

## The Impact of Corporate Governance on Dividend Decisions: Evidence from Non-Financial Sector of Pakistan

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### *Abstract*

*This study sought to ascertain the impact of corporate governance on dividend decisions of non-financial firms listed on Pakistan stock exchange (PSX). Panel data was collected from 2011 to 2016. Data was collected from Non financial firms annual reports and State Bank of Pakistan (SBP) data base. The STATA software was used to analyze the data. The study investigates the association of firm's performance and corporate governance. Specifically, this study investigate dividend decision (dividend per share(DPS)), corporate governance (board independence ,board size, size of firm, leverage, profitability, Insider ownership, individual ownership, and institutional ownership). A total of 42 non-financial firms are used to determine this relationship. The results show a positive significant relation between the Profitability, individual ownership with DPS. This study also found a negative and significant relationship between insiders ownership, financial institution ownership with DPS. It has also been found that Board independence, board size, firm size and leverage have negative and insignificant relationship with dividend per share (DPS).*

**Keywords:** *Corporate Governance, Dividend Decisions, Dividend Policy.*

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### **Introduction**

Since early 1990s, capital market of Pakistan faced many important and critical issues, the development of a weak regulatory framework, the inefficient and non-performing stock market and stagnation, and the poorly organized and publicly owned mutual fund industry, which contributed little in the development of capital markets. From the past few year owing to tight CG rules and regulation there is a huge boom in the market capitalization along with the stock market index.

According to Bajwa et al. (2011), Pakistan is a progressing economy in Asia with inadequate rules and regulation on the arrangement of the board. There is noteworthy research potential on the effect of the synthesis of the Board of Directors (BOD) on the payments of corporate dividends (CD) in Pakistan. CG comprises of different supervisory bodies, for example, Management, Shareholders, the Board of Directors

and auditors of the Company who secure investors' rights and have critical effect on the payment of CD (Kowalewski et al., 2007; Bebczuk, 2005).

Berkley & Myers (2005) argue that the decision to allocate dividends is one of the biggest unsettled issues in corporate finance. However, it becomes significant in the case of CG. Dittmar et al. (2003) elaborate that the agency's dilemma was more weak point of the CGS. In a weak CG system, agency problem arises where interior shareholders obtain individual advantages from exterior shareholder. For such reason, external shareholder prefers to pay dividends (Jensen, 1986; Mayers & Framk, 2004). Petschnigg (2005) explains the organizational framework as the organizational entities that explain and develop the financial regulations for organizations to follow.

The dividend payment provides information regarding company financial position (Afza & Mirza, 2011). Financial researchers are granted and viewed that there is no solitary factor that affecting the CDP. The difficulties in dividend policy become more complicated due to the determinants of dividend policy. Dividend policy serves as a control instrument in minimizing conflict for shareholders and managers because shareholder wish to make profit in the form of dividend on the other hand managers want to keep the fixed assets safe by not declaring dividend.

According to Jansen (1986) and Rozeff (1982) companies employ dividend to minimize the agency's problems. In addition to dividend payments, the corporate governance the agency cost can be reduced. Gulger and Yurtuglo (2002) report the association between CG and divided of companies. In their research ownership structure and attentiveness of owners are taken as proxy for CG. The results show a negative influence of CG variables with dividend payout ratio of the firms.

Varma (1997) and Bollard (2003) discussed the board impact and its ownership on financial performance and its consequences as "recent events, such as the Enron scandal and other CG failures, have put corporate governance on the front pages of main newspapers. It has highlighted the important role that corporate governance plays in a modern economy and the consequences of getting it wrong, and it has strengthened the incentives for directors and policymakers alike to reassess the structures needed to produce high quality corporate governance."

The clear split between the two periods is critical to pushing the dividend debate in corporate finance. Amidu (2007) confirm this assertion when it revealed that the policy of dividend distribution and dividends policy have effect on company achievement oppositely. This study was also supported by Baker and Powell (2000) viewed that the allocation of dividend differs from company to company. The researchers found the nature and association between dividend payout and profitability differs between services and manufacturing industries in USA. This study was also supported by Baker and Powell (2000) that distribution of dividend varies from company to company. Who found the nature of the relationship between dividend payout and profitability vary between services and manufacturing industries in the United States.

The arrangement of the board is directed predominantly by the corporate governance system (CGS). After large scandals such as Enron, WorldCom in United States and Crescent Investment Bank in Pakistan magnetized the concentration of people to great extent towards corporate governance (CG) (Shah & Khan, 2009). All such scandals on examination predominantly ensure one main factor that the board of directors can play a vital role in influencing the financial performance of the firms.(Bajwa, Bashir, & Lions, 2011). These scandals have elevated the demand for investigation on the impact of the Board's attributes on corporate dividend policy (CDP) and to evade issues in the future for a few reasons. The incident of such big scandals has badly ruinous the investor confidence in corporate governance system.

## Problem Statement

For a good financial reporting system CG important determinants in corporate governance, as reported by previous researcher improve firm performance. However, it is also been reported that the existence of rules do not matter until these are implemented. Now if the rules are not implemented and firms do not perform thus they are no more likely to distribute dividend. On the other hand, if firm perform well under a strict corporate governance system firms are more likely to distribute dividend. This strand of literature is limited and thus needs investigation. Therefore, the proposed study investigates the association of firm's performance and corporate governance. Specifically this study investigate dividend decision (dividend per share), corporate governance (board independence ,board size, size of firm, leverage, profitability, Insider ownership, individual ownership, and institutional ownership).

## Objectives of the Study

The main aim of this paper was to determine the influence of corporate governance on dividend decisions in non-financial firms in Pakistan. Afza and Sehrish (2011) argue on the impact of board directors decisions on dividend policy. Their study adds a new dimension to it by adding new variables of board size, board independence, insider ownership, institutional ownership, individual ownership, firm size, leverage, profitability to measure the governance system of board.

This study will be more specific from the non-financial firm's point of view.

## Research Questions

The impact of Corporate Governance on dividend decisions of non-financial firms operating in Pakistan.

## Literature Review

In corporate finance sector, dividend policy play important role, to solve this problem of industrial sector many studies carried out from past till now. Through agency theory the conflict between the investor and the management of the organization can be minimize releasing the dividend to the shareholder, so that the executives will not impound the retained earnings of corporations (Mayers,2000; Jensen, 1986). Rozeff (1982) were of the view that reduction in dividend is due to the presence of inside shareholder. For the sample of 1000 US organization he used DPS as a tool of measuring dividend policy and investigate very negative relationship between dividend and payout ratio and existence of inside shareholder.

According to Belden et al. (2005) argue that dividend payment raise at the presence of outside investor in the board. They investigated 524 prime American corporations for sampling and search out a negative relationship between the dividend payout and the outsider directors in the board. Mitton and Todd (2004) investigate the relationship of dividend payout ratio and corporate governance of the firm. The sample of 19 emerging economies is used and found that when there is strong corporate governance then there is positive impact on the dividend payment of the firm.

Amidu (2007) argue that various theories of corporate dividend decisions such as agency theory, customer impact, theory of signaling, life cycle theory and tax preference theory have been explained to a large extent in corporate finance literature. This section reviews current empirical literature on dividends and corporate performance.

Shah et al. (2011) reports the influence of ownership structure of firms operating in Pakistan in terms of dividend policy. In their study, a positive impact was found between ownership structures on dividend payout. Moreover, Afzal and Sherish (2011) reports the significant influence of investment opportunities, firm size on dividend policy.

In Pakistan context there is inadequate confirmation on the impact of institutional ownership on the dividend distribution of scheduled firms; thus, these studies investigate the function of various institutional shareholder in shaping dividend profits of Pakistani firms. Pakistan is a lawful country where corporate practice is administrate by the Companies Act of 1984 and the security and Exchange Act of 1969. Unluckily the level of CG in Pakistani Firms is compared with developed countries are weak. Pakistani firms are usually in “cross circular ownership” or it is in the form of “pyramid ownership structure” the firm all affairs are carried by the principal owners.

## Research Methodology

The methodology of the study is explained in the sections given below.

### Population of the Study

A total of 300 non-financial firms that started their operations in Pakistan before 2011 and has not discounted till 2016 was the population of the study.

### Sample of the Study

The panel data set covers a 6-year period from 2011 to 2016, with a sample of top 42 non-financial firms listed on PSX were selected based on convenience sampling techniques. The data was taken from the annual reports of companies, PSX website, and SBP official website.

### Variables of the Study

Variable of the study contains dependent and independent variables with definitions and its collection source.

Table 1: Variables definitions

Variable definition	sources	
Dividend per share DPS	Total dividends paid / number of ordinary shares in issue	FIRM data from SBP
Board independence BIND	Independent non-executive directors / total number of directors setting in the board	FIRM data from SBP
Board size BSIZE	total number of directors setting in the board of directors	FIRM data from SBP
Size of firm Size	Log of total assets	FIRM data from SBP
Leverage Lev	Total debt/total assets	FIRM data from SBP
Profitability PRFT	Net profit after tax/no of shares outstanding	FIRM data from SBP
Individual ownership INVLOS	No of shares held by individual/total No of shares held	FIRM data from SBP
Insider ownership INDROS	No of shares held by insiders/ total no of shares held	FIRM data from SBP
Institutional ownership FINSOS	No of shares held by institutions/total no of shares held	FIRM data from SBP

### Empirical Model

The DPS is taken as proxy for the dividend policy. The regular dividend paying companies were selected for the analysis. Model is given below.

$$DPS_{it} = \alpha_0 + \alpha_1 BIND_{it} + \alpha_2 BSIZE_{it} + \alpha_3 FSIZES_{it} + \alpha_4 LEV_{it} + \alpha_5 PRFT_{it} + \alpha_6 INVLOS_{it} + \alpha_7 INDROS_{it} + \alpha_8 FINSOS_{it} + \mu_{it}$$

### Where

$i = i^{th}$

$t =$  time period (2011-2016)

$\alpha_0 =$  intercept

$\alpha = [\alpha_1, \alpha_1, \alpha_1, \alpha_1, \alpha_1, \dots, \alpha_9]$ , slop coefficients

$\mu =$  Error term.

DPS= dividend per share

BIND=board independence

BSIZE= board size

SOF=size of firm

INVLOS=individual ownership

INDROS=insider ownership

FINSOS=financial institutions ownership

### Results and Data Analysis

Descriptive statistics is given below.

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max	Skewness	kurtosis
DPS	252	13.38226	31.71651	0	368.97	1.50	4.44
BIND	252	.7499562	.1347282	.25	1	-1.127089	4.31
BSIZE	252	8.400794	1.546774	7	14	1.176585	4.03
SOF	252	17.08092	3.112615	8.954564	24.69107	.3973118	3.12
Lev	252	.4509001	.2159773	.02	1.055911	.3194175	2.46
PRFT	252	20.06429	27.99916	-22.6	207.24	0.164	4.44
INVLOS	252	.7515835	.246935	.0184413	1.615301	-1.315337	4.82
INDROS	252	.1728564	.2069363	3.68e-09	.8211273	1.039516	3.13
FINSOS	252	.8090695	.2323935	.0238022	1.092135	-1.175715	3.65

The Table 2 above presents descriptive statistics. A total of 252 observations were analyzed. The minimum value for DPS was 0 while the maximum was 368.97. Mean and std. Dev was 13.3822 and 31.716 respectively while the skewness and kurtosis was 1.5 and 4.44 respectively. Moreover, the BIND no of observations was 252 while the min and max values were 0.25 and 1 respectively. In the same way the BIND mean and std dev were 0.7499 and 0.134 respectively. While the skewness and kurtoses are also within the specified range. BSIZE no of observations are 252 while the min and max values are 7 and 14 respectively. Moreover, the mean and std dev is 8.4 and 1.5 respectively. The kurtosis and skewness for DSIZE is within the prescribed limits. Furthermore, for SOF the no of observation continues to be the same as 252 while the min and max values are 8.95 and 24.69 respectively. The mean and std dev are 17.08 and 3.11 respectively. The skewness and kurtosis are within the limits of statistics. The min and max value for LEV is 0.02 and 1.0559 respectively while the mean and std dev are 0.4509 and 0.2159 respectively. The

min and max values for INVLOS are 0.01844 and 1.615 respectively while the mean and std dev are 0.751 and 0.246 respectively while the skewness and kurtosis are -1.315 and 4.82 respectively. The min and max values for INDROS are 0.001 and 0.821 respectively while the mean and std dev are 0.172 and 0.2069 respectively. The min and max values for FINSOS are 0.0238 and 1.0921 respectively while the mean and std dev is 0.809 and 0.232 respectively. The skewness and kurtosis are -1.175 and 3.65.

Table 3. Correlation matrix for firms

Variables	DPS	BIND	BSIZE	SOF	LEV	PRFT	INVLOS	INDROS	FINSOS
DPS	1.0000								
BIND	0.2522	1.0000							
BSIZE	0.0258	0.2168	1						
SOF	-	-	-	1					
LEV	0.1390	0.0156	0.0979	0.1288	1				
PRFT	0.0634	0.0742	0.0496	0.1413	0.0991	1			
INVLOS	0.7682	0.1498	0.1225	-	-	-	1		
INDROS	0.1113	0.1016	0.0645	0.0064	0.1210	0.0853	-	1	
FINSOS	-	-	-	0.3298	-	-	-0.1578	-	1
	0.1069	0.2143	0.2786	0.0136	0.1491	-	-	-	-
	0.0242	0.1734	0.2247	-	0.0509	0.0710	0.1582	-0.322	1
				0.2567					

The table 3 above shows the correlation among the variables. The highest correlation value between two independent variables is 0.3298 which lower then 0.80. It means we didn't have any multicollinearity problem as suggested by Gujarati (2003).

**Multicollinearity Test**

Table 4. Multicollinearity

Variables	VIF	1/VIF
INDROS	4.41	0.226636
FINSOS	4.01	0.249598
SOF	1.17	0.855634
BIND	1.15	0.866227
BSIZE	1.14	0.878717
PRFT	1.11	0.897323
INVLOS	1.07	0.936621
LEV	1.06	0.944686

Table 4 above shows the VIF values for the variables in our model. The highest VIF value is 4.41. According to O'Brien (2007) in order to get rid of the multicollinearity problem all the VIF values must be within 0.05 < VIF < 5. So we can conclude that in our model we fulfill the minimum criteria.

**Fixed effect model**

The Table 5 below shows the fixed effect regression model. The DPS being the dependent variable is regressed with the independent variables like BSIZE, SOF, BIND, LEV, PRFT, INVLOS, INDROS, and FINSOS of non-financial firms to find its impact using Fixed Effect Panel Least Square Method. The R-square value is 30.53%. BIND has a positive relation with DPS but it is also statistically insignificant this

study also supported by Belden et al. (2000) he also found the same result of the study. BSIZE has a positive relation with DPS. While Klein (2002) reports that board size has an impact on control mechanism. In our analysis, it is statistically insignificant but at level 5%.SOF has also a negative relation with DPS and it is statistically insignificant at level 5%. Richard (2001) also supports our result of the study and he also found the negative and insignificant result of the study.

Table 5. Fixed Effect Panel Least Square

Variables	Coefficients	St. errors	T-Values	P> t
BIND	15.99321	14.75385	1.08	0.28
BSIZE	1.935218	2.074275	0.93	0.352
SOF	-0.4422468	1.698212	-0.26	0.795
LEV	-8.30161	8.810712	-0.94	0.347
PRFT	0.6604713	0.093825	7.04	0
INVLOS	7.982306	5.591207	2.43	0.055
INDROS	-36.15407	19.45046	-1.86	0.065
FINSOS	-35.30606	9.637593	-3.66	0
_cons	11.99112	36.3823	0.33	0.742
R-sq	0.3053			

Hafeez and Attiya Ahmad (2010) found negative and insignificant result of the LEV in their study on the other hand baker et al. (2007) and Belans et al. (2007) also found the same results these study support our result of leverage. While PRFT and INVLOS have a positive relation with DPS and both are statistically significant and the result of Eriostis and Vasilios (2003) and Alam and Hossain (2012) also support our result. INDROS has negative relation with DPS but it is significant at level 10% and this study also support by Al Malkwai (2007). FINSOS has a negative relation with DPS and it is statistically significant at level 1% this study supported by Afzal and Sehrish (2010).

**Random Effect Method**

Table 6. Random Effect Panel Least Square

Variables	Coefficients	St. errors	Z-Values	P> z
BIND	12.50648	11.37733	-1.1	0.272
BSIZE	0.4125166	1.196393	-0.34	0.73
SOF	-0.2939284	0.64824	-0.45	0.65
LEV	-4.092844	6.991013	-0.59	0.558
PRFT	0.8001386	0.060135	13.31	0.00
INVLOS	7.514979	5.182022	1.45	0.08
INDROS	-37.46226	13.13525	-2.85	0.004
FINSOS	-37.85676	9.364876	-4.04	0.00
_cons	48.49507	19.66706	2.47	0.014
R-sq	0.2845			

The Table 6 shows dependent variable DPS that is being regressed by the independent variables like BSIZE, SOF,BIND,LEV, PRFT, INVLOS, INDROS, and FINSOS of non-financial firms to find its impact using Fixed Effect Panel Least Square Method. The R-square value is 30.53%. BIND has a positive relation with DPS but it is also statistically insignificant this study also supported by Belden et al. (2000) he also found the same result of the study. BSIZE has a positive relation with DPS. While Klein (2002) reports that large boards have an influence on the control of the firm. SOF has also a negative relation with DPS and it is statistically insignificant at level 5%. Richard (2001) also supports our result of the study and he also found the negative and insignificant result of the study. They found negative and insignificant result of the LEV in their study on the other hand baker et al. (2007). Belans et al., (2007) also found the same

results these study support our result of leverage. While PRFT and INVLOS have a positive relation with DPS and both are statistically significant and the result of Eriostis and vasilios (2003) also support our result. INDROS has negative relation with DPS but it is significant at level 10% and this study also support by Al Malkwai (2007). FINSOS has a negative relation with DPS and it is statistically significant at level 1% this study supported by Afzal and Sehrish (2010).

**Hausman test**

Table 7: Hausman test

Variables	Random	Fixed	Difference	S.E
BIND	-12.50648	15.99321	-28.49969	.
BSIZE	0.4125166	1.935218	-2.347735	.
SOF	0.2939284	0.4422468	0.1483184	.
LEV	-4.092844	-8.30161	4.208766	.
PRFT/EPS	0.8001386	0.6604713	0.1396673	.
INVLOS	7.514979	7.982306	-0.4673273	.
INDROS	-37.46226	-36.15407	-1.308192	.
FINSOS	-37.85676	-35.30606	-2.550705	.

In order to select between the suitable models for our analysis Hausman test should applied (Asteriou & Hall, 2007). As per the Null hypothesis: Fixed effect model is better while the alternate hypothesis: Random effect model. As the P-value is 0.008 so, fixed effect is the suitable model of analysis for our model.

**Conclusion**

The main focus for the introduction of the corporate governance was to protect the investor’s right. The focus on paying dividend in Pakistani firms is very low. Which shows that the firm authorizes didn’t give due importance to the shareholders. Now, to give due importance to the shareholder or the real owners of the firms, corporate governance practices were introduced by SECP in Pakistan. In this regard the main for this paper was to investigate the influence of the corporate governance practices on dividend polices in Pakistani non financial firms listed on PSX. The sample period selected for the research was from 2011 to 2016. A total of 42 firms were selected based on convince sampling. The results show that firms with large boards that represent directors both from minority shareholder and large shareholders has a high dividend payout ratio. Moreover, the board independence didn’t show any influence on DPS. An important result was indorsed in this paper was that large individual ownership shows little concern towards dividend payments. Mostly the insider owners has the influence on the decision of whether to pay dividend or not. A significant relation was observed between the institutional ownership and DPS but the relation was negative in nature. Higher the level of institutional ownership lower will the DPS and vice versa. In Pakistan, mostly the dividend is paid regularly but the magnitude of the dividend is low. Moreover, if the firms are high leverage this magnitude of dividend paying ratio is further effected (Baker et al., 2007).

So, we may conclude based on our findings that large board size has an influence on the dividend policy of the firm. It may improve the ratio DPS in a positive way with the concern that the executive and non-executive directors ratio should be kept in check. Moreover, individual ownership, insider ownership and institutional ownership has significant role to play in the dividend decision making but the individual



ownership shows a positive influence while the insider ownership and institutional ownership has negative influence on the dividend decision's making. The SECP can play a positive role in introducing and making it compulsory for the non-financial firms to adopt the corporate governance practices to safe guard the interest of the shareholders.

### Limitation of the Study

During the data collection process of this research, it has been observed that hardly 30 percent of the sample companies fulfill my requirements of the research as we randomly select the companies for data collection. Mostly the annual reports of companies were not available and were not updated till 2016 regarding the corporate governance compliance code. we collect data from the annual reports of many firms, they paid high amount of dividend per share while they had earn less than that.

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