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Ownership Structure and Dividend Policy: Evidence from Malaysian Companies

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The paper investigates the effect of large shareholders and dividend policy of Malaysian companies using panel data from 2002 to 2006. Ownership structure in Malaysia is concentrated, therefore the relevant agency conflicts to analyse are the one that arises from the relationship between large shareholders and minority shareholders. The result shows that companies make higher dividend payout as the shareholding of the largest shareholder increase. The magnitude of dividend payout is also larger when there is a presence of the substantial second largest shareholder in the company.

Field of Research: Accounting and Finance

1.0 Introduction

Recent studies such as Claessens et al. (2000), Faccio et al. (2001) and La Porta et al. (1999) observe that many public listed companies located outside the US and UK have high concentration of ownership, with a single large shareholder or shareholder group predominantly controlling companies. The evidence of large shareholders in developed countries beside US and UK, European countries and East Asian countries are against the concept of the separation of ownership from control viewed by Berle and Means (1932). The effective control of the large shareholders enables them to influence the decisions regarding how companies are run and also decisions on corporate policies. However, as stated by Holderness (2003), the role of large shareholders is not well developed in the ownership literature, especially the role of the largest shareholder. The largest shareholder is a unique group of shareholder, as their holding can be associated with benefits and costs, especially the underinvestment costs (Claessens et al. 2002; Truong and Heaney 2007).

Dividend policy is one of companies' decisions that are found to be influence by corporate ownership structure. Dividends can be used to mitigate agency problems in a company (Easterbrook 1984; Jensen 1986; Rozeff 1982), thus substitute large ownership as monitoring tools. On the other hand, large shareholders could use their power to expropriate corporate resources for their own private consumption. This

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could limit the dividend payments of companies that are associated with severe agency conflicts (Faccio et al. 2001). In view of this argument, it is essential to examine the association between large shareholders, especially the largest shareholder and dividend policy to gain better understanding on corporate dividend decisions.

The main focus of this study is to investigate the effect of the largest shareholder on the corporate dividend policy by examining Malaysian listed companies from 2002 to 2006. Malaysia provides an interesting background to examine this issue as the ownership structure is concentrated and large shareholders are in control. On average, the study finds that the largest shareholder or a shareholder group owns around 40 percent of the company paid-up capital. In addition, the study also interested in analysing the effect of the second largest shareholder on corporate dividend decisions, as it is observe that more than 75 percent of the observations have a significant second largest shareholding. Prior research on the relationship between ownership structure and dividend policy has largely focused on companies in the US and the UK, where the markets are well regulated and ownership is widely distributed. Only few single country-based studies have examined the relationship between the largest shareholder and dividend policy, and the existing evidence mainly focuses on European companies (e.g. Goergen et al. 2005; Mancinelli and Ozkan 2006; Maury and Pajuste 2002).

The remainder of this paper is as follows. The next section provides a review of prior literature and hypothesis development for the paper. Section 3 discusses the data, the methodology and variables employed in this study. Section 4 presents the results and the discussion of the analysis. Section 5 contains a summary of the findings and conclusion.

2.0 Literature Review and Hypothesis Development

Agency theory suggests that large shareholders' ownership may either alleviate or exacerbate agency conflicts. A high level of managerial ownership could minimize agency problems, as managers have to bear a portion of the losses arising from their divergent behaviour (Jensen and Meckling 1976; Morck et al. 1988). Large shareholders have a strong incentive to maximize the company's wealth, have control over the company to have their interest respected (Shleifer and Vishny 1997) and have the advantages in collecting information and monitoring the company (Shleifer and Vishny 1986). Nonetheless, the interest of large shareholders might not match the interest of minority shareholders, thus leading to possible expropriation by large shareholders (Shleifer & Vishny, 1997).

Agency theory also suggests that dividends can be used as a corporate governance (CG) mechanism to mitigate agency concerns. Rozeff (1982) develops an optimal dividend payout/cost minimization model and postulates that dividend payments are part of a monitoring device. Dividends can also minimize agency conflicts by subjecting companies to the scrutiny of capital market monitoring (Easterbrook 1984). Based on the free cash flow hypothesis, Jensen (1986) suggests that high payment of dividends could limit the cash available for managers. Therefore,

managers' investment in uneconomic projects or wastage on perquisites can be minimized. The association between the managerial ownership and dividend policy has been extensively examine in empirical studies (e.g.Agrawal and Jayaraman 1994; Moh'd et al. 1995; Rozeff 1982). Evidences show that companies pay lower dividends when the managerial shareholding in companies is relatively high.

Dividends also play a significant role in controlling possible agency conflicts between large shareholders and minority shareholders. By paying dividends, a pro-rata distribution can be guaranteed to all shareholders and limit corporate wealth from large shareholders' control Dividends can also be utilised by controlling shareholders to off-set the minority shareholders' concern in an environment where expropriation by controlling shareholders prevails (Faccio et al. 2001). However, in the presence of large shareholders, lower dividend payments can be observed as dividends are not needed to function as an alternative agency control device (Goergen et al. 2005). Dividends are viewed as a substitute mechanism to large shareholder ownership in mitigating agency conflicts.

Several studies have examined the relationship between the largest shareholder and dividend policy. A negative relationship between the largest shareholder and dividends are observed by Gugler and Yurtoglu (2003), Maury and Pajuste (2002), Mancinelli and Ozkan (2006), Renneboog and Szilagyi (2006) and Renneboog and Trojanowski (2007) for companies from Germany, Finland, Italy, Netherland and UK, respectively. While a positive association between the largest shareholder and dividend payouts is observed by Truong and Heaney (2007) based on the sample drawn from 37 countries.

Recent studies has analyse the effect of other large shareholders, beside the largest shareholder on companies based from agency perspectives. Other large shareholders could monitor the controlling shareholder (Bolton and von Thadden 1998; Pagano and Roell 1998). The monitoring role play by the other large shareholders thus, could limit the expropriation of minority shareholders' resources. However, other large shareholders may collude with the controlling shareholder in expropriating corporate resources and share the private benefits (Faccio et al. 2001; Pagano and Roell 1998). Empirical evidence on the impact of other large shareholders on dividend policy has been limited. Faccio et al. (2001) find that the presence of multiple large shareholders in Europe minimizes the expropriation activity of the controlling shareholder, thus resulting in higher dividend payments, while in Asia, lower dividend rates are being observed. They conclude that the controlling shareholder collaborate with other large shareholders to expropriate the minority shareholders in Asia. Several single country studies that analyse the effect of other large shareholders, particularly the second largest shareholder on dividend policy yield mixed results. For Finland, Maury and Pajuste (2002) show that dividend payouts are negatively related to the second largest shareholder. In contrast, Gugler and Yurtoglu (2003) find a positive relationship between the second largest shareholder and dividend payouts in Germany.

The existence of controlling shareholders in East-Asian companies, namely Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand had been related to the conflicts between large shareholders and minority

shareholder, which lead to expropriation of minority shareholders (Claessens et al. 1999). In line with this view, the hypotheses of this study are as follows:

> *Hypothesis 1. The dividend policy of Malaysian companies is negatively related to the ownership interest of the largest shareholder.*
>
> *Hypothesis 2. The dividend policy of Malaysian companies is positively related to the ownership interest of the second largest shareholder ownership.*

3.0 Methodology

This study consists of non-financial public listed companies (PLCs) of Bursa Malaysia (Malaysian Stock Exchange), which consistently listed over the period of 2002 to 2006. This study applies a systematic random sampling of one for every two companies in the population. Financial, trusts and closed-end funds companies are excluded, as they are subjected to a regulatory framework that does not apply to other listed companies. In addition, companies that were classified under Practice Note 4/2001 during 2002 to 2006 are excluded (distressed companies/companies with negative shareholders' funds). The final sample contains 245 companies, which covers 1,225 firms-years observations.

3.2 Sources and Collection Of Data

Data on the ownership of the sample companies are hand-collected from the annual reports, which are downloaded from the website of Bursa Malaysia (http://www.klse.com.my). The process of collecting the ownership data is by examining the analysis of shareholdings section discloses in the annual reports. Two categories of large shareholders are the focus of this study, namely the largest shareholder and the second largest shareholder. The largest shareholder is defined as a shareholder who own directly and indirectly the total equity of the company. The second largest shareholder is defined as the next largest shareholder who is not affiliated with the largest shareholder. We scrutinize thoroughly each of the company's annual reports to collect the relevant information. Extra care is taken in identifying the indirect holding of the largest shareholder.

The main source for financial data is OSIRIS database. Apart from that, companies' annual reports and Thomson One Analytical database are used. The main source is confirmed by reference to other sources whenever this is possible to improve accuracy.

3.3 Model Specifications

The study use random-effects tobit regressions to analyse the influence of large shareholders on the level of dividend payouts. The model to be estimated can be expressed as:

$$Y_{it} = \alpha + \beta_1 \text{LARGESHAREHOLDERS}_{it} + \beta_2 \text{CONTROL}_{it} + \beta_3 \text{TIME}_{it} + \beta_4 \text{INDUSTRY}_{it} + \mu_{it}$$

(Equation 1)

where:
μ_i = the unobserved error component
Y_{it} = the dividend payout ratio

$$Y_{it} = \begin{cases} Y_{it}^* \text{ if } Y_{it}^* > 0 \\ 0 \text{ if } Y_{it}^* \leq 0 \end{cases}$$

(Equation 2)

Details of the dependent and independent variables use are explained in Table 1.

Table 1: Summary of the dependent and independent variables

DEPENDANT VARIABLE		
Dividend payout ratio (DIVE)	:	Dividends/earnings ratio, where earnings are measured after taxes and interest but before extraordinary items
INDEPENDENT VARIABLES		
LARGE SHAREHOLDERS		
LARGEST	:	the proportional holding of the largest shareholder
SECOND	:	the proportional holding of the second largest shareholder
SECOND5%	:	a dummy variable taken the value of 1 if the second largest shareholding is equal or more than 5%, 0 otherwise
CONTROL VARIABLES		
ROA	:	is the ratio of earnings before interest and taxes to total assets
SIZE	:	is the natural log of total assets
INV	:	is the ratio of market capitalization to total assets
DEBT	:	is the ratio of the book value of total debt to total assets
RISK	:	is the standard deviation of monthly share returns
Year-effects	:	years dummies that, respectively take a value of 1 for 2002, 2003, 2004, 2005,2006, or 0 otherwise
Industry-effects	:	industry dummies that take a value of 1 for companies belonging to the construction, consumer, industrial, infrastructure project companies, hotels, plantations, properties, technology and trading/services, or 0 otherwise

4. Results and Discussion

4.1 Descriptive Statistics

Table 2 summarizes the financial characteristics of the companies in this study. While Table 3 shows the distribution of the sample companies' ownership. Results in The largest shareholder on average holds 40.21 percent of the company's total equity holding. The second largest shareholder also holds a substantial holding; with a mean value of 10.79 percent. The number of companies with significant second

largest shareholding is high; where more than 75 percent of the observations have a second largest shareholder that owns more than 5 percent of equity holding.

Table 2: Firm's characteristics of 245 Malaysian listed companies, 2002-2006

Variables	N	Mean	Median	Min.	Max.	SD
Total assets (RM Mil)	1225	1,772	467	2	65,092	5,458
Total debt/total assets	1225	0.218	0.198	0.000	1.646	0.198
Investment	1225	0.691	0.458	0.024	13.784	0.865
Return on assets	1225	5.40%	6.00%	-129.03%	79.62%	0.122
Firm's risks	1225	0.091	0.079	0.015	0.549	0.058
Dividends by dividend paying firms (RM 000)	878	38,520	7,600	78	1,013,300	102,026

Table 3: Ownership structure of 245 Malaysian listed companies, 2002-2006

	Percentage Holding			
	N	Mean	Median	Standard Deviation
LARGEST	1225	40.21%	40.41%	0.163
SECOND	1225	10.79%	9.18%	0.071
SECOND ≥ 5 %	929	13.18%	12.02%	0.065

Table 4 shows the dividend payouts of Malaysian companies over the period 2002 to 2006. Panel A consist of all companies in the sample. In panel B, to control for outliers, the study exclude firm-year observations with (a) with dividend per earnings ratio above 300 percent and (b) where the earnings figure is negative or zero and the firms pays dividends (where the ratio would be negative). On average, Malaysian listed companies paid around 22 percent (29 percent in panel A) of their earnings as dividends. The trend of the dividend payout ratio shows in Panel B of Table 4 has been on increasing during the period under review. The dividend payout ratio increased from 21.71 percent in 2002 to 27 percent in 2006. The average dividend payout slightly decreases in 2003 and to 2004, but increase substantially in 2005.

Table 4: Dividend payouts of 245 Malaysian listed companies, 2002-2006

Panel A	DIVE				Panel B	DIVE			
	N	Mean	Median	SD		N	Mean	Median	SD
Avg. 2002-2006	1225	29.14%	13.43%	1.544	Average 2002-2006	1171	22.43%	13.87%	0.308
2002	245	12.56%	9.16%	1.307	2002	231	21.71%	10.34%	0.335
2003	245	32.75%	12.53%	1.309	2003	234	19.94%	12.85%	0.241
2004	245	19.30%	13.76%	1.394	2004	235	19.91%	13.87%	0.251
2005	245	34.29%	15.31%	1.229	2005	235	23.58%	15.50%	0.333

2006	245	46.64%	16.46%	2.240	2006	236	27.00%	16.68%	0.359

4.2 Empirical Results

This section examines the influence of on the influence of the largest and other large shareholders on the level of dividend payout. The findings in model 1 to 4 in Table 5 show that companies with lower debt ratios pay higher dividend payout. There is a strong, and statistically significant, negative relationship between the variable representing company debt level and the dividend ratio. As expected, the coefficients for variables representing the size of the company (SIZE) and profitability level (ROA) are positively and statistically significantly related dividend ratio. These associations are consistent with prior studies, such as Fama and French (2001) and Truong and Heaney (2007), on the effect of size and profit on the likelihood of dividend payments. However, there is no statistically evidence that investment opportunities of Malaysian companies (INV) have any influence on the level of companies' dividend payout. Furthermore, there is a strong negative association between company risk levels and the dividend payout, consistent with findings previously documented (Farinha 2003; Holder et al. 1998).

Specification 2 examines the influence of the largest shareholder on the magnitude of dividend payout. The coefficient of the largest shareholding, represent by the LARGEST variable, shows a positive sign with a significant level of 1 percent. The result is not consistent with the study's prediction that higher largest shareholding is negatively related to the dividend payout. This result can be interpreted that higher level of ownership concentration in terns of the holding of the largest shareholder can not be associated with a higher probability of expropriation of minority shareholders. Instead of holding corporate resources under their control for private benefits, the largest shareholder distributes return to the all shareholders.

Specification 3 includes the second largest shareholding (SECOND) in the regression analysis. The results show that there is no statistical evidence that the second largest shareholding have any effect on the dividend payout. However, the coefficient of the LARGEST variable increase slightly compared to specification 2. The inclusion of an indicator variable, SECOND5% in model 4 indicates that the presence of substantial holding of other large shareholders at a minimum of 5 percent holding have a significant and positive impact on dividend payouts. The LARGEST variable in model 4 remains positive at 1 percent significant level. This indicate that the presence of other large shareholders in companies encourage the largest shareholder to payout higher dividends. Indeed, the coefficient of the LARGEST variable in model 4 is higher compared to model 2 and 3.

5.0 Conclusion

This study examines the relationship between large shareholders and dividend policy of Malaysian listed companies. Analysis has been carried out with the view that companies' dividend policy may be used to expropriate wealth from minority shareholders. Malaysia provides an excellent setting to investigate the relationship as the corporate ownership structure is characterized as concentrated in nature. Furthermore, this study provides evidence from East-Asian country, where this region

is describe with severe agency conflicts between controlling shareholders and minority shareholders.

The tobit regression results suggest that controlling shareholders does influence the dividend policy of Malaysian listed companies. Contrarily to the notion that the largest shareholder might expropriate the companies' wealth, the study observes that companies with high level of the largest shareholding have higher dividend payouts. The presence of second largest shareholder also has a significant and positive effect on companies' dividend payout. This indicate that the presence of other large shareholders in companies encourage the largest shareholder to payout higher dividends.

Overall, the study finds that large shareholders have effects on Malaysian dividend policy. However, further tests are needed to ensure that the study's findings are robust and valid. Hence the result of this study should be interpreted with caution. It is recommended that further research is done in on this issue. Future research also can tests whether the type of the largest shareholder, i.e. whether the large shareholder is a family or the Government, have an impact on dividend policy. In addition, future studies could investigate the relationship between the large shareholders and dividend policy of East-Asian companies. The legal system of each country in East-Asia could also explain the variation, if any, of the relationship between large shareholder and dividend policy.

It is hoped that this study will add to the literature and enhance the understanding of the subject by providing evidence from an Asian country. In addition, the ongoing CG reform in Malaysia may result in dividend policy being used as a CG tool, especially in an environment where conventional governance instruments have proven unsuccessful with regard to their monitoring function (Tam and Tan 2007). Thus, this study may also provide insights and additional guidance for policy makers in improving the design of CG features. It may further provide new insights into agency issues unique to the Malaysian corporate environment.

Table 5: Random-effects tobit regression explaining the effect of the large shareholders on the level of dividend payout

The results of random-effects panel tobit regression. The sample consists of listed companies on the Bursa Malaysia between 2002 and 2006. The dependent variable, DIVE is total dividends divided by earnings before interest and taxes but before extraordinary items. DEBT is total debt over total assets. INV is the ratio of market capitalization to total assets. ROA is the ratio of earnings before interest and taxes to total assets. SIZE is the natural log of total assets. RISK is the standard deviation of the monthly share return. LARGEST is the proportional holding of the largest shareholder. SECOND is the proportional holding of the second largest shareholder. SECOND5% is a dummy variable equal to 1 if the second largest shareholder holds equal or more than 5 percent of the company's paid capital. *, ** and *** denote 10%, 5% and 1% significance level respectively.

	DIVE											
	1			2			3			4		
Variables	Coeff.	Z-stat		Coeff.	Z-stat		Coeff.	Z-stat		Coeff.	Z-stat	
INTERCEPT	-1.946	-2.05	**	-2.076	-2.18	**	-2.228	-2.32	**	-2.567	-2.66	***
DEBT	-1.138	-2.57	***	-1.050	-2.37	**	-1.020	-2.30	**	-1.169	-2.63	***
INV	-0.022	-0.21		-0.039	-0.38		-0.037	-0.35		-0.046	-0.43	
ROA	2.137	2.86	***	2.053	1.84	***	2.061	2.78	***	2.001	2.71	***
SIZE	0.164	2.38	**	0.134	1.93	*	0.132	1.90	*	0.119	1.71	*
RISK	-3.664	-3.33	***	-3.451	-3.14	***	-3.407	-3.10	***	-3.251	-2.98	***
LARGEST				1.233	2.57	***	1.321	2.72	***	1.697	3.43	***
SECOND							1.142	1.18				
SECOND5%										0.632	4.07	***
SQLARGEST												
Year dummies	Yes			Yes			Yes			Yes		
Industry dummies	Yes			Yes			Yes			Yes		
No. of observations	1225			1225			1225			1225		
Left-censored observations	387			387			387			387		
No. of firms	245			245			245			245		
Wald test	53.68		***	60.41		***	61.76		***	75.82		***
Log-likelihood	-1733.488			-1730.169			-1729.473			-1721.792		
Sigma u	1.070			1.070			1.068			1.077		
Sigma e	1.341			1.337			1.337			1.324		
Rho	0.389			0.391			0.390			0.398		

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