and other features of corporate landscape on dividend payout decision. Drawing on the prevalence of closely held firms coupled with a unique corporate landscape in which ownership is dominated by families, this study attempts to investigate the influence of ownership on the dividend payout decisions of Malaysian listed firms. The findings contribute to the growing literature on dividend decisions in different contextual setting specifically found in developing economies. Overall, the study finds that dividend is positively and significantly related to ownership structure. Agency theory suggests that when managers are also the controlling shareholders, their interest may not be aligned with minority shareholders. As a result, these firms are likely to pay higher dividend in order to dampen agency conflict. The findings also reveal that profitability is positively and significantly related to dividend payout. This finding supports the assertion that profit is viewed as a major device of a firm's capacity to distribute dividend. This result suggests that highly profitable firms distribute higher dividend to their shareholders. Finally, firm size and leverage are found to be negatively related to dividend payout at very strong and relatively weak level of significance respectively. This finding suggests that larger firms are more likely to have better market knowledge and therefore are more likely to have better investment opportunities than other firms. Therefore, the excess cash flow will be more focused on these needs, thereby causing a low dividend payout. Meanwhile, companies with higher leverage are more likely to pay less dividend because they are obligated to serve companies' debt.



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