The Impact of Board Composition and Ownership Structure on Dividend Policy in Pakistan

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Abstract:

The purpose of this study is to investigate the relationship of ownership structure and board composition with the dividend policy in Pakistan. In order to obtain the objective, ownership structure and board composition were taken as independent variables while dividend payout ratio as dependent variable. A sample of 18 companies listed at Karachi Stock Exchange from 2008 – 2012 selected from Cement Industry of Pakistan. Multiple Regression model is used to regress the explanatory variables. The result revealed that there was positive significant relationship of individual ownership and insider ownership with dividend policy. Board size, Board independence and Institutional ownership were statistically found insignificant relationship with dividend policy.

Key words: Board composition, ownership structure, Dividend policy

1.0 Introduction:

The policy of dividend is concerned with financial policies regarding how much pay the cash to shareholders out of firm profit. In the time of excess cash exist and no more needy by the company then managers of the company is decided pay the cash to the shareholders in shape of dividend otherwise to again purchase the shares of the company in the way of a share buyback program. Some companies issue the right shares rather than pay cash dividend.

Dividend policy is challenged for management and board of directors of the firm for the reason that the thought of any investors have different about current divided and expected gain on capital. The dividend payment decision is very important for corporate finance management and board of directors. The existing cash dividends are very few risky than gain on capital which is received in future.

If the firm pays the dividend to its shareholders then shareholders reinvest in shape of purchase new shares of the firm. If firm do not pay the dividend to the shareholders out of profit and keep the retained earnings for new investment they should be keep in mind the return of that investment to be equal the risk of that investment because other investments have high risk (Walter modal). The dividend is a good way for express the company’s information spread in the market. Dividend can diminish the agency conflict between management and shareholders and reduce the agency cost through communicate the information in the market.

Agency theory The concept of agency theory is that dividend payment become the reason of creating conflicts among the managers and shareholders of the firms because the motive of managers are to retain resources instead of paying dividends to the shareholder and on the other side share holder prefer dividend instead of retain earning. According to the point of view of shareholder if amount of
The dividend is not provided to the shareholder, probably it might be use manager for personal use instead of investing in profitable projects.

Corporate governance is also very important tool for reduce the cost of agency problem as an outcome it affect the company’s policy of payout. Corporate governance is combination of method which include laws and different ways for manage the any organization's operations and it’s finally function to increase the performance of firm and decrease and reduce the cost of agency conflict. Through corporate governance to protect shareholder’s benefits and have more reliable impact on the policy of dividend in which the company take the decision on dividend.

Further accurately the main impact of the corporate governance is board composition in which includes directors. In Pakistan the directors of the board does not more work on policy of dividend. The board of directors act a very vital job for resolving the issue of dividend policy. in corporate governance directors of the board is very big part all decision takes by board about the performance of the business. Dividend policy is very big decision for the board.

The corporate ownership structure in Pakistan is extremely determined. The majority of owners of the corporations in the Pakistan is a single person held the ownership of the business or most companies’ ownership held by one family which is particular.

Pakistan tax situation will change in developed countries. Revenue from Sale of shares of the capital gain is exempt from tax. On the other hand, the 10% withholding tax is levied on dividend income, such as a block of individual shareholder income Dividend income is taxed independently. In this way, capital gains dividends for individual investors suffer adverse tax system, the difficulty of choosing to give up the double taxation of dividend income.

Bird-in-the-hand theory Gordon (1962) in Bird-in-the-hand theory argued that outside shareholder prefer the large amount of dividend policy. They prefer today higher uncertain capital gain from a questionable future investment.

1.1 Problem Statement:

Today’s the institutional owners and individual owners demanding the high dividend from the companies and the insider owners did not demand the dividend and reinvest the profit of the companies in new projects besides the factors of the positive or negative NPV (net present value). The structure of ownership is very complex in Pakistan. This recent study is help to the companies what type of ownership and board should be which is suitable for the companies. In this situation the role of board composition is very important because the board is decided that dividend pay or not. The agency problem can be creating between investors and management.

1.2 Objectives of the Study:

- To check the relationship of board size with the dividend payout ratio.
- To find the association of board independence with the dividend payout ratio.
- To discover the linkage of individual ownership with the dividend payout ratio
- To ensure the connection of insider ownership with the dividend payout ratio
- To verify the relationship of institutional ownership with the dividend payout ratio

2.0 Literature Review:

Arshad, Akram, Amjad and Usman (2013) conducted the study in published paper that is ownership structure and dividend policy. In this study they take the variables dividend payout ratio and dividend decision as a dependent variable. The independent variables were individual, insider and institutional ownership, CEO duality, board size, Board Independence, Size of Firm, Leverage return on asset and return on equity. and they used the models that is ordinary least square (OLS) and regression model in this study finding Effect of Board Size on Dividend Payout Dividend Decision insignificant Return on Equity and Growth on Dividend Decision Significant Leverage on Dividend Decision insignificant Return on Equity and Growth on Dividend payout significant Leverage on
Dividend payout insignificant and conclusion was The finding in this paper that CEO duality have affect on the firm’s dividend policy. The board size has no significant effect on the firm’s dividend policy. Dividend payout had a positive relationship with size leverage and ROE. But on the other side shows a negative relationship with growth ROA and CEO Duality.

Al- Gharibeh, Zurigat and Al-Harahsheh, K.(2013) researched the study in published paper that is effect of ownership structure on dividend policy. in this study they take the Dividend policy and proxy variable dividend payout ratio and as a dependent variable. The independent variables were managerial, institutional ownership and control variables Size of Firm Profitability Leverage free cash flow. And they used Full adjustment modal and partial adjustment modal. in this study finding Institutional ownership is positively linked to the dividend payout ratio Managerial ownership is negatively linked to the payout ratio.

Odia and Ogiedu (2010) conducted the study in paper that is payout policy agency conflict and corporate governance in Nigeria. In this study they take the dividend payout as a dependent variable. The independent variables were Firm size Directors shareholding Directors salaries and compensation Leverage Research and development Cash flow investment opportunity Institutional ownership CEO ownership .and they used the models that is ordinary least square (OLS) model. in this study finding Investment opportunity and leverage have significant effect on the dividend payout and conclusion was The investment opportunities and leverage has positive and significant association with the dividend payout. The insider’s ownership and institutional ownership have positive and non-significant association with the dividend payout. The cash flow and growth of firm’s sales has negative and non-significant association with the dividend.

Warrad, Abed, Khriasat and Al-Sheikh (2012) conducted the study in published paper that is the effect of ownership structure on dividend policy. in this study they take the Dividend policy as a dependent variable. The independent variables private ownership Family ownership foreign ownership Government ownership .and they used the models that is regression model. In this study finding the foreign ownership show significant effect on dividend payout and conclusion was the estimated results show the empirical results reveal that there is no relation between Private ownership, government ownership, foreign ownership structure and the dividends policy measured by Tobin’s Q

Merzaei (2012) conducted the study in published paper that is A survey on relationship between ownership structure and dividend policy in Tehran stock exchange. in this study they take the dividend policy as a dependent variable. The independent variables were ownership structure, institutional ownership foreign ownership managerial ownership. and they used the models that is multiple linear regression modal. In this study finding No significant between managerial ownership and dividend per share and conclusion was Negative relationship between institutional ownership and dividend per share

Hommel (2011) conducted the study in published paper that is the impact of ownership structure on dividend policy in Netherlands firm. In this study they take the dividend payout as a dependent variable. The independent variables were managerial ownership, a institutional ownership and investment government ownership. And they used the models that is ordinary least square (OLS) regression and signalling model. In this study finding the ownership variables, some evidence is found. In model 5, both current and lagged managerial ownership show a negative correlation significant at the 1% level. For non-institutional ownership, a negative correlation significant at the 5% level is found in models 2, 4 and 9, significance at the 1% level in model 6. For institutional ownership, no significant results could be obtained. .and conclusion was the purpose of this study is to explore the implications of the Free Cash Flow hypothesis concerning the disciplinary role of managerial and institutional ownership in corporate dividend policy.
3.0 Conceptual Framework:
Independent Variables

- Board size
- Board independence
- Individual ownership
- Insider ownership
- Institutional ownership

Dependent Variable

Dividend payout ratio

4.0 Data and Research Methodology:
The data is collected from secondary sources. The data is taken from the listed companies of Karachi stock exchange. The data is taken from the balance sheets and annual reports of the companies. The data taken from the cement sector of the Karachi stock exchange 2008 - 2012 the sector is consist 21 companies but I took 18 companies for analysis. In this study dividend payout ratio is as a depended variable which is measure from: cash dividend per share / earnings after tax per share. The dividend payout ratio is percentage of earning which is pay to the shareholders in the form of dividend. The independent variables are board composition is measure by two variables one is board size which is measured from: total number of directors in the board the large board size may be effective or not and second is board independence which is measure from: independent non-executive directors / total number of directors in the board the insider board of directors have more information but outsider board of directors have less information about company. In this situation the independent directors may be not efficiently monitoring.

Individual ownership is an independent variable which is measure from: number of shares held by individual / total number of shares. Insider ownership is an independent variable which is measure from: number of shares held by insider / total number of shares. The institutional ownership is a independent variable which is measure from: number of shares held by institutions / total number of shares. Institutional stock holders can be performing like a monitoring tool for managers of corporations. Shleifer and Vishny (1986) and Allen and Michaely (2001) argue that smaller institutional investors are not extra ready and competent to monitor the management of corporation as compared to large institutional investors. Following Short et al (2002), Karathanassis and Chrysanthopoulou (2005).

4.1 Research Hypothesis:
- There is positive relationship between Board size and dividend payout ratio.
- There is positive relationship among the Board independence and dividend payout ratio.
- There is negative relationship between insider ownership and dividend payout ratio.
- There is positive relationship among institutional ownership and dividend payout ratio.
- There is positive relationship between individual ownership and dividend payout ratio.

4.2 Model:
DPR = $\beta_0 + \beta_1 BSIZE_{it} + \beta_2 BINDE_{it} + \beta_3 INDVLOS_{it} + \beta_4 INDROS_{it} + \beta_5 INSOS_{it} + \mu_{it}$

Where:

- $i$ = firm samples which is regularly pay dividend (1,2,3,........)
- $t$ = time period (2008 – 2012)
- $\beta_0$ = intercept
- $\beta = (\beta_1, \beta_2, \beta_3, .......)$ Slope coefficient
- $\mu_{it}$ = error term

**Table No. 1 Descriptive Statistics**

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std.Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size</td>
<td>90</td>
<td>7.00</td>
<td>10.00</td>
<td>7.7333</td>
<td>.94572</td>
</tr>
<tr>
<td>Board Independence</td>
<td>90</td>
<td>.10</td>
<td>.90</td>
<td>.6936</td>
<td>.16504</td>
</tr>
<tr>
<td>Individual Ownership</td>
<td>90</td>
<td>.04</td>
<td>.84</td>
<td>.3251</td>
<td>.22279</td>
</tr>
<tr>
<td>Insider Ownership</td>
<td>90</td>
<td>.00</td>
<td>.8678</td>
<td>.7414</td>
<td>.091450</td>
</tr>
<tr>
<td>Institutional Ownership</td>
<td>90</td>
<td>.00</td>
<td>.37</td>
<td>.0687</td>
<td>.08944</td>
</tr>
<tr>
<td>Dividend payout ratio</td>
<td>90</td>
<td>.00</td>
<td>.57</td>
<td>.0382</td>
<td>.11123</td>
</tr>
</tbody>
</table>

In Table no.1 the results of descriptive statistics of all variables of this study it shows that dividend payout ratio is mean value is 3.8% and its maximum value is 37% and minimum is 0% and standard deviation which is deviate from mean value is 94%. The average board size is 7 members in every company and standard deviation of board size is 94%. The maximum value is 10 and minimum value of board size is 7. The board independence average value is 69% and standard deviation is 16%. The maximum value is 90% and minimum value of board independence is 10%. The average value of individual ownership is 32% and standard deviation is 22%. The maximum value is 84% and minimum value of individual ownership is 4%. The mean of insider ownership is 74% and standard deviation is 9%. The maximum value is 86% and minimum value of insider ownership is 0%. The institutional ownership average is 6.87% and standard deviation is 8.94%. The maximum value is 37% and minimum value of institutional ownership is 0%.

**Table No. 2 Correlations**

<table>
<thead>
<tr>
<th></th>
<th>B size</th>
<th>Board Indep</th>
<th>IndivOwnership</th>
<th>Insidr Ownership</th>
<th>Instit Ownership</th>
<th>DPR</th>
</tr>
</thead>
<tbody>
<tr>
<td>B size</td>
<td>1</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B Indep</td>
<td>.020</td>
<td>1</td>
<td>.008</td>
<td>1</td>
<td>.223(*)</td>
<td></td>
</tr>
<tr>
<td>Indiv Own</td>
<td>-.223(*)</td>
<td>.008</td>
<td>1</td>
<td></td>
<td>.085</td>
<td></td>
</tr>
<tr>
<td>Insidr Own</td>
<td>-.085</td>
<td>.011</td>
<td>-.116</td>
<td>1</td>
<td>.381(**)</td>
<td></td>
</tr>
<tr>
<td>InstitOwn</td>
<td>.381(**)</td>
<td>.242(*)</td>
<td>-.115</td>
<td>.408(**)</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>DPR</td>
<td>-.129</td>
<td>.047</td>
<td>.408(**)</td>
<td>-.037</td>
<td>-.118</td>
<td>1</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

In Table No.2 show the correlations of variables. There is negative and insignificant relationship between dividend payout ratio and board size. The positive and insignificant relationship among the
board independence and dividend payout ratio. The positive and significant relationship between the dividend and individual ownership. There is negative and insignificant relationship with dividend payout and insider ownership. The negative and insignificant relationship in the middle of dividend payout and institutional ownership. The positive insignificant relation among the board size and board independence and board size show the negative significant relationship with the individual ownership. There is negative insignificant relationship of insider ownership and board size and positive significant relation among the board size and institutional ownership. The institutional ownership has positive significant relation between board independence and insider ownership.

Table No.3   Coefficients

<table>
<thead>
<tr>
<th>Mode</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig. Std. Error</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td>B</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>.061</td>
<td>.110</td>
<td>.558</td>
</tr>
<tr>
<td></td>
<td>Board size</td>
<td>-.006</td>
<td>.009</td>
<td>-.053</td>
</tr>
<tr>
<td></td>
<td>Board independence</td>
<td>.012</td>
<td>.050</td>
<td>.018</td>
</tr>
<tr>
<td></td>
<td>Individual ownership</td>
<td>.097</td>
<td>.039</td>
<td>.193</td>
</tr>
<tr>
<td></td>
<td>Insider ownership</td>
<td>.000</td>
<td>.000</td>
<td>.128</td>
</tr>
<tr>
<td></td>
<td>Institutional ownership</td>
<td>-.084</td>
<td>.100</td>
<td>-.067</td>
</tr>
</tbody>
</table>

Table no.3 shows the constant value is 6.1% and shows the positive and insignificant result. The Board size shows the negative and insignificant. The significant positive result of the Board independence. The Individual ownership has positive and significant result. The Insider ownership shows the positive and insignificant result. There is negative and insignificant result of Institutional ownership. In Table No.4 show the results of this study with the help of regression model. F. Statistics show the significant of model. The R Square in this result is 62.4%. It mean that 37.6% other factors can be effect the dividend payout policy.

5.0 Conclusion:

The practices of corporate governance introduce for fine excellence corporate culture in the companies and motivate to the directors and management for protection of investors right in the emerging capital market of Pakistan. Dividend is the most important part of the financial decision of the any company. The company pay the dividend to its shareholders from its profit. The management decide that dividend pay or not. Therefore our study is to empirically address and found the impact of ownership structure and composition of board on the dividend payout ratio of the KSE listed companies in Pakistan from 2008 – 20012. The results show that board size negative impact on the dividend payout. The board independence has positive insignificant impact. If the size of board is large then the company make good decision about payment of dividend to its shareholder. The positive and significant impact of the individual ownership on dividend payout. A negative insignificant
relationship between Institutional ownership and Dividend payout. The one hypothesis accept which is positive relationship between individual ownership and payout ratio and one is reject that is positive relationship among the institutional ownership and dividend policy.

6.0 Recommendation:
The companies should be paid the dividend to the investors because if the investors receive the dividend then they increase their investment in those companies which is paying the dividend. The Government should take interest about dividend and strictly apply the rule on the companies according dividend policy. All investor should be takes the action against those companies they are not paying dividend on regular basis. The following points should be kept in mind when future researchers doing the work on this topic:

- Sample size of same study should be increase in future research.
- Further variables will be needed to find the impact of ownership structure and board composition on dividend policy.
- The researcher should be use the longer period of study for increase the predictability of the research because in this study the data is takes only five year.
- Researchers can increase this study by comparing financial and non financial firms, public and private firms.

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- Afzal, M., and Sehrish, S.,(2009), Ownership Structure, Board Composition and Dividend Policy in Pakistan