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The Paradox of Managerial Dividend Policy in Corporate Malaysia

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ABSTRACT

The prime objective of this paper is to survey the managers of Bursa Malaysia listed non-financial firms and to divulge their views regarding the significance of various potential factors that may affect dividend decisions. In addition to that, we are also interested in highlighting that how managerial perception about the importance of these factors varies from country to country. Our next objective is to know the level of importance, Malaysian managers give to dividend processes and pattern, firm value. Dividend policy (DP) and residual dividend policy (RDP). Finally, we are interested in measuring the level of support that Malaysian managers provide for different justifications for the payment of dividends. Survey instrument including a cover letter was mailed to chief finance officers (CFO) and finance managers of 493 Bursa Malaysia listed firms in October 2017. In the cover letter, a request was made to all respondents that in case of their non-involvement in dividend decision the letter must be forwarded to concerned authority involved in dividend decisions. The response rate of the current study is 40.09 percent (202 out of 493 firms). The study has used a mail survey of Bursa Malaysia listed non-financial firms that have paid at least one cash dividend during the period of 2013-2016 as a primary means of collecting data. No single pattern in rankings of factors among different countries has emerged. However, like their American, Canadian and Indonesian counterparts, According to Malaysian managers, dividend decisions have a significant effect on firm value. Although, a great deal of support has already been established with all dividend theories, however clientele and agency theory has proven to be the strongest one.

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1. Introduction

The dividend payment, leverage, and cash holding decisions are at the heart of agency theory. Throughout the previous century the corporate finance has been confronting the issues related to principle-agent conflicts and the possibilities regarding alignment of interest, however scientists have failed to work out any single solution so far. Dividend policy (DP) is one of the most important issues in modern financial literature. It has turned out to be one of the most interesting and extensively researched topics among all. DP is regarded as one of the most debated subjects in finance among researchers. This situation has led to the emergence of a number of researchers who focused their attention to explicate different theoretical explanations about dividend policy. In previous studies, the majority of the empirical work did not have sufficient explanations regarding the DP matters and corporate values in firms (Baker, Kilincarslan & Arsal, 2017). DP can be defined as a company's policy which determines the amount of dividend payment and also the amount of retained earnings, a firm wants to invest back in a new business project. Though researchers have used a variety of theoretical models such as bird in hand theory, signaling theory, tax and clientele effect, and agency theory and employed different normative and idiosyncratic approaches to determine the factors which affect the dividend policy. However, still, they are unable to answer how firms decide between highly taxed capital gains and cash distributions.

Linter (1956) carried out a survey research and concluded that the managers of the companies considered three factors to be most crucial while making dividend decisions. Firstly, they decided a target payout ratio by agreeing upon the distribution of the portion of their income after tax. Secondly, the dividend pattern and payout ratio had to be dynamic and adjustable to change in income. Lastly, Mangers in Linter surveys were more concerned about the changes in divided rather than leveraging the dividends. Recently, Felimban, Floros, & Nguyen (2018) argued that the DPof the company should be formulated by keeping in mind the following criterion a) investment opportunities, b) degree of financial leverage, c) stability in earning, d) the alternative sources of Capital and the stakeholders' characteristics.

The current study is founded on the counter arguments broached by the Miller and Modigliani (1961), in which they claimed that the DP has no effect on the market value of the firm. In an effort to explore the managerial views for dividend policy, the current study has employed a survey method and has visited the mangers of Malaysian non-financial firms listed on Bursa Malaysia. Previous studies on the issues of dividend policies have already covered many aspects of dividends such as the effects of dividend payout on firm value, reasons for firms paying dividends, the determinants of DP and dividend trends and many other aspects. In addition, there were various characteristics in firms and markets that have been used in earlier research and have become important factors which have high potential in determining the DP of a firm.

The current research is carried out to achieve the following research objectives. Level of importance by Malaysian non-financial firms to different factors that explain a firm's dividend decisions. Secondly, we have also compared the level of agreement to these factors by Malaysian managers with those of their occupational community members from other countries. In addition to that, this study highlights the perspective of Malaysian manufacturing firm's managers regarding dividend process, pattern, firm value and RDP. Finally, we are interested in measuring the level of support that Malaysian managers give to various explanations for paying dividends.

2. Literature Review

The issue came on the surface, after the proposition of irrelevance hypothesis by MM in 1958, in which it was proposed that in a perforce market with no cost, the dividend decisions are irrelevant to firm value. Later many researchers (Lasfer, 1995; Woolridge & Ghosh, 1985; Soter et al., 1996; Bell & Jenkinson, 2002; Basheer et al., 2014; Shi et al., 2017; Basheer et al., 2019) have shown a disagreement with MM, and argued that in real world, because of opportunity cost, transaction cost, agency cost, and other costs the corporate financial decisions including dividend has a significant impact on the firm value. In line with the conclusion of Fama and French (2001), Baker and Wurgler (2004b) found that firms now have a tendency to pay fewer dividends.

Baker and Ridder (2004) further clarify the nature of the dividend disappearance supported by Fama and French (2001). They showed that although the number of dividend payers was reduced by 50%, total dividend payout by industrial firms has in fact increased between 1978 and 2000. They pointed out that dividends have become more concentrated among a few players where 81.8% of dividends are distributed by the first 100 dividend paying firms. The authors conclude that dividend patterns are changing but not disappearing. They argued that the decreasing trend of dividend-paying firms is primarily caused by the firms distributing small dividends. Therefore, the impact of nonpayment by such firms is not felt by the 'dividend supply'. The finding shows that the dividend payout by the large firms continued to increase and it was argued further that this increase even nullified the effect of non-payment by the small firms. DeAngelo et al. (2004) also provide strong evidence for Lintner's model as findings revealed that dividend increase comes from earnings' increase; therefore, dividend concentration also follows earnings concentration. Unlike the previous studies which have excluded financial and utility firms due to their unique regulatory structure, DeAngelo et al. (2004) demonstrate that the number of dividend payers in these firms has increased by 9.5% over the period studied. This implies that reduced propensity to pay dividends is limited to industrial firms.

Lintner (1956) documents that earnings and previous dividends are the most important determinants of dividend payout decisions. Empirical studies have provided further evidence on the importance of these variables. Earnings are positively and significantly related to dividends (Ameer, 2007). Chemmanur, He, Hu, and Liu (2010) argued that firms are reluctant to reduce dividend levels even when there are insufficient internal funds to finance good investment opportunities. They documented that past dividend is positively and significantly related to current dividend policy. This finding was confirmed by Bradford et al. (2013). The relationship between past dividend and the current dividend has been used to explain the concept of dividend smoothing by Lintner (1956). Thus, dividend smoothing involves maintaining a relatively constant rate of dividend from one period to another. Studies have shown that there are costs associated with dividend smoothing as some managers forego profitable investments or even seek external financing in order to maintain stable dividend levels (Zurigat & Gharaibeh, 2011).

Cash flow is another determinant of the dividend. On one hand, prior studies have confirmed the free cash flow hypothesis by showing that failure to pay out free cash flow as dividends results in its diversion or misuse . Thus, dividend payout increases with higher levels of free cash flow. From another perspective, Adelegan (2003) argued that cash flow is superior to earnings in explaining dividends due to two reasons: the possibility of manipulating the accruals component of earnings. Therefore, cash flow is reported to be positively related to dividends.

In answer to the question, which factors affect the dividend policy, the corporate finance literature has developed and used different theories. The detail of these theories is given in the next section.

2.1 Dividend Theories

As previous studies have established that the researchers have been using different theoretical models in identifying different factors which explain the firm dividend decisions. Notwithstanding, there are many theoretical models used to answer these questions. However, we have discussed the four widely used theories which are bird in hand theory, agency theory, signaling theory, and tax preference theory.

2.1.1 Bird-in-Hand Theory

The bird hand explanation of dividend supports an investor's preference regarding continuous dividend and in contradiction to the tax theory it argues that the cash in hand through the dividend is better than the capital gains through re-investing (Baker et al., 2017). The theory was given by Gordon (1962) and is based on a famous proverb that a bird in hand is better than the two in bushes.

2.1.2 The Signaling Explanation

Signaling theory was pioneered by Akerlof (1970) and generalized by Spencer (1973). Their work forms the basis for models later developed on signaling theory of dividend (also referred to as the signaling hypothesis). The prominent signaling models were developed by Bhattacharya (1979). The signaling theory of dividend proposed that dividend announcement relay information to investors regarding the firm's future prospects (Baker et al., 2017).

2.1.3 Tax and Clientele Effects

Dividend clientele refers to a group of investors with a preference for a particular DPthat best suits their interests (Qammar et al., 2017). This theory explains the fact that the different groups of investors have preferences for the varying policies of a company and the tax policies of countries. As a result, investors alter their shareholdings in response to changes in company policies and this has an effect on the share prices (Renneboog & Szilagyi, 2015).

2.1.4 Agency Theory

Agency Theory of Dividends is a theory that is concerned with resolving problems that emerge from agency relationships (Basheer, 2014). Jensen and Meckling (1976) in their pioneering work of agency theory of dividends showed that agency costs arise from the differing objectives of the managers and the shareholders. Easterbrook (1984) and Jensen's (1986) models theorize that dividends play an important role in mitigating the agency issues between managers and the shareholders.

2.1.5 Maturity Hypothesis

Mueller (1972) propounded the life-cycle theory of the firm. The life cycle theory of dividend explains that the corporate payout policy of a firm varies over the different stages of its financial life cycle (Fama & French, 2001). The theory extends the explanation Jensen (1986), who propsed the free cash flow hypothesi. Based on the life cycle theory, availability of free cash flow for onward disbursement to shareholders as dividends depends on the stage a firm has attained in its financial life cycle.

2.1.6 Catering Theory

This theory gave momentum to the behavioral arguments used to explain dividend decisions by Shefrin and Statman (1984). According to Shefrin and Statman (1984) investor's preference for dividends by putting up reasons why dividend and capital gains cannot be regarded as perfect substitutes. Baker and Wurgler (2004a) hypothesized that payment of dividend is influenced by investor's demand for the dividend.

2.1.7 Linter Model

This hypothesis which establishes the importance of dividend stability derives from the survey evidence provided in the seminal work of Lintner (1956). Lintner's (1956) findings revealed that firms are largely concerned about maintaining stable dividend levels.

3. Research Design

3.1 Survey Instrument

The study is among the pioneering studies carried out to explore the managerial perspective of Malaysian firms. To achieve the research objectives the study has employed the survey questionnaire developed and used by Baker et al., (2012) recently confirmed by Baker et al., (2017). The third section is examining the level of agreement is amended by adding three more explanation and amended is followed by the recent work of Baker et al., (2017). The instrument is composed of three sections in the first section the managers are asked to present their views on the significance (which is measured from 0=none to 3=very high) of 22 factors which affect the formulation of dividend policy. The second section is managers of Malaysian firms are requested to presents their level of agreement on issues such as dividend process, dividend pattern, dividend, and firm value and residual DP involving dividend policy. In the third and final section, the managers of Malaysian manufacturing firms have shown their level of agreement with the different theoretical explanation given for dividend payment policy. For the sake of collection of data, we have used the mail survey.

3.2 Sample and Response Rate

Initially, all manufacturing firms listed on the Bursa Malaysia were chosen as a sample of the study. However, a later firm with at least two dividends in the last three years are selected as the final sample of the study, so the final sample is comprised of 493 firms. The data of dividend payment is collected from the firm’s annual reports. Survey instrument including a cover letter was mailed to chief finance officers (CFO) and finance managers of 493 KSE listed firms in October 2017. The response rate of the current study is 40.09 percent (202 out of 493 firms).

4. Results and Discussion

4.1 Respondents and firm profile

To know the profile of respondents and their firms six background questions were asked. When asked about the most influential personality in firm’s DP formulation, 89 percent replied he is CEO .78 percent of the firms are paying dividend annually.53 percent firms has an explicit payout ratio.94 percent of the respondent are actively involved in DP development and 66 percent respondent are finance managers.

4.2 Determinants of DP

The prime objective of the current study is to identify the level of importance given by the Malaysian managers to the factors which determine the DP in the Malaysian firms. We have employed the t-test to measure the mean difference in the responses of managers. The result of the study is reported in table 1. It is evident from the findings of the study that, the Malaysian managers have considered the stability of earning as topmost consideration while the liquidity constraints of the firms and the predictability of future cash flow as second most important. These results are in line with propositions that the liquidity and uncertainty in cash flows arising because of economic turbulence are the most important factors which affect the dividend decisions of Malaysian managers.These findings of the study are consistent with previous findings Baker et al. (2017), Baker et al (2012), and Baker et al. (2010) Basheer (2019).

The second objective of the current study is to compare the importance of these factors given by Malaysian managers with the manager of other countries. The result of the current study is compared with the studies carried out on the sample of Turkish, USA, Canadian and Indonesian firms. Though Malaysian managers have shown a great deal of agreement with their occupational community members working in Turkish, USA, Canadian and Indonesian firms. However, there is no single pattern emerges. Malaysian Managers ranked F1, F14, F11, F3, F2, and F10 consecutively at the top. But the ranking of F4, F8, and F5, F9 is lower i.e Malaysian manager consider expected future earning and target capital structure less important in determining dividend policy. Moreover, Ranking of F14, F11, and F10 is significantly higher than other financial markets which indicates that for Malaysian manufacturing firms factors such as needs of current shareholders, availability of cash and the future state of the economy.

Table 1: The level of importance given by Malaysian manufacturing firms mangers to the factors affecting the dividend policy in corporate Malaysia (DP)

	Level of Importance										
	None	Low	Moderate	High	Mean	Rank					
No	0	1	2	3		BM	IDX	NYSE	NASDAQ	TSX	BIST
1	0	10	40	150	2.70	1	1	6	2	2	2
14	2	6	84	108	2.49	2	6	10	9	9	14
11	2	8	90	100	2.44	3	4	8	14	5	3
3	0	8	52	140	2.66	4	2	15	3	4	1
2	2	10	52	136	2.61	5	7	3	1	3	5
10	6	10	80	104	2.41	6	8	18	18	17	8
4	4	20	72	104	2.38	7	3	1.5	4	1	4
8	0	20	96	84	2.32	8	18	13	11	10	NA
5	2	18	102	78	2.27	9	5	4	5	7	12
6	2	18	102	74	2.24	9	13.5	NA	10	8	10
13	4	22	104	70	2.23	9	10	9	7	6	7
17	2	38	90	70	2.14	12	21.5	5	8	12	15
16	2	48	88	62	2.05	13	13.5	19	20	21	19
9	8	50	84	58	1.96	14	19	11	6	13	6
12	8	60	80	52	1.88	15	17	14	13	18	20
18	6	68	76	50	1.85	16	20	16	12	19	NA
7	22	64	70	44	1.68	17	12	NA	17	15	13
20	4	96	66	36	1.50	18	9	7	15	11	9
15	32	94	60	34	1.41	19	15	15	21	20	NA
21	20	96	48	36	1.32	19	11	NA	16	16	17
22	24	100	44	32	1.26	19	21.5	17	22	22	NA
19	42	98	40	20	0.99	22	16	12	19	14	16

4.3 Managerial issues Related to Dividend

The current study is to examine the Malaysian manager's views regarding dividend policy, dividend patterns, RDP, and firm value. The findings are reported in Table 2. The result reported in Table 2 highlights that the Malaysian managers are agreeing with the explanation provided by Linter's (1956) behavioral model, as majority investors agreed on the fact that a stable investor will rate stable dividends more than the stable payout. Similarly, it is evident from the results that a stream of the dividend is preferable in the eyes of investors and managers consider it most important while deciding about the dividend. The 87 percent of respondents are agreed on the fact that the firms should go for a stable dividend if there is no major shift in earning, and for this firm must have a target payout ratio.

In panel 2, results related to dividend pattern are discussed, the results are positive and significant, which indicates that the dividend pattern has a significant impact on the dividend decisions of the managers of the Malaysian listed non-financial firms. In Panel 3 the results related to the impact of DP on firm value are reported. The result of the study has shown a great deal of agreement with the fact that in the real market the dividend decisions have a significant impact on the firm value of Malaysian listed non-financial firms. In Panel 4 the result related to residual DP are reported. The findings of the study highlight the fact that according to the Malaysian Mangers the investment opportunities, is significantly linked with the financing decisions and ultimately affect the firm dividend decision.

Table 2: Level of Agreement shown by the Malaysian Manufacturing Firms Mangers on Issues related to Dividend Policy

Sr. no	T-VALUE	Mean	Sr. no	T-VALUE	Mean
Panel 1	Dividend Process		Panel 3	DPand firm value	
I8	4.568***	1.5400	I9	4.964***	1.4200
I7	4.332***	1.4600	I10	4.376***	1.2800
I6	3.394***	1.0700	I13	3.326***	1.0300
I5	2.402***	0.8100	I15	2.486***	0.8300
I4	2.026***	0.5300	I11	1.312***	0.3600
Panel 2	Dividend Pattern		Panel 4	RDP	
I1	4.628***	1.3400	I14	4.090***	1.4500
I2	4.292***	1.2600	I12	2.142***	0.5100

4.4 The Reasons for Paying Dividends

The endmost objective of the current study is to explore, the agreement of Malaysian managers with the theoretical exploitation. The results are reported in table 3.

The results of the panel A are indicating that Malaysian managers consider bird in hand explanation as for the logical explanation behind dividend decisions. Whereas the results of the second section provide support to signaling theory. According to the signaling theory, the investors consider dividend as a signals to distinguish a performing, underperforming and non-performing firms. Meanwhile, according to Malasyain Managers, the dividend payment are key determinants of the stock price. The investor uses these signals to distinguish between a performing and non-performing firm. Malaysian managers consider dividend as an important determinant of stock price (I19, I20). Malaysian firm managers consider dividend decisions as a signal of firm future decisions (I18, I17). The results of I22 and I21 indicate that Malaysian managers have placed moderate importance on information asymmetry. Responses of I24 show that Malaysian managers consider a tax on cash dividend as important determents of dividend policy. Malaysian managers have placed a moderate agreement with I25 which means that Malaysian investors generally prefer to invest in the firm who's DP supports their tax preferences. Overall results (I24, I25) reveal the fact that managers of KSE firms are aware of clientele effect, and the significant results are consistent with Kester et al. (1995-1996). The results reported in panel D (I27) showing the agreement with agency. However, disagreement has been shown with the notion that dividend payments force managers to increase external financing (debt or equity).

The results of the Panel E are providing support to the intermodal which argues that the investors put a high premium on firms that have a stable dividend policy, and this is reflected in the higher valuation of the firm by the market. Similarly, the result of section F is showing consistency with the maturity hypothesis which is based on the life Cycle theory. Based on the life cycle theory, availability of free cash flow for onward disbursement to shareholders as dividends depend on the stage a firm has attained in its financial life cycle. There are different indicators of the stage of a firm in its financial lifecycle. Finally, the Malaysian managers seem agreed with the explanation of the catering theory.

Table 3: Level of Support that Malaysian Manufacturing Firms Mangers provide to Various Theoretical justification for Paying Dividends

Sr. No.	t-Value	Mean	Sr. No.	t-Value	Mean
Panel A	Bird in Hand Theory		Panel D	Agency Theory	
I16	4.998***	1.1900	I27	4.208***	1.2400
Panel B	Signaling Theory		I26	-0.840***	-0.200
I20	5.712***	1.3600	Panel E	Linter Partial Adjustment Model	
I19	5.250***	1.2500	I30	4.023***	1.143
122	3.864***	0.9200	I28	4.001***	1.123

121	5.944***	0.6900	I29	3.765***	1.023
I18	2.898***	0.4000	I32	3.105***	0.985
I17	0.462***	0.1100	I31	2.765***	0.754
Panel C	Tax and Cliental affect		Panel F	Substitute Model of Dividend	
I24	4.662***	1.1100	I33	3.978***	1.123
125	2.100***	0.5000	Panel G	Catering Theory	
			I36	4.234***	1.456

5. Conclusion

The current research is carried out to achieve the following research objectives. Firstly, the level of importance by Malaysian non-financial firms to different factors that explain a firm's dividend decisions. Secondly, we have also compared the level of agreement to these factors by Malaysian managers with those of their occupational community members from other countries. In addition to that, how the manager of Malaysian manufacturing firm views the dividend process, pattern, firm value and RDP. Lastly, we are also keen in knowing how the managers of non-financial Malaysian firms view the theoretical explanation of paying dividend. In author knowledge, this is the first study to explore the managerial view of dividend policy. The first objective of this study deals with the identification of factors, which for Malaysian managers are most important in formulation firm's dividend policy. This study has provided support to the real market hypothesis (Baker et al., 2017), and argued that the real market the dividend decisions have a significant impact on the firm value of Malaysian listed non-financial firms. The Malaysian mangers has provided support to the hypothesized result and confirmed that the investment opportunities, are significantly linked with the financing decisions and ultimately affect the firm dividend decision and firm value. According to Malaysian managers, Bird in hand and Signaling theory are most viable explanation of deterring a dividend policy. The Malaysian mangers are agreed that there are different indicators of the stage of a firm in its financial lifecycle and provided support to catering theory. The study has employed a survey-based method and visited the managers of Malaysian non-financial firms listed on Bursa Malaysia. The results are shown in table 1, 2 and. Results indicate that Malaysian manager has shown a great deal of agreement with the academic community.

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