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IMPACT OF OWNERSHIP STURCTURE ON DIVIDEND POLICY OF FIRM

(EVIDENCE FROM PAKISTAN)

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Abstract—**This study has been conducted to find out the impact of ownership structure on dividend payout behavior of firms. Data has been analyzed for the period of 2002 to 2006. We have used panel data of Pakistani firms listed at Karachi stock exchange to explain the relationship. Common Effect Model has been applied as a research tool and the results have shown a positive relationship between ownership structures and dividend policy. The results have also consistently supported the potential association between ownership structure and dividend payout policy.**

Keywords: Ownership Structure, Dividend Payout.

I. INTRODUCTION

Dividend payout decision is the primary element of corporate policy and has been viewed as an issue of concentration in the financial literature. Dividends, the reward to shareholders in return of their investment and risk exposure, depends on various factors. Primarily, these factors are profit level, financing limitation, investment chances, firm size, shareholders' pressure and regulatory regimes. When company makes a decision regarding dividend payouts, one important subject of interest is the understanding its relationship with the share price of the company. This relationship between stock returns and dividends have been documented on in various studies. However, the justification of commonly observed findings has been controversial and come up with two different questions; Is higher stock price a result of higher dividend payouts and vice versa? What is the influence of dividend announcements on the stock market? The first question is known as clientele problem and the second is ex-date effects on dividends. In clientele effects, the studies assume that some classes of investors select different levels of dividends due to their different levels of taxation. The Ex-date of dividends means that a share, purchased on its ex-dividend day, does not include a claim to a previously announced dividend.

The association of agency costs and dividend policy has been a current development in the corporate finance theory focusing on how dividend payout can be used to control the agency cost of the firm. Following the above mentioned theory, the market can be convinced that the manager is not in a position to influence its control and helping in reducing agency cost. The basic impetus for the agency models of dividends is that until profit of the firms are paid out as dividends, managers may deflect the cash flow for personal use or follow unbeneficial investment projects.

Different theories segregated agency model in two different viewpoints; the first considers dividend as a solution of the contention among managers and shareholders further between outsider shareholder and controlling shareholder. In the second view, dividend payout policies are alternate for governance issues in an organization.

In this paper we focus on the association between ownership structure and dividend payout of the firms listed on Karachi stock market. And this study intends to investigate the research question
"Does ownership structure affect the dividend policy of the firm?"

At a time when code of corporate governance (rules to run the company in the manner to make sure the concern of all stakeholders) has been newly adopted by Pakistan, this study will be very beneficial to the policy makers by providing them insights while developing strategies.

II. LITERATURE REVIEW

Dividend is one of the most comprehensively researched areas in finance. Researchers have analyzed a lot to solve out the dividend puzzle. Black (1976 p.5) therefore, probably rightly reaching the conclusion "The harder we look at the dividend picture, more it seems like puzzle, with pieces that just don't fit together."

Firm's dividend policy is the financial decision, that how much dividends should be paid to the share holders, and normally when and in what forms they should be disbursed. It is the board of directors who decide all about the dividend policy; normally small share holders don't have adequate control to observe the board but the large share holders have sufficient rights to look in to the dividend policy and can monitor the board (Shleifer and Vishny, 1986). Therefore, such large share holders' interest provides them with the nuisance to shape a firm's dividend policy.

Interestingly, there have been divergent results of the theoretical and empirical studies regarding the dividend policy and the market value of the firm. Some studies have found that the dividend policy does impact the market value of the firm and yet the others establish that the dividend policy don't have any effect on the firm value at all. Besides this some theories have made an attempt to explore as to why and when firms payout dividends. Miller and Modigliani (1961) suggested that the firm's value is not affected by dividend in the Perfect markets. If the firm's investment policy remains unchanged, shareholders would have no concern to receive cash flows as dividends or in the form of capital gain.

According to Seppo Kinkki (2001), traditionally dividend policy of a corporate firm has been observed in the context of considering firm as a single unit where aim of the management is to maximize overall value of the firm. The agency cost approach, however, is different from the traditional approach as it clearly recognizes the firm as managed by one group of individuals and owned by other group of individuals with conflicting interests and self-seeking motives. These behavioral implications, in turn, cause promoting an individual interest instead of maximizing firm's wealth. Thus, the agency theory presented by Jensen and Meckling (1976) is focused on the conflict among manager and shareholder and the ratio of equity controlled by the insider owner to influence the dividend policy. Crutchely-Hansen (1989) argued that three variables can control the agency cost of a firm, i.e. mangers personal equity ownership, corporate leverage and corporate dividend payments.

It is a conviction that managers alter dividends only when it is necessary. The Decrease in dividends takes place only when the firm faces financial complexity while the anticipation being the sustainability of maintaining the higher dividends in the future periods. If it is true, then the change in dividend policy of the firm works as a signal to investors, who may react accordingly. Bhattacharya (1980) in the signaling theory stated that dividend information creates asymmetry between mangers and share holders by conveying inside information of firm's future prospects.

Corporate governance and dividend policy has been researched widely because dispersion of firm ownership limits the owners' access to observe or control management's use of free cash flows. Which leads to formation of an opinion that dividend payout is the key element which may restrain management's access to free cash flows or their mistreatment of discretionary funds. Jensen (1986) in concluded that a firm having considerable free cash flows do have a trend towards high agency costs. This may lead management to carry out suboptimal investments projects. To control agency cost and reduce cash flows available at the discretion of mangers, it is good to disburse the excess cash to share holders in the form of dividend than to invest in projects which are less profitable. Moh'd et al (1995) concluded that in US firms, where ownership is spread out, the dividend ratio is on a higher side. Gugler and Yurtoglu (2003) on the other hand observed increase in German firm's payout ratio with the increase of power of second largest equity holder. Mondher Kouki and Moncef Guizani (2009) while studying Tunisian companies found that dividend payment is very much linked and affected by highly concentrated ownership.

A. Dividend policy and ownership structure

The link of ownership structure with the dividend payout has been closely monitored by many researchers. Some of them have even tried to explore the agency cost theory in the perspective of ownership structure.

B. Institutional Ownership

Institutional investors play an effective role at monitoring management than the individual investors. Because of their investment size and the resources at their disposal, Institutional investors have better incentive and capabilities to collect and evaluate information pertaining to their investments. They also possess the clout to discipline management and even bring about the changes when management performs inadequately (Stouraitis and Wu, 2004). Since institution manage larger pool of funds and investment of funds is higher therefore to avoid risk they should allocate resources to monitoring (Grossman and Hart, 1980; Shleifer and Vishny, 1986).Pound (1988) commented that the institutional investors act as a controlling indicator to overinvestment problems.

Institutional investors, with more available recourses and knowledge, not only can do monitoring but some times they influence corporate information which individual investors cannot (Michaely and Shaw, 1994). Eckbo and Verma (1994) in their study concluded that institutional shareholder in order to reduce agency costs prefer the free cash flow distribution in the form of dividends. Agrawal and Mandelker(1990) pointed that institutional investors offer important monitoring services and operate as a self-control to opportunistic behavior of managers and helps in reducing agency cost.

C. Managerial Ownership

Several researches argued differently about a manger's role in ownership. The ownership hat being on the heads of managers may help in elimination of free cash flow problem and may better support the mutual interest of management and shareholders. Thus it results in high payout ratio keeping more shares with the mangers (White, 1996; Fenn and Liang, 2001).

Researchers have suggested dividend payment as an apparatus to control the management compass as the inside ownership provide direct opportunity to use internal funds on unprofitable projects. This approach anticipates negative relationship between insider ownership and dividend payout (Rozeff, 1982; Moh'd, Perry and Rimbey 1995; Short, Zhang, and Keasey, 2002). D'Souza (1999) observed the negative relationship among agency cost and market risk with dividends payment. Zeckhauser and Pound (1990) studied US firms and concluded that there is no significant difference among dividend payouts with or without large block shareholders. Vhen and Sinha in their working paper "Large Shareholders and Dividend" investigated that payoff policies can be manipulated by the voting power rather than equity ownership.

III. METHODOLOGY

Sample of the study was taken from the companies listed at Karachi Stock Exchange (KSE). Data of the companies was obtained for the period of five years from 2002 to 2006. Resources of the data collection are from annual reports, balance sheets analysis of State Bank of Pakistan and KSE's website. The information gathered from the above mentioned sources was about the variables of interest i.e. return on equity, firm size, Dividend payout ratio, leverage, and the proportion of shares held by the board of directors.

A. Empirical Model and Variables

Relationship of ownership structure and dividend payout has been analyzed by taking dividend payout as independent variable and ownership structure as dependent variable.

B. Independent Variable

Ownership structure has been calculated by the percentage of shares held by board of directors divided by total numbers of shares.

C. Dependent Variable

We used dividend yield (Smith and Watts, 1992; Agrawal and Jayaraman, 1994) to symbolize the firm's payout policy since the management may influence the profit and the dividend ratio will be affected.

Dividend = Dividend paid/Net Income available to the share holders

D. Control Variables

E. Firm Size

Size of the firm has been taken as a control variable. It has been estimated through the current research related proxy i.e. total number of directors present in the Board of Directors.

F. Return on Equity (ROE)

Another control variable has been used and calculated as Net Profit/ Shares holder equity.

Leverage (LEV) may also affect firm's choice of payout policy and this variable is defined as Debt/ Equity. According to Jensen and Meckling (1976), financial leverage has an important role in monitoring managers thus reducing agency cost arising from the shareholder manager conflict.

G. Data Analysis

As we have used both cross sectional and time series data, the use of Common effect model for this panel data analysis seems to more appropriate. This has been used to find out the relationship between ownership structure and dividend payout. Following equation represents the model: -

$$DPO\ it = \alpha_{it} + \beta_1\ O.S\ it + \beta_2\ Size_{it} + \beta_3\ Leverage_{it} + ROE_{it} + \epsilon_{it}$$

Where; DPO it = Dividend Payout

αit = Intercept

β1 = Coefficient of ownership structure

β2 = Coefficient of size of the firm

β3 = Coefficient of leverage

IV. RESULTS

Descriptive statistics have been applied to find out the nature of the data. The results of which are presented in the following table: -

A. Descriptive statistics

TABLE I. DESCRIPTIVE STATISTICS

Descriptive Stats	DPR	Size	ROE	Lev
Mean	0.198371	6.87871	0.325123	0.701153
Standard Error	0.035591	0.058392	0.283405	0.026336

Median	0	6.865995	0.072211	0.680995
Minimum	1.02041	3.994524	-2.03571	0.04612
Maximum	7.5	9.456646	72.14286	3.540136

B. *Common Effect Model*

Common Effect Model performs the test with constant coefficients, i.e. constant intercept and constant slope. The application of this model to our data, the following results were observed:-

TABLE II.

Description	Co-efficient	t-Value
Intercept	0.009781455	0.031551458
Size	0.029002755	0.729842994
ROE	-0.000570407	-0.07207529
Lev	-0.102672875	-1.169938475
OS	0.179813743***	2.123745477***

It shows that ownership structure has significant positive effect on dividend policy of the firm. Which means the companies where more owners are present on the board pays more dividends as far as Pakistani corporate culture is concerned. Or we may infer that the companies where more owners are sitting in the Board, they tend to take care for the dividends. This relation ship is significant at 95% confidence level as t value is more than 1.96. So we may conclude that ownership structure has positive effect on the firm's dividend policy.

The size of firm, chosen as a control variable, has shown positive effect on dividend payout but is not statistically significant. Another control variable, ROE has been found negatively related with dividend payout but this also being statistically insignificant. Leverage has also been found having negative relationship with dividend payout but is insignificant.

TABLE III.

R-Square	0.155518
Adjusted R-Square	0.154852
F-Statistics	0.953572295
Significance of F	0.043366703

Value of R square indicates that only 15.55% variability is being described by the independent variables. This is low but as data consists of both cross sectional and time series so, it may be relied upon. F statistics shows that model applied is valid.

C. *Discussion of Results*

The results show that there is a positive and significant relationship of ownership structure with dividend payout. This means that the companies where shareholders are sitting in the board they try to influence their power in the decision making regarding dividend policy. This reduces the agency conflict and develops the trust of the outsiders and shareholder on the company. The results are supported by (Shleifer and Vishny, 1986) and Gugler and Yurtoglu (2003). The size of the firm is found statistically insignificant but has positive relationship.

V. CONCLUSION

In developed markets, where ownership is highly varied, the market power may stress the management to distribute dividends and to meet the demands of the investors. Minority shareholders do not have enough power to compel the management and controlling share holders for dividend payout. However, the controlling, managerial share holder demands for the distribution of dividend.

The issue of corporate governance is emerging as one of the most important elements in formulation and/or implementation of corporate policies and strategies in the present circumstances. The world is vigorously following to improve the parameters of governance. In such a scenario, our study has focused on one of the key governance elements i.e. the ownership structure and its impact on dividend policy. We have investigated the dividend policy of the listed companies in perspective of ownership control. We found that cash dividend level is higher where the owners' presence in the board of directors is higher. Results point out that managerial ownership appears to have a visible and significant effect on dividend payout. Our results are suggestive of a significantly positive relationship between them it supports the earlier work of Kouki and Guizani (2009), and Kumar (2003).

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