THE DETERMINANTS OF DIVIDEND POLICY: EVIDENCE FROM TRADING AND SERVICES COMPANIES IN MALAYSIA

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Abstract: *The dividend policy is a great important issue in all companies. Therefore, many previous studies have been conducted to determine the determinants of dividend policy. However, the research about this study are still unclear and still cannot solve the problems exist. Thus, the aim of the study is to reveal the determinants of dividend policy on listed trading and services companies in Malaysia. Using panel data analysis, the study considered 107 companies listed firms on trading and services sector at the Bursa Malaysia for the period 2007 until 2016. Data is retrieved from DataStream Professional and being analyzed using Stata10 package. As a final result, fixed effect model (FEM) is chosen as a best model. Dividend payout ratio is considered as dependent variable while liquidity, leverage, profitability and firm size as independent variables. The findings revealed that the dividend payout policy is positively affected by liquidity whereas profitability and leverage has negative relationship with dividend payout ratio and firm's size shows insignificant impact. The study suggested that profitability as the most significant determinant in influencing dividend payout ratio.*

1. Introduction

Dividend policy in a firm is an important consideration for some investors because dividends represents as a vital source of income for investors and also give information and perceptions in the market. In addition, the dividend decision is important role as a signal to attract investors and help businesses to access medium and long-term capital at the lower costs. Since company leaders are often the largest shareholders and have the most to gain from a generous dividend policy, the dividend policy also considered. Dividend policy is a financing decision made by the board of directors on how they pay out the profits to shareholders or the owners of the firms in form of dividend payment. Management of the company needs to decide on the total of dividend, timing to pay the dividends and considers various other factors that influence dividend payments over time to ensure the firm can maintain the profits.

In addition, if a firm decides not to pay or pays fewer dividends, the firm will have more internal earnings, thus reducing its reliance on external earnings (Yusniliyana & Suhaiza, 2014). On the other hand, if a firm pays high dividends, it will result in less internal earnings, thus increasing firm's dependence on debt or other external financing (Yusniliyana & Suhaiza, 2014). The firms can plan whether to have more internal earning or to increase the external

financing in the company. This implies that the decision to raise funds is directly related with dividend policy of the firm.

2. Literature Review

2.1 Dependent variable

2.1.1 Dividend payout ratio

Dividend payout ratio is referred to the profits of the company that are paid out to the shareholders as a dividend payment. It is important for the investors to review a dividend payout ratio and make it as a guideline because it is an indicator of how safe a dividend payment of the firms. The payout ratio measures the magnitude of dividends relative to earnings (Narman, 2015). Thus, dividend payout ratio is the most appropriate measurement for dividend policy in the firm. The positive relationship with the dividend payout ratio can be interpreted as an evidence for the relevance of dividends to firm value to some extent. The research is consistent with Ibrahim (2015) which the dividend payout ratio is analyzed in relation to liquidity and profitability ratios. He revealed that the dividend payout ratio is positively affected by the liquidity variables which they are significantly related but earning per share has insignificant positive relationship with dividend payout ratio.

Bahaa (2015) examined that dependent variable as the amount of earnings paid out as dividends and measured by dividend payout ratio. The selection of variables is based on the previous empirical studies where dividend policy is proxied by dividend payout ratio. He seeks to find the factors of dividend policy of the firms in Kuwait Stock Exchange (KSE) that can influenced the dividend decision. The study used a firm-level panel data set of publicly traded firms on the Kuwait stock exchange (KSE) from 2011 to 2014.The results shows that the dividend policy in Kuwait Stock Exchange (KSE) market has positive relationship with leverage and risk and also positively affected by profitability and firm's size.

2.2 Independent variables

2.2.1 Profitability

Profitability can be defined as the primary indicator and the important factors of a firm to know the capacity to pay dividends to the shareholders. Calistus, Fredrick & Ambrose (2014) who investigated dividend payout of agricultural firms in Kenya revealed that profitability is positively affected on the dividend payment of the firms. The firms will pay higher dividends to shareholders when they have higher profitability. Firms with more stable earnings will payout a higher proportion of its profits as a dividend payment than a firm with variable earnings. Return on equity of shareholders was used to proxy the profitability of the companies.

Bogna (2015) on the other hand reported significant negative relationship between profitability and dividend payout ratio of Polish listed companies on Warsaw Stock Exchange (WSE) that are profitable companies tend to use their retain earnings as capital sources and are less likely to pay dividends to the shareholders.

2.2.2 Liquidity

Liquidity can be describing as the degree to which the firms can be quickly bought or sold an asset in the market in cash. In the view of a firm, they consider the dividend payments as a cash outflow in their firm. Hashim, Shahid, Sajid & Umair (2013) suggested that liquidity has significant negative relationship with the dividend payout of Pakistani banks. It is because their total operations are based on liquid cash. Thus, to smooth out the operations they prefer to maintain a substantial amount of liquid cash even in case of high liquidity.

Ibrahim (2015) who analyses dividend payment of the 24 UAE national banks however reported significant positive correlation between dividend and liquidity. The result is consistent with Wasike & Jagongo (2015) that suggested that a good liquidity position in the firm will increases the ability to pay more dividends to shareholder. A poor liquidity position means less generous dividend due to shortage of cash in the companies (Wasike & Jagongo, 2015).

2.2.3 Leverage

Highly leveraged firms may get ability to have more debt and interest obligations and it will affect the dividend payment and they have high interest expense which will lead to low dividends for shareholders. Matthias, Nyema & Bariyima (2013) who analyse the determinants of dividend policy of 29 listed African firms revealed that a financial leverage of a firm is significantly negative affected the dividend decision. The findings also in line with Bali (2003) who also reported negative correlation between debt and dividend payment suggested that debt-equity level of firm plays an important role in its dividend policy.

Narman (2015) also found that leverage has negative association with the dividend decision. Firms with higher leverage are more likely to retain their earnings due to negative sign of leverage. In other words, highly-leveraged firms are lead to lower dividend payout ratios. Bogna (2015) who employed panel data analysis to study the determinants of dividend policy on Polish listed companies also revealed the evidence of negative relationship between leverage and dividend payout ratios. This indicates Polish companies with high leverage ratio are expected to pay low dividends to shareholder and it is also in line with the agency cost theory of dividend policy.

2.2.4 Firm size

Anupam (2012) investigated the determinants of dividend payout for all firms listed on the Abu Dhabi Stock Exchange from 2005 until 2009 find out the firm size as the most significant variables that influencing dividend payout ratio in the United Arab Emirates (UAE) firms in making dividend decisions. The result of the study also seems to be similar with the other studies done using dataset from the developing countries. Furthermore, Christopher & Rim (2014) investigating the factors determining the dividend payout policy in the Lebanese banks listed on the Beirut Stock Exchange using an unbalanced panel dataset from 2005 and 2011 revealed the firm size is significant positive relationship which means larger firms have easier access to fund and are able to distribute dividends to shareholders better than smaller firms. The results also suggest that large banks choose to pay more dividends to reduce agency conflicts and maintain bank's reputation.

Similar to previous studies, Yusniliyana & Suhaiza (2014) also found that firm size and large shareholders have a positive significant influence on dividend policy. This is because larger firms have the potential to generate the profits and enable to pay more dividends. Having a greater proportion of shares owned by large shareholders implies greater control over the management, which in a way pressures the management to ensure the shareholders' wealth is maximized by way of distributing higher dividends (Yusniliyana & Suhaiza, 2014).

3. Data and Methodology

The sources of secondary data were collected from Datastream Professional. The datasets comprise of 107 out of 215 trading and services companies listed in Bursa Malaysia. It includes the financial statement and other information which is relevant for trading and services sector of listed companies for period of ten years which is 2007 until 2016. Altogether, there are 1070 firm-year observations.

3.1 Descriptive statistics

Table 3.1: Descriptive statistics of variables

Stats	DPR	ROE	CR	DR	FS
Max	2.752035	2.005629	5.386786	2.721295	11.79713
Min	-3.86461	-7.820552	-1.203973	-2.302585	1.331046
Mean	-1.034704	-2.439528	.7574155	-1.137831	6.516319
CV	-.860097	-.4290232	.9494	-.6558367	.2738818

Notes: The summary statistics are based on the 1070 firm-year observations. The dependent variable is dividend payout ratio (DPR). The explanatory variables are defined as follows: profitability (ROE), liquidity (CR), leverage (DR) and size of firm (FS). (Ln) Log transformation has been specified for these variables.

3.2 Correlation analysis

Table 3.2: Correlation between independent variables

	DPR	ROE	CR	DR	FS
DPR	1.0000				
ROE	-0.4462	1.0000			
CR	-0.0295	0.0117	1.0000		
DR	-0.1380	-0.2572	-0.3408	1.0000	
FS	0.0531	0.0628	-0.2816	0.1747	1.0000

Notes: The correlation analysis is based on the 1070 firm-year observations. The dependent variable is dividend payout ratio (DPR). The explanatory variables are defined as follows: profitability (ROE), liquidity (CR), leverage (DR) and size of firm (FS). (Ln) Log transformation has been specified for these variables.

3.3 Estimation equation

The general form of the model can be specified as follows:

$$DPR_{i,t} = \beta_0 + \beta_1\, ROE_{i,t} + \beta_2\, CR_{i,t} + \beta_3\, DR_{i,t} + \beta\, FS_{i,t} + \varepsilon_{i,t}$$

Where,

$DPR_{i,t}$	= Dividend Payout Ratio firm $_i$ at time $_t$
β_0	= Coefficient beta value
$\beta_1\, ROE_{i,t}$	= Profitability firm $_i$ at time $_t$
$\beta_2\, CR_{i,t}$	= Liquidity firm $_i$ at time $_t$
$\beta_3\, DR_{i,t}$	= Leverage firm $_i$ at time $_t$
$\beta\, FS_{i,t}$	= Firm's Size firm $_i$ at time $_t$
$\varepsilon_{i,t}$	= Error term firm $_i$ at time $_t$

4. Empirical Results

The table 4.1 shows the regression results from static panel data: fixed effect model. In the table below, overall R-squared is 0.5389 which revealed that 53.89% of the variation in dependent variable (dividend payout ratio) can be explained by all independent variables (profitability, liquidity, leverage and firm size) and another 46.11% cannot be explained by independent variables.

Table 4.1: Determinants of dividend policy for trading and services companies in Malaysia

Explanatory variables	Expected sign	Dividend payout ratio
ROE	+/-	-0.7563***
		(-19.54)
CR	+/-	0.3283***
		(3.37)
DR	+/-	-0.1920***
		(-2.73)
FS	+	0.0246
		(0.33)
R^2		0.5389
Prob > F		0.0000

Notes: Estimations results from panel data Fixed Effec Model (FEM) on 1070 firm-year observations. The dependent variable is dividend payout ratio (DPR). The independent variables include: profitability (ROE), liquidity (CR), leverage (DR) and size of firm (FS). The abslte value of the t-statistics are given in the parenthesis below the coefficient estimates. ** and *** indicate significance at 0.05 and 0.01 respectively.

The results revealed that profitability, liquidity and leverage are statistically significant in affecting the dividend decision among trading and services companies in Malaysia. Return on equity (ROE) has appeared to be the most significant factor that affecting dividend policy by giving negative 75.63 percent changes in dividend payout ratio (DPR) when 1 percent increases in ROE. This finding is similar with Christopher & Rim (2014) who found negative relationship between ROE and DPR by saying that the surplus earnings of the firm are being allocated mostly to the growth opportunities of the firms. Besides, they also added that the

companies need to use the surplus earnings because of political instability and other than that it is being allocated into retention for the plugging back for economic recession periods. In addition, the result also seems to be parallel with Ibrahim (2015) who explained the reliance of the United Arab Emirates (UAE) banks which they finance the continuous expansion using the profits gained. At the same time, Bogna (2015) expressed negative relationship between profitability and dividend policy when the profitable Polish companies listed on Warsaw Stock Exchange (WSE) use their retain earnings as capital sources and are less likely to pay dividends to the shareholders. The other studies by Narman (2015) also reported negative relationships between profitability and dividend payment because firms are more likely to retain their earnings when they have higher earnings levels.

The second determinant which gives high impact on DPR is liquidity that is measured by current ratio (CR). Liquidity is found to be significant at 1 percent with positive impact on dividend payout ratio (DPR). Any 1 percent changes in current ratio will definitely drag about 32.83 percent changes in dividend payout ratio. These two variables are seems to move in the same direction. This finding is consistent with Theophano, Sunil & Kean (2012), Calistus (2014), Ibrahim (2015), Wasike & Jagongo (2015), Nishant & Jitendra (2016), Imad (2016) and Rashid et.al (2014). They are all agreed that the ability of the firm to pay dividend is increases when there has a good liquidity position in the firm due to the excess amount of cash.

The leverage that is measured by debt ratio (DR) is also significant at 1 percent level. It shows negative association between leverage and dividend payment. The negative relationship result between DR and DPR is similar with Bogna (2015) who indicates that Polish companies are tend to pay less dividends to the shareholders because of higher leverage ratio. Recently, Nishant & Jitendra (2016) highlighted that the firms will reduce the dividend payment to common equity shareholders when the firm having higher proportion of debt and have higher level of commitment to pay the fixed interest charges. Matthias, Nyema & Bariyima (2013), Narman (2015) and Soondur, Maunick & Sewak (2016) also reported the same results suggested that the level of financial leverage is negatively affecting the dividend payment of the firms. They added that firms with high portion of debt are more likely to retain their earnings when they have higher leverage in the firm.

Size of firm (FS) which is measured by total assets of the firm however does not show any statistically significant impact on dividend payout ratio. Even though the variable is insignificantly affecting the dividend decision of trading and services companies in Malaysia, the relationship of size and DPR is still hold. The association of firm size FS and DPR is consistent with Hashim et al. (2013) who also reported positive relationship between size of firm and dividend payment.

5. Conclusion

As a conclusion, profitability is the most significant determinant in influencing the dividend payout ratio in trading and services listed companies in Malaysia. This is also consistent with pecking order theory by Modigliani and Miller (MM Theory) suggesting that companies prioritize their financing sources using internal funds, because issuing new equities would have incurred high expenses. Therefore, more profitable companies are more likely to retain their earnings rather than paying dividends to the common shareholders. Leverage also seems to be a significant factor too in affecting Malaysian's trading and services companies in paying dividends. The higher the debts acquired by the companies, the lower intention of these companies to pay dividends to their shareholders. Empirical research by Kester (1986), Titman and Wessels (1988) and Rajan and Zingales (1995) also reported negative relationship between leverage and profitability. Liquidity condition of a firm is affected but also affects dividend

decisions. Firms with higher cash availability are more likely to pay dividends than firms with insufficient level of cash. Therefore, the likelihood a firm will pay cash dividend is positively related to liquidity. This positive relationship is supported by the signaling theory of dividend policy (Ho, 2003).

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