Impact of Ownership and Board Structure on Dividend Pay-Out under High and Low Growth Opportunities: Evidence from Non-Financial Firms of Pakistan

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Abstract

The aim of this study is to observe the association among corporate governance practices and dividend pay-out under high and low growth opportunities of 82 manufacturing firms listed at PSX during the period of 2011 to 2016. The study observed the corporate governance dimensions in terms of managerial share-ownership, institutional share-ownership, foreign share-ownership, minority share-ownership, board independence and CEO Duality. Firm size, debt, Tobin Q and ROA are used as control variables. The median value of Tobin Q is used to classify the data into high & low growth opportunities. We used panel regression model for the analysis of data. Among common effects, fixed effects and random effects, the fixed effects model is used to test the hypothesis. The final results direct that under high growth opportunities, all the dimensions of corporate governance except minority share-ownership are significantly influencing the dividend pay-out. While under low growth opportunities only foreign share-ownership, minority share-ownership and board independence are significantly influencing the dividend pay-out. These outcomes recommend that the influence of corporate governance practices on dividend pay-outs of high growth firms is more significant as compared to low growth firms.)

Keywords: Corporate governance; Dividend pay-out; Institutional ownership; Managerial ownership; Foreign ownership; CEO duality; Board independence

Introduction

According to La Porta, et al. (2000) "Corporate governance is, to a certain extent, a set of mechanisms through which outside investors

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protect themselves against expropriation by the insiders." The insiders mean the major shareholders and managers of the firm.The security and exchange commission of Pakistan has issued the code of corporate governance in March 2002 for the betterment of the governance structures of Pakistani companies and bring a transparency and improvement in the financial reporting of the firms. SECP collaborated with the ICMAP and the other stock exchanges to introduce that code. The references counted in that code are according to the international codes of corporate practices. All the registered firms are required to attach a statement with the annual reports which will show either the firm is complying with the practices of corporate governance or not. SECP is working on the real implementation of these codes and for that purpose it introduces a project in alliance with the UNDP and EADP. SECP carried out a survey on these codes. The findings of this survey suggest that there is need of understandings the benefits associated with these codes by the directors of the companies.

The common structure of share ownership in Pakistan is the concentrated share ownership. Usually more than 50% shares are held in the hands of few people. These are usually the families that run and control most of the businesses in Pakistan. (Ghani & Ashraf, 2005) stated that external shareholders perceive the firms controlled by families or groups less transparent and poor with respect to the governance mechanism and that is why they wanted the discounted values of the shares of these firms even they perform better as compared to others in the markets. They concluded that concentrated share ownership mechanism in Pakistan provide opportunities to majority shareholders to expropriate the wealth of outsiders.

Berle and Means (1932), delivered ownership structure which is spread among minor shareholders and the control function is performed only by the managers. This form of ownership structure is found in develop countries and it is strongly backed by most of the finance literature. Since it suggests that the function of control and ownership is separate from each other, therefore it leads towards the conflict among managers and shareholders, which is known as agency problem. It is also known as principal-agent conflict. In contrast, some studies conducted in developing countries provided evidences that are not in line with the above statement of ownership and control. They concluded that concentrated share ownership is a common form of ownership in developing countries. For instance, La Porta, Lopez-de-Silanes, Shleifer, and Vishny (2000) investigated the form of ownership that is prevailed in developing countries and concluded that most of the firms in these areas are family-controlled firms and the concentrated share ownership is the

most popular form of ownership there. So the agency problem here is the conflict among majority and minority shareholders, which is recognized as principal- principal conflict. Daily, Dalton, and Cannella (2003)provided that agency theory behaved differently in emerging countries as compared to established countries, and the findings of widely-held ownership corporations cannot be generalized in to concentrated ownership corporations. Many studies provided number of solutions regarding that problem. For instance, (Easterbrook, 1984) stated that agency cost can be minimized by an increase in the dividends payments of the firm. As more dividends means low retain earnings and the management will go to the capital markets in order to arrange finance required for firm's investment projects, where management performance is monitored effectively. As these agency problems often affect the confidence of investors, therefore it is necessary to create once again the lost confidence of investors by establishing independent bodies and such regulations in the firms that serve for the stake of all the stake holders equally because Establishing a new venture or running existing business, it all require investment and investors are very important for that. According to La Porta et al. (2000) "Corporate governance is, to a certain extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders." The insiders mean the "major shareholders" and managers of the firm.

The intent of this study is to observe the association among "corporate governance practices" and dividend pay-out of listed firms in one of the major South Asian emerging markets Pakistan. Most of the studies conducted in this area only captured the developed markets. Therefore, this study draws its significance by capturing developing market Pakistan. Furthermore, the study differentiates from earlier ones by estimating the above association in high and low growth opportunities separately. The study used two internal dimensions of corporate governance "Board independence and CEO Duality: and four external dimensions "Foreign ownership, Institutional ownership, Minority ownership and Managerial ownership".

Literature Review

The existing literature found mixed findings on the relationship among corporate governance practices and dividend pay-out. This section of paper displays the review of what is concluded in the previous studies according to the objectives of the study.

CEO Duality

Mansourinia, Emamgholipour, Rekabdarkolaei, and Hozoori (2013) provided that one of the stuffs that can help in creating independence and neutral board is the splitting the role of CEO and

chairman which in turn lower the need for dividend induced monitoring device. Chen, Li, and Shapiro (2011) considered relationship among corporate governance practices and dividend pay-outs. They found that board composition is directly related with dividend pay-outs and CEO Duality is negatively related with dividend pay-outs.

Foreign ownership

Jeon, Lee, and Moffett (2011)argued that foreign shareholders demanded more transparency in financial recordings from the management and provide more monitoring on the management actions and hence they do not need dividend as a tool for their protection. They concluded an adverse influence of foreign share ownership on pay-out of the firms. Manos (2002) said that despite of holding great skills, foreign shareholders often find the monitoring of management actions costly and difficult because of the differences in the political environment and cultural environment. Therefore, they depend upon the dividend as a tool for the monitoring purposes, which suggest a positive connection among foreign shareholding and dividend.

Board independence

Farinha (2003) argued that independence of board and dividend can act as a substitute for each other in minimizing agency cost and monitoring the management, therefore the presence of adequate number of outsiders on the BOD lower the need for dividend induced monitoring device. He also said that when the independent non-executive directors feel their monitoring inefficient, they can put a pressure on the management to pay out high dividends so that their monitoring can be done by the external equity markets. Belden, Fister, and Knapp (2005), concluded that higher independence of board results in low agency cost and better shareholder protection. They also said that the more independent directors on the BOD, the more dividends the firm willing to pay. Borokhovich, Brunarski, Harman, and Kehr (2005), considered the association among board independence and dividend policy for the period 0f 1992-1999. Their outcomes have revealed a significant negative association among board independence and dividend pay-out.

Institutional ownership

Demsetz and Lehn (1985) said that financial institutions can monitor the activities of the management effectively and hence the need for dividend as a monitoring purposes decreases.Farinha (2003), provided that when the institutions perceive their monitoring insufficient and expensive, they tend to put pressure on the management to pay greater amount of dividends in order to enhance their monitoring by the capital markets.

Minority ownership

Easterbrook (1984), said that minority shareholders have a very weak position in the controlling functions of their firms therefore they require high dividends. Shleifer and Vishny (1997), delivered that in the countries with weak investor's protection, large shareholders usually have upper hand on the management. But it failed to give any security to the minorities in the companies. Therefore, they tried to avail their wealth in the form of dividends and to make sure there is nothing left in the possession of the governing bodies. Wang, Manry, and Wandler (2011), said that there are states like china where capital gains are exempt and dividends are taxed. The small investors desire for capital gains rather for dividends.

Managerial ownership

Jensen and Meckling (1976), provided alignment effect of managerial ownership. They argued when the managers hold shares of the firm, their own wealth is linked with the worth of the firm, and they tried to follow the policies which results in the appreciation of the value of the firm. Contrary to this hypothesis Stulz (1990) on the other hand presented the entrenchment effect of managerial share ownership. He said when the managers hold substantial amounts of shares in the firm; they tend to follow their own interests as their expropriation powers were increased.

Growth Opportunities, Dividend and Corporate Governance

La Porta et al. (2000), suggested that growth opportunities have varying effects on dividend pay-outs depending upon the governance systems of the firms. They presented two hypotheses in this regard, the first one is outcome model that suggest that dividends are the outcomes of corporate governance. According to this model the firms having good growth opportunities and a strong corporate governance mechanism prefer to invest the earnings rather to distribute it in the form of dividends because the shareholders observes that their interests are well served and their rights are protected, they are ready to leave the cash flows with the management of these firms in case of any growth opportunity. This model recommends a strong adverse association among growth opportunities and dividend for the firms with strong corporate governance and less negative or insignificant relationship among these for the firms having poor corporate governance. The second one is substitution model which suggest that dividends are substitute for corporate governance. According to this model firms having good growth opportunities and weak corporate governance mechanism prefer to pay high dividends as they have a strong incentive to send positive signals to the market to earn a reputation which will be helpful for them

in external financing. This model suggests a strong positive relationship among growth opportunities and dividend for the firms with weak corporate governance and less positive or insignificant relationship among these for the firms with strong corporate governance.

Lin and Shen (2012) investigated the association among dividends, growth opportunities and corporate governance. The findings of their study supported the substitution model as they concluded a positive association among growth opportunities and dividends for the firms having poor corporate governance mechanisms.

Hypotheses of the study

H1 There is significant association among corporate governance practices and dividend pay-out.

H2 There is significant association among corporate governance practices and dividend pay-out under high growth opportunities.

H3 There is significant association among corporate governance practices and dividend pay-out under low growth opportunities.

Research Methodology

This section of paper displays information about the sample size, sampling technique, sources of data and statistical tools used for the analysis of data.

Sample Size and sampling technique

Initially 92 firms were selected as a sample out of 396 manufacturing firms listed at PSX. The firms that paid dividend consistently from 2011 to 2016 were selected. The sample consisted of 552 observations initially but some of these are dropped because of abnormalities issues in the data and finally 492 observations are used for the analysis.

Sources of data

The sources of data include "Annual reports of the firms and balance sheet analysis by state bank of Pakistan". It covers the period of 2011 to 2016.

Econometric Techniques:

Descriptive statistics used to explain mean, minimum and maximum values and also it calculated standard deviation and no. of observations in sample firms used. Correlation analysis explains the strength of relationship among dependent and independent variables either its strong, moderate, weak or very weak relation. Regression analysis estimates the relationship among variables i.e. dependent and independent variables.

Hausman test used to decide either to use random effect model or fixed effect model for regression analysis. If the p-value of Hausman

test is less than 0.05 it shows Null hypothesis rejected and study will used fixed effect model for regression analysis.

Econometric Models:

The statistical tools used in this study include descriptive analysis, correlation and regression. Econometric models employed in this study are following.

Conceptual framework

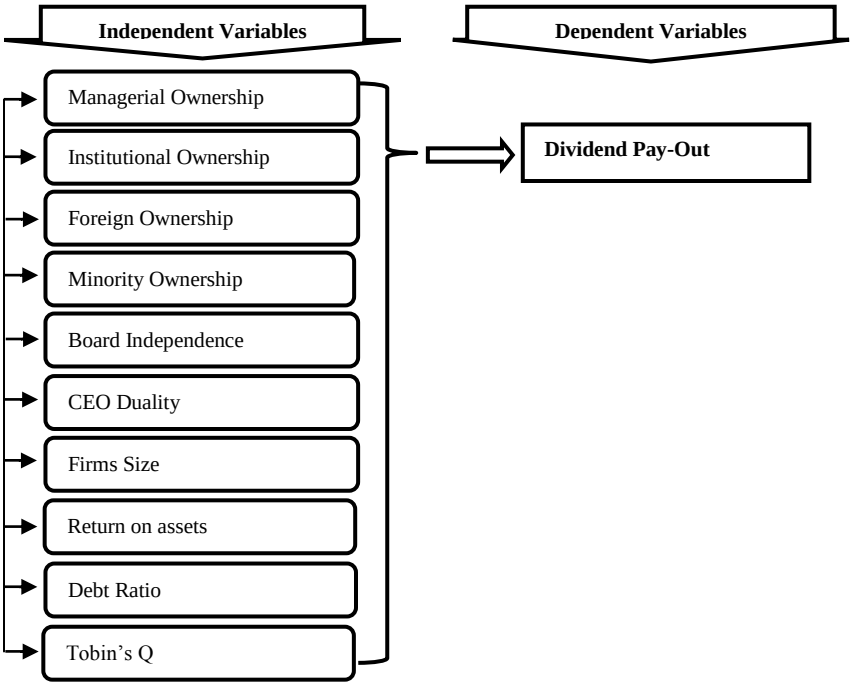

Figure 1: Conceptual Framework

General Research Model

$DP_{it} = \beta o + \beta_1 MO_{it} + \beta_2 IO_{it} + \beta 3\ FRO_{it} + \beta 4\ MRO_{it} + \beta 5\ BI_{it} + + \beta 6 CD_{it} + \beta 7\ SIZ_{it} + \beta 8\ DEB_{it} + \beta 9\ TQ_{it-1} + \beta 10\ ROA)_{it}$

Model for High Growth Opportunities Firms

$DP_{it} = \beta o + \beta_1\ MO_{it} * HQ + \beta_2\ IO_{it} * HQ + \beta 3\ FRO_{it} * HQ + \beta 4\ MRO_{it} * HQ + \beta 5\ BI_{it} * HQ + \beta 6\ CD_{it} * HQ + \beta 7 SIZ_{it} + \beta 8\ DEB_{it} + \beta 9 ROA_{it}$

Model for Low Growth Opportunities Firms

$DP_{it} = \beta o + \beta_1 MO_{it} * LQ + \beta_2\ IO_{it} * LQ + \beta 3\ FRO_{it} * LQ + \beta 4\ MRO_{it} * LQ + \beta 5 BI_{it} * LQ + \beta 6 CD_{it} * LQ + \beta 7\ SIZ_{it} + \beta 8\ DEB_{it} + \beta 9\ ROA_{it}$

Where;

HQ is interaction term which is 1 if Tobin Q is > than median value otherwise zero

LQ is interaction term which is 1 if Tobin Q is < than median value otherwise zero

DP is dividend pay-out, MO is managerial ownership, IO is institutional ownership, FRO is foreign ownership, MRO is minority ownership, BI is board independence, CD is duality of chief executive officer, SIZ is firm size, DEB is debt, TQ is Tobin Q, ROA is return on assets.

Table 1. Summary of study variables and their measurement

Variable	Definition	Measurement
MO	Managerial ownership	Shares held by directors, top management, their spouses and children/ Total shares outstanding
IO	Institutional ownership	Shares held by financial institutions/ Total shares outstanding
FRO	Foreign ownership	Shares held by foreign shareholders/ Total shares outstanding
MRO	Minority ownership	Shares held by small shareholders (<5%)/ Total shares outstanding
BI	Board independence	Number of independent directors/ total directors
DP	Dividend pay-out	Dividend / Total assets
CD	CEO Duality	Its value is 1 if the CEO is the chairman of the board, otherwise its value is 0
ROA	Return on assets	Net income/total assets
SIZ	Firm size	Natural log of all assets
TQ	Tobin Q	MV of equity + book value of debt / total assets
DEB	Debt	Total debt/ total assets

Results and Discussions

Table 2 Descriptive Statistics

	Min	Max	Range	Mean	Median	Std.Dev
DPR_TA	0.0000	0.2703	0.2703	0.0434	0.0256	0.0486
MAN_OWN	0.0000	0.9843	0.9843	0.2611	0.1989	0.2645
INST_OWN	0.0000	0.4818	0.4818	0.1207	0.1030	0.1045
FOR_OWN	0.0000	0.9400	0.9400	0.1012	0.0000	0.2164
MIN_OWN	0.0000	0.8113	0.8113	0.2083	0.1688	0.1560
BOARD_IND	0.0013	0.0100	0.0088	0.0070	0.0075	0.0018
CEO_D	0.0000	1.0000	1.0000	0.1280	0.0000	0.3345
F_SIZE	10.0085	20.1949	10.1864	15.8586	15.6412	1.5497
ROA	-0.0511	0.4149	0.4660	0.0942	0.0803	0.0648
D_RATIO	0.0000	0.5566	0.5566	0.1164	0.0972	0.0959
TOBINS_Q	0.1767	7.2617	7.0849	1.4686	1.0594	1.0968

Table 2 displays the descriptive statistics of independent and dependent variables used in this study. Descriptive statistics is used to present the data in summarizing ways. The above table depicts that the highest mean value among independent variables is 15.8586 for firm size and highest standard deviation is 1.5497 is also for firm size. The board

independence shows a mean value of 0.0070 and standard deviation 0.0018 which is lowest among all the variables.

Table 3 Correlation Matrix

	DPR	DO	IO	FO	MO	BI	CEO_D	FS	ROA	DR	TQ
DPR_TA	1										
MAN_OWN	0.3228	1									
INST_OWN	0.0818	-0.3110	1								
FOR_OWN	0.1641	-0.3543	-0.0451	1							
MIN_OWN	-0.1243	0.0592	-0.0120	-0.3063	1						
BOARD_IND	0.1623	-0.3251	0.1304	-0.0082	-0.1145	1					
CEO_D	0.0451	-0.1453	0.1525	0.0122	0.0066	-0.1330	1				
F_SIZE	0.1734	-0.3598	0.2107	0.1885	-0.3213	0.1267	0.1768	1			
ROA	0.6300	-0.2681	-0.0505	0.1334	-0.1674	0.1374	-0.0409	0.1389	1		
D_RATIO	-0.1837	0.1369	0.0104	-0.2134	0.1515	0.0861	-0.0213	0.1182	-0.2137	1	
TOBINS_Q	0.4010	-0.1377	-0.0683	0.1169	-0.0433	0.1551	-0.0332	-0.0253	0.4402	-0.0878	1

Table 3 depicts the correlation among dependent and independent variables used in this study. The correlation among all independent variables is weak which shows that there is no multicollinearity problem in this study. All the independent variables except minority ownership and debt positively correlated with the dependent variable. ROA and MAN_OWN has a strong correlation with dividend pay-out.

Table 4 Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	44.615351	11	0.0000

The significant values of above test suggesting that fixed effect model is suitable for estimating the regression equation.

Table 5 Regression Results of Model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.164427	0.063807	2.576951	0.0103
MAN_OWN	0.016624	0.025450	-0.653194	0.5140
INST_OWN	0.046350	0.040899	-1.133293	0.2578
FOR_OWN	0.121749	0.042936	2.835608	0.0048
MIN_OWN	-0.050388	0.027622	-1.824179	0.0689
BOARD_IND	3.657621	1.186680	3.082230	0.0022
CEO_D	0.008707	0.005887	1.478939	0.1399
F_SIZE	0.009859	0.003961	-2.489164	0.0132
ROA	0.191899	0.025000	7.676089	0.0000
D_RATIO	-0.066458	0.023304	-2.851840	0.0046
TOBINS_Q	0.004290	0.001419	3.023261	0.0027
R-squared	0.839245	**F-statistic**		22.94788
Adjusted R-squared	0.802673	**Prob(F-statistic)**		0.000000

Table 5 displays the regression results combined opportunities firms. Foreign ownership (FOR_OWN) and board independence (BOARD_IND) are positively related with the dividend pay-out. The findings are in line with the findings of previous study of O'Connor (2013). Minority ownership (MIN_OWN) shows a negative impact on the dividend pay-out which is in line with the findings ofWei and Xiao

(2009). However, the impact of managerial ownership (MAN_OWN), institutional ownership (INST_OWN) and CEO duality are not significant. In relation to control variables, it is clear from above table that firm size (F_SIZE), ROA and Tobin Q are positively linked with dividend pay-out which is in line withLin and Shen (2012). Debt is negatively related with the dividend pay-out.

R^2 is the rate of change in dependent variable which could be expected from independent variable. On the other side, adjusted R^2 indicates the compatibility of independent variables with dependent in order to confirm the decisions established on regression model. In the above table the value of R^2 is 0.839245 which indicates 83.92% change in dependent variable due to independent variables and the remaining variance is due to all other factors. Value of adjusted R^2 is 0.802673 which is the overall change in investment of our sample firms from manufacturing sector in Pakistan by combined variation in independent variables.

Table 6Regression Results of Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.021686	0.015299	1.417422	0.1579
MAN_OWN_H	0.113844	0.063331	1.797605	0.0737
INST_OWN_H	0.157062	0.069115	2.272469	0.0241
FOR_OWN_H	0.259285	0.090104	2.877601	0.0044
MIN_OWN_H	0.054459	0.053552	1.016926	0.3104
BOARD_IND_H	6.811981	2.484509	2.741781	0.0066
CEO_D_H	0.031338	0.013777	2.274694	0.0239
F_SIZE_H	0.007568	0.002239	-3.380631	0.0009
ROA_H	0.296338	0.043235	6.854174	0.0000
D_RATIO_H	-0.090349	0.043653	-2.069690	0.0397
R-squared	0.844522	**F-statistic**		15.19432
Adjusted R-squared	0.788941	**Prob(F-statistic)**		0.000000

The above table depicts the results of high growth firms. It can be seen from the table that managerial ownership (MAN_OWN_H), institutional ownership (INST_OWN_H), foreign ownership (FOR_OWN_H), board independence (FOR_OWN_H) and CEO Duality are positively and significantly related with the dividend pay-out. These findings are consistent with(Farinha, 2003; Jensen, 1986; Jeon et al. (2011); O'Connor, 2013). Only minority ownership (MIN_OWN_H) shows an insignificance association with the dividend pay-out. In relation to control variables, firm size (F_SIZE_H), and ROA are directly linked with dividend pay-out while debt is indirectly linked with the dividend pay-out.

Furthermore, in the above table the value of R^2 is 0.844522 which indicates 84.45% change in dependent variable due to independent variables and the remaining variance is due to all other factors. Value of

adjusted R^2 is 0.788941 which is the overall change in investment of our sample firms from manufacturing sector in Pakistan by combined variation in independent variables.

Table 7 portrays the results of low growth firms. The data in the table shows that among all independent variables, only foreign ownership (FOR_OWN_L), minority ownership (MIN_OWN_L) and board independence (BOARD_IND_L) are significantly related with the dividend pay-out, and only ROA is significantly impacting dividend pay-out among control variables.

Moreover, in the above table the value of R^2 is 0.770352 which indicates 77.03% change in dependent variable due to independent variables and the remaining variance is due to all other factors. Value of adjusted R^2 is 0.677218 which is the overall change in investment of our sample firms from manufacturing sector in Pakistan by combined variation in independent variables.

Table 7Regression Results of Model 3

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.088893	0.073715	1.205901	0.2294
MAN_OWN_L	0.020971	0.024211	-0.866175	0.3875
INST_OWN_L	0.019877	0.036332	-0.547090	0.5850
FOR_OWN_L	0.199744	0.050775	3.933921	0.0001
MIN_OWN_L	-0.055819	0.025850	-2.159396	0.0321
BOARD_IND_L	2.380264	1.188169	2.003304	0.0466
CEO_D_L	-0.000862	0.005252	-0.164095	0.8698
F_SIZE_L	0.005250	0.004748	-1.105715	0.2703
ROA_L	0.132039	0.024980	5.285851	0.0000
D_RATIO_L	-0.005417	0.024173	-0.224088	0.8229
R-squared	0.770352	**F-statistic**		8.271363
Adjusted R-squared	0.677218	**Prob(F-statistic)**		0.000000

Conclusion

To achieve the objectives of the study, the data is classified into high and low growth opportunities with help of median value of Tobin Q. Panel regression model is used for the analysis of data. The results regarding first hypothesis show that foreign ownership and board independence is positively related with the dividend pay-out, and minority ownership is negatively related with dividend pay-out. However, we could not find any evidence regarding the significance of managerial ownership, institutional ownership and CEO Duality to dividend pay-out in first econometric model. The results of second hypothesis show that except minority ownership, all the dimensions of corporate governance (managerial ownership, institutional ownership, foreign ownership, board independence, and CEO Duality) are positively and significantly influencing the dividend pay-out. The results of third hypothesis show that among the independent variables, only foreign

ownership & board independence has a positive and minority ownership has a negative relation with dividend pay-out. We did not find any evidence regarding the significance of managerial ownership, institutional ownership and CEO Duality to dividend pay-out in low growth firm's data.

These results indicate that the impact of corporate governance practices on dividend pay-outs of high growth firms is more significant as compared to low growth firms. It means that countries like Pakistan where the shareholders protection is weak, high growth firms need to pay out maximum dividends to maintain good reputation in the market and minimize the information asymmetry because they have a greater need for external financing. These results are in line with the (Lin and Shen (2012)).

The present study recommended that all the listed firms should improve their governance structures and enhance the independence of governance mechanisms. The poor governance mechanism is the basic cause of information asymmetry in Pakistani markets which restrict the management from using internal funds and obtaining costly financing for their investment projects. There are many causes of poor governance mechanisms in Pakistan, some important one of these are following;

The board of directors usually consisted of a very few independent directors. Therefore, their decisions are not based on merit and they failed to protect the stake of all shareholders.

The institutional investors in Pakistan usually do investments in the companies on short term bases. Therefore, they do not really bother about the commencement and affairs of the firms, despite that they have the capabilities to pressurize the management to make their decisions in the favor of all stake holders.

Therefore, it is recommended that the corporations should ensure that their board of directors consisted of enough independent directors and the financial institutions should play a role in improving the governance structures of listed firms.

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