Corporate Governance Characteristics and Operating Cash Flow as Determinants of Dividend Payout: Evidence from Pakistan

Waleed Malik
School of Accounting and Finance
Faculty of Management Studies
University Of Central Punjab
Lahore, PAKISTAN

Ali Raza Sattar
FCCA, UAECA, APFA
Lectuere City University
College of Ajman, UAE

Abstract

Grounded in the agency theory as underpinning, the current study designed to examine the Corporate Governance Characteristics and Operating Cash Flow as Determinants of Dividend Payout in Pakistan. The statistical population included a non-financial sector companies in Pakistan Stock Exchange for the period of 2017. A quantitative data collection was to be analyzed and compares the effects on the selected variables. Data analysis was carried out with the help of SPSS 22. The Ordinary Least Square (OLS) method was to be applied to record their observation of the theory variables. The purpose of this study showed that Corporate Governance Characteristics such as board size, CEO duality, individual ownership and managerial ownership and operating cash flow including firm size with form of dividend payout in Pakistan listed companies.

Keywords: Corporate Governance Characteristics, Operating Cash flow, Dividend Payout, Ordinary Least Square, Pakistan

Introduction

Dividend is an investment segment for every shareholder who invests in the company. Moreover, shareholders predict the future in the light of past and present activity of the board(Grosvold, Rehbein, & Baker, 2015). Dividends provide a distinctive diversification among the investors. Furthermore, changes in dividend policies over time may change the investor's subsequent behavior regarding investment decision(Caoa, Du, & Hansen, 2017). Dividends help to scrutinize the interests of managers and investors by reducing the free cash flow within the firm (Biswas & Benjamin, 2017). Consequently, align corporate governance role whereas, large cash flow may leads to managerial discretion and agency problem(Lin & Lin, 2016).

Myers (2000) argued that organizations pay dividend which may invite the outside financing from banks and adequate to hold external stakeholders payments in a stipulated time period while paying dividend. In this sense a dividend is a pre-responsibility tool. Where arm's-length financial specialists need to control over directors, a high dividend payout diminishes the organization expenses of free income and powers the firm to associate with the capital market for supporting future developments.

Every investor around the globe is interested in secured investment by ensuring the financial condition of the company(Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). In addition to this, companies across the globe now rapidly growing, increasing profits by attracting investors and result to increase shareholder's wealth (Kajola, Desu, & Agbanike, 2015). On the other hand, companies fail to maintain good financial position, they start losing investors' attention and result in capital reduction (Kanwal & Hameed, 2017).

Corporate governance may vary company to company from all across the globe (Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). This study examined that additional corporate governance characteristics and other regulatory measures are mitigating the dividend payout in the light of agency theory. However, corporate governanace is especially designed to protect the interest of shareholders(Brickley, Smith, & Zimmerman, 2003).

The role of board has gained attention for many decades in relation with dividend but result so far has been mixed. Board member improves the board's capability to think about a more extensive scope of alternative option and achieve more compelling decision. Conversely, these advantages would just be show if the contrasting perspectives of board members are joined into board verbal confrontations and decisions(McGuire & Taylor, 2017).

CEO is the chief cognizer and decision maker in the firm. He is the key responsible for setting goals, strategies plans for the firm, and additionally the obligation regarding directing activities that will understand those plans (Gioia&Chittipeddi, 1991; Calori, Johnson, &Sarnin, 1994). CEO Duality is the characteristic of powerful structure of the corporate board and is a fundamental variable of its output (Mallette & Fowler, 1992). The dichotomous idea of the CEO duality develop, joined with the solid and differentiating empirical findings that every theory makes, would appear to allow researchers to preclude one theory and maintain another with only one critical finding(Elmagrhi, Ntim, Crossley, Malagila, Fosu, & V.Vu, 2017). Apart from that, the prior study shows a negative association identified that CEO and chairman are distinctive view for dividend payout decision in Chinese firms (Zhang, 2008).

Individual shareholding is an unfavorable position because of less proxy in shareholding meetings. The in-activism of individual shareholders probably results less dividend as well as less monitoring for management performance(Xu & Wang, 1999). Individual shareholders are less preference to dividend paid stock because of tax penalties(Redding, 1997). Many studies have been found a negative relationship with dividend payout (Thanatawee, 2013; Riaz, Liu, & Ahmad, 2016).

Managerial ownership is an important internal control characteristic of corporate governance which has been contended to be a component and determinant of risk which owned and absorbed by the firm owner(Chen & Steiner, 1999). Managerial ownership engaged in reducing the conflict between external shareholder and the management. The important finding is steady with the conclusion that managers increase their own personal wealth in their firm and common stock levies lower diversification cost. This gives new dilemma to be predictable as agency cost.

Cash flow from operating activity is one of the most important components of cash flow statement which shows the daily inflow and outflow of the firms. Moreover, greater cash flow generated from operating activity with influence the higher level of certainty to pay the divided (Lin & Lin, 2016). Cash flow is the helpful variable to sort out the relationship between investment and dividend(Lin & Lin, 2016). Hashemi and Zadeh (2012) result identified that positive relationship between cash flow and dividend payout.

The size of the firm is an essential factor in deciding to pay dividend by a firm because of the idea known as economies of scale which can be found in the customary neo traditional perspective of the firm (Doğan, 2013). Giant firms have more competitive threat as compare to smaller firms. In such situation, big firms have requires a huge capital to invest, more product diversification, huge market share, more opportunities for the investor to gain benefit of its investment in terms of dividend, bonus shares, preference shares. It becomes cash flow are more stable (Fama& French, 2001;Denis & Osobov, 2008).

Problem Statement

Dividend is the one of the most strengthen character of every shareholder who invests in the company especially in third world countries like Pakistan. Many financial economists have conducted research on dividend policy with applying different models but the issue remained inconclusive and unresolved for last four decades (Kanwal & Hameed, 2017). Therefore, inconsistencies and contradictions in results create sufficient justification for conducting research on the topic. Along with that there are a lack of studies in connection with corporate governance characteristics (board size, CEO duality, individual ownership, managerial ownership) and operating cash flow including control variable (firm size) on dividend payout in public listed companies of Pakistan. Thus, to fill the current negated this study is being conducted to fill the gap in the body of knowledge by studying board size, CEO duality, individual ownership, managerial ownership and operating cash flow including control variable (firm size) on dividend payout.

Literature Review

Controversies exist among several previous studies which were limited in scope and research is conducted on several topics on dividend payout from across the globe which was claimed that dividend behavior may change time to time for shareholder point of view (Ajanthan, 2013; Florackis, Kanas, & Kostakis, 2015; Abdelwahed, 2016; Atmaja, 2016; Mulyania, Singh, & Mishrab, 2016; Riaz, Liu, & Ahmad, 2016; Caoa, Du, & Hansen, 2017).

Dividend Payout

In this modern era, investor thought have varied according to his investment. Majority shareholders invest in different companies as portfolio to obtain different benefits to the companies in shape of bonuses, right shares, preferrence shares, and dividend (cash and stock). Majority companies are more preferrence to distribute dividend amongs investors(Brown & Roberts, 2016).

Dividend payments encourge information transmission, promising suppliers fund that management diverting cash ouflow not for the sake of personal benefits, also examining the capital market to keep the shareholders with them while raising the external capital(Ghosh & Sun, 2014). Moreover, Dividend payments have created a conflict between corporate managers and shareholders because managers are on the right they could effort for the company growth as to retain more benefit and to control more resources in it but profit sharing has distributed among shareholder this could change the goal of managers and creates agency conflict between them(Ullah, Fida, & Khan, 2012).

Corporate Governance Characteristics

Board size

The size of board of director is a key factor in corporate governance that controlled and governed in a company. Several researchers have different critics on board size in relation with dividend payout behavior from across the globe. Corporate Governance Codes stipulate boards not to be too large and a perfect size of board is between 5 to 16 contingents upon the size and enlargement of the organization(Yasser, Entebang, & Mansor, 2011). Board size of the company has positive correlation with dividend payout(Kaddumi & Al-Kilani, 2015). Higher the size of the board could pay higher dividend to its shareholder in Amman Stock Exchange which may results to attract more investor leads more ownership dilution.The main corporate governance characteristic, board size has shown volatile correlation with dividend payout (Abor & Fiador, 2013;Arshad, Akram, Amjad, & Usman, 2013;Nuhu, 2014).

CEO duality

The CEO duality contains both positions of CEO and chairman in the firm. The CEO duality could work for the benefit of firm to maximize the shareholder wealth but CEO behavior varied when he appointed for both positions in the firm. Thus, it could be considered as factor to effect the dividend payments. The prior studies show both negative and positive correlation between CEO duality and dividend payout across the globe especially developing nations have very common practices of CEO duality due to popularity of family ownership(Abor & Fiador, 2013;Elmagrhi, Ntim, Crossley, Malagila, Fosu, &Vu, 2017;Ahmad, Rashid, & Gow, 2017).

Individual Ownership

Individual ownership belongs to the individual asset or property. Individual ownership is the whole responsible for all losses and profit in the business. They have a pros and corns of individual ownership in the firm performance by considering the researcher study with dividend payout in the firm. The previous study examined that coefficient on the individual ownership has negative association with dividend payments in Thailand as a sample of 1,927 observation for the period of 2002-2010(Thanatawee, 2013). In addition to this, the study showed a insignificant relationship between individual ownership and dividend payout as a sample of 100 non financial listed companies at Karachi Stock exchange by using ordinary least square method(Ehsan, Tabassum, & Nasir, 2013). Furthermore, the study found that individual ownership and dividend payout have negative association because majority of individual investors have more prefer to speculate his profit rather than hold your investment for a longer period for dividend purpose(Mirza & Azfa, 2010).

Managerial Ownership

Managerial ownership belongs to the managers and board of director interest in the firm equity to act as owner and to reduce the exploitation of external stakeholder. Managerial ownership is defined as the number of shares owned by director divided by total number of shares issued by the company (Zabihi & Ghaleb, 2013). Managers may have a more voting power and attempt to more influence the internal gimmick as corporate control. In scenario, counteract has associated with higher level of managerial ownership which affects the lower dividend payout to the shareholder(Florackis, Kanas, & Kostakis, 2015). Many previous studies have a negative association between managerial ownership and dividend payout (Din & Javid, 2011;Gharaibeh, Zurigat, & Al-Harahsheh, 2013;Florackis, Kanas, & Kostakis, 2015)

Operating Cash Flows

The most important components of cash flow statement are the cash flow from operation in which dividend paid to shareholders with same proportion. Companies have a greater cash flow generated from daily activity of the operations with affect higher dividend paid to the shareholder (Lin & Lin, 2016). The researcher has been considered the cash flow as a most important variable of this study to affect the dividend payout. several previous studies found that there are a significant and positive association between operating cash flow and dividend payout (Mirza & Azfa, 2010;Hashemi & Zadeh, 2012;Manneh & Naser, 2015;Tijjani & Sani, 2016)

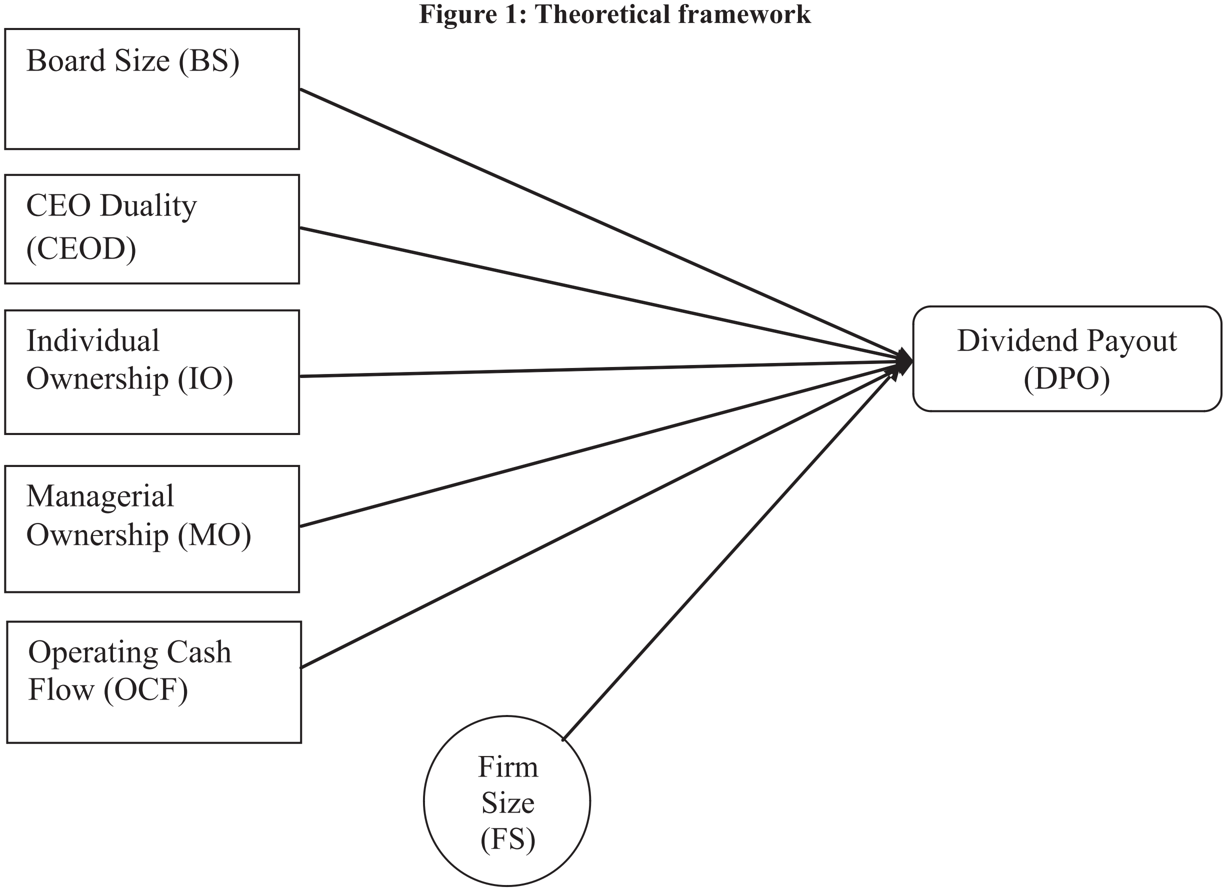
Control Variables

Firm Size

Firm size plays a significant role in determining the dividend payout behavior. Musiega, Alala, Douglas, Christopher and Robert (2013) examined that positive relationship between firm size and dividend payout among non-financial firm on Nairobi stock exchange in Kenya. The firm size has positively and significantly effect the dividend payout in the territory of Nigeria(Abor & Fiador, 2013). The study pointed out that larger firm have a stable and smooth cash flow they more prefer to pay dividend to its shareholder rather to invest in future investment or to retain his profit. On the other side, firm size have significantly negative association with dividend payout as a sample of 23 firm in Ghana Stock Exchange(Bokpin, 2011).

On the basis of these variables that have been highlighted by the literature the framework has been developed. This study is in continuation of agency Theory, and supports the arguments that are raised on the basis of variables. In this study, board characteristics and operating cash flow represented as an independent variable including firm size as control variable meanwhile the firm's dividend payout represented as the dependent variable. These independent variables are supported by agency theory as underpinning theory but operating cash flow is the main contribution of this study.

Figure 1: Theoretical framework



Hypothesis Development and Methodology

Research Hypotheses

The following hypotheses have been developed between the variables:

Ha1: There is a significant relationship between board size and dividend payout

Ha2: There is an insignificant relationship between CEO duality and dividend payout

Ha3: There is an insignificant relationship between individual ownership and dividend payout

Ha4: There is a significant relationship between managerial ownership and dividend payout

Ha5: There is a significant relationship between operating cash flow and dividend payout

Ha6: There is a significant relationship between firm size and dividend payout

Research Methodology

The purpose of the study is to identify the relationship between corporate governance characteristics and dividend payout by using Ordinary Least Square (OLS) method as a best approach to examine thisstudy. This study hypothesis can be evaluate with quantitative data analysis as in this study apply quantitative data collection rather than qualitative data collection because it will explain the numerical outcomes in more favorable and conclusive form.

The data needed for the study has retrieved and collected from the company's annual reports that are available on the PSX and companies' official website in Pakistan. In this study, the data that the researcher collected has analyzed by using the SPSS 22 software.

The total number of companies listed on Pakistan Stock Exchange is 581 including all sectors. In this study used only non-financial sector companies that are 511. From 511 companies, the researcher has choose only 100 largest companies that measured by the natural logarithm of total asset from all non-financial sector companies which have larger capitalization at the end of year 2017.

The descriptive analysis is to be performed regarding the data mean, minimum, maximum and the standard deviation for each variable of the sample that has been chosen by the researcher in the present study. In order to check the reliability of the instrument Cronbach's alpha has been applied. Further, correlation matrix and linear regression analysis were to be applied in order to examine the relationship between corporate governance mechanism and operating cash flows with dividend payout by using Statistical Package for the Social Sciences 22 (SPSS).

Table 4.1 Summary of Descriptive Statistics,MulticollinearityTest, Correlation Matrix

Model	Mean	SD	VIF	DPO	OCF	CEOD	BS	MO	IO	FS
DPO	0.3907	0.28817		1.000						
OCF	0.1157	0.13327	1.071	.394	1.000					
CEOD	0.0300	0.17145	1.025	-.039	.005	1.000				
BS	7.3300	1.70593	1.068	.071	.060	.096	1.000			
MO	17.5821	24.0796	1.224	.238	.146	.032	-.016	1.000		
IO	22.4952	15.6022	1.225	-.289	.180	-.101	-.039	-.097	1.000	
FS	10.3076	0.55686	1.448	.330	.005	.009	-.211	.390	.365	1.000

Proposed Equation

$DPO = \alpha 0 + \beta 1\ BS + \beta 2\ CEOD + \beta 3\ IO + \beta 4\ MO + \beta 5\ OCF + \beta 6\ FS + \varepsilon$

Findings and Discussion

The table 4.1 above shows, the mean and standard deviation of the variables, VIF for all variable values is less than 10 it means all independent variable are in the range and free from multicollinearity problem, the correlation matrix shows that managerial ownership has a positive and small correlation with the dividend payout, result at 0.238 respectively. The board size has a positive and small correlation with the dividend payout, result at 0.071 respectively. On the other hand, operating cash flow and the control variable firm size has a positive and medium correlation with the dividend payout, result at 0.394 and 0.330 respectively. It is significant at 5%. It means that four variables have significant correlation with the dependent variables in this study.

On the other hand, the CEO duality, individual ownership has a negative correlation with the dividend payout. The negative correlation has revealed between the CEO duality, individual ownership at -0.039, -0.289 respectively, and both are not significant with the dividend policy on the 100 largest non-financial listed companies in Pakistan Stock Exchange in 2017

Table 4.2 *Summary of Linear Regression Analysis*

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.710	.581		-1.221	.225
BS	.021	.015	.124	1.997	.010
CEOD	-.030	.151	-.018	-.1966	.845
IO	-.002	.002	-.133	-1.355	.179
MO	.031	.001	.088	2.001	.022
FS	.121	.055	.234	2.199	.030
OCF	.693	.198	.320	3.500	.001

The table 4.2 above displays the result for the coefficient of linear regression on the sample of data in the present study. It shows that if the board size increases by one, the dividend payout has increased by 0.021, t value above 1.96 is 1.997 and significance value below 0.05 is 0.01. For CEO duality, if it increased by one, the dividend payout has decreased by 0.030, t value is -0.196 and significance value is 0.845 which is above 0.05. If individual ownership increased by one, the dividend payout has decreased by0.002, t value is -1.355 and significance value is 0.179.

For managerial ownership, if it increased by one, the dividend payout has increased by about 0.031, t value is 2.001 and significance value is 0.022. If operating cash flow increased by one, then the dividend payouthasincreasedby0.693, t value is 3.5 and significance value is 0.001.Finally, if firm size increases by one, then the dividend payout has increase by 0.121, t value is 2.19 and significance value is 0.030.

Conclusion

By summarizing all the discussion which we made above, all of the variables have been found to have a positive and negative relationship with the dividend, and it is insignificant except the relationship of operating cash flow and firm size that have a significant mark. The findings indicate that the largest number of board size in the 100 companies in Pakistan Stock Exchange would affect the dividend payout. Even though the relationship is not strong, but by appointing the large number of boards in a company, it can secure the interest of shareholders as the boards have search for higher dividend payment.

In the future research, the longer period of data sample is recommended because in this study, the researcher only covers the one year period. The researcher also covers only 100 largest companies' data to analyses the study. Future research must aim to increase the number of companies and can focus on, such as 100 largest companies and 100 smallest companies in order to examine the difference result between large companies and small companies and also give the recommendation to Pakistan Stock Exchange by intimate the companies to upload the financial on time for retrieve and ease for the future researchers. Besides that, the future research also can increase the number of variables in the study and add more corporate governance variables in order to know the latest relationship with the dividend payout.

References

Abor, J., & Fiador, V. (2013). Does Corporate Governance explain Dividend Policy in Sub-Saharan Africa?

International Journal of Law and Management,, 55, 201-225.

Biswas, P. K., & Benjamin, S. J. (2017). Board gender composition, dividend policy and cost of debt: The implications of CEO duality. Financial Markets and Corporate Governance, 1-22.

Bokpin, G. A. (2011). Ownership structure, corporate governance and dividend performance on the Ghana Stock Exchange. Journal of Applied Accounting Research, 12(1), 61-73.

Brickley, J. A., Smith, C. W., & Zimmerman, J. L. (2003). Corporate governance, ethics, and organizational architecture. Journal of Applied Corporate Finance, 15, 34-45.

Brown, T., & Roberts, H. (2016, December). Agency theory, corporate governance and dividend payout in New Zealand. Asia-Pacific Research Exchange, 32.

Caoa, L., Du, Y., & Hansen, J. Ø. (2017, October). Foreign institutional investors and dividend policy: Evidence from China. International Business Review, 26(5), 1-12.

Chen, C. R., & Steiner, T. L. (1999). Managerial ownership and agency conflicts: A nonlinear simultaneous equation analysis of managerial ownership, risk taking, debt policy, and dividend policy. The Financial Review, 34(1), 119-136.

Doğan, M. (2013). Does firm size affect the firm profitability? Evidence from Turkey. Research Journal of Finance and Accounting, 4(4), 53-59.

Ehsan, S., Tabassum, N., & Nasir, R. (2013). Insider and individual ownership structure influence on dividend payout policy of the firms: (A case from Pakistan's KSE 100 index listed firms). Proceedings of the Northeast Business & Economics Association, 4p, 73-76.

Elmagrhi, M. H., Ntim, C. G., Crossley, R. M., Malagila, J. K., Fosu, S., & V.Vu, T. (2017). Corporate governance and dividend pay-out policy in UK listed SMEs: The effects of corporate board characteristics. International Journal of Accounting & Information Management, 25(4), 459-483.

Florackis, C., Kanas, A., & Kostakis, A. (2015, March). Dividend policy, managerial ownership and debt financing: A Non-parametric perspective. European Journal of Operational Research, 241(3), 1-38.

Ghosh, C., & Sun, L. (2014). Agency cost, dividend policy and growth: The special case of REITs. The Journal of Real Estate Finance and Economics, 48(4), 660-708.

Grosvold, J., Rehbein, K., & Baker, P. (2015). Predicting board decisions: Are agency theory and resource dependency theory still relevant? Academy of Management Proceedings, 1, 121-155.

Kaddumi, T. A., & Al-Kilani, Q. A. (2015). Apropos of accounting information indicators as determinants of cash dividend policy decision: A comparative study on Amman Stock Exchange (2001-2013). International Journal of Economics and Finance, 7(4), 135-145.

Kajola, S. O., Desu, A. A., & Agbanike, T. F. (2015, June). Factors influencing dividend payout policy decisions of Nigerian listed firms. International Journal of Economics, Commerce and Management, 3(6), 539-557.

Kanwal, M., & Hameed, S. (2017). The relationship between dividend payout and firm financial performance. Research in Business and Management, 4(1), 1-13.

Lin, D., & Lin, L. (2016). How does corporate governance affect free cash flow? Journal of Applied Finance and Banking, 6(3), 145-156.

Mallette, P., & Fowler, K. (1992). Effects of board composition and stock ownership on the adoption of "poison pills.". Academy of Management Journal, 35, 1010-1035.

McGuire, J., & Taylor, E. (2017). Board of director and committee diversity and firm financial performance. Academy of Management Proceedings, 1, 1-10.

Mirza, H. H., & Azfa, T. (2010). Ownership Structure and Cash Flows as Determinants of Corporate Dividend Policy in Pakistan. International Business Research, 3(3), 210-221.

Porta, R. L., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2000). Investor protection and corporate governance. Journal of Financial Economics, 58(1-2), 3-27.

Redding, L. S. (1997). Firm size and dividend payouts. Journal OF Financial Intermediation, 6, 224-248.

Thanatawee, Y. (2013). Ownership structure and dividend policy: Evidence from Thailand. International Journal of Economics and Finance, 5(1), 121-132.

Ullah, H., Fida, A., & Khan, S. (2012). The Impact of ownership structure on dividend policy Evidence from emerging markets KSE-100 index Pakistan. International Journal of Business and Social Science, 3(9), 298-307.

Xu, X., & Wang, Y. (1999). Ownership structure and corporate governance in Chinese stock companies. China Economic Review, 10, 75-98.

Yasser, Q. R., Entebang, H., & Mansor, S. A. (2011). Corporate governance and firm performance in Pakistan: The case of Karachi Stock Exchange (KSE)-30. Journal of Economics and International Finance, 3(8), 482-491.

Zabihi, A., & Ghaleb, R. (2013). Investigating the effect of ownership structure and cash flows on the dividend policy in accepted companies of Stock Exchange of Tehran. Interdiciplinary Journal of Contemporary Research In Business, 5(6), 102-114.

Zhang, H. (2008). A comparison of Chinese firms listed in Hong Kong and in the mainland. China Economic Review, 19(3), 437-459