Efekt indeksa korporativnog upravljanja na politiku dividendi: Istraživanje pakistanske tekstilne industrije

Effect of Corporate Governance Index on Dividend Policy: An Investigation of Textile Industry of Pakistan

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***Abstract**:* This study empirically observes the impact of corporate governance index on dividend payout policy by using the data on thirty textile firms listed at Karachi Stock Exchange. The data cover the five-year period from 2009 to 2013. The data were gathered from financial statements of all the sample firms. Multiple regression models were used to check the impact of corporate governance on dividend policy. No effect of corporate governance index on firm dividend policy was found, and the largest shareholders also had no impact on dividend payout policy. A significant positive relationship was found between payout policy and stock value. Gross profit margin and operating profit margin had significant positive impact on the firm's dividend payout policy. There is a significant correlation between the firm's performance and payout policy.

Keywords: Corporate Governance Index, Dividend Policy, Textile Industry, Largest Shareholders, Multiple Regression Model

1 Introduction

The term Corporate refers to a larger entity that is split into units different from the owners. Corporation has the right to enter into contracts, take money from people who invest or lend money to people, and it can take legal action against companies or be sued by someone. It pays taxes and also owns some assets. Corporate Governance refers to the formation of policies and constant monitoring of their proper implementation by the members of the administration of an organization. It includes the tools necessary for the balance of power among the members and their primary duty of enhancing the prosperity and possibilities of the organization. Corporate Governance refers to the layout of policies and some regulations through which accountability and purity in the relationships with the company stakeholders are protected by the board of directors. Payout Policy refers to the policy used by the company to find out how much it will pay to the company shareholders.

Corporate governance is an important component in advancing the profitability and growth of firms through achieving allocative efficiency, so that scarce funds are transferred to investment projects with higher returns. Generally speaking, efficiency can be achieved if the investment projects offer higher returns as compared to the cost of capital (Zulkafli et al., 2003). Corporate governance mechanism provides protection to shareholders and other stakeholders, particularly investors. Good governance practices help to increase the share prices that could get higher capital. They also allow for the international investors to lend money and purchase shares in domestic companies (Okpara, 2010).

Schwert (1981) investigated the market reaction to corporate governance mechanism. The author argues that those firms which were greatly affected by such governance practices reacted more profoundly when compared to the firms exhibiting good governance practices. In addition, Larcker, Ormazabal and Taylor (2011) investigated the market reaction to corporate governance practices. They criticize the governance practices for being value-destroying as they found abnormal return, reductions in CEO pay, a number of large block holders, facilitations for institutional investors, and presence of a staggered board.

Dividend payout policy is very important in the company's valuation procedure, but the issue is still insufficiently explored in the countries experiencing a changeover. Dividend policy refers to the decision of dividing the net income of the company into dividends for shareholders and retained earnings. The concept of corporate governance is one of the issues that have attracted the attention of researches and organizations around the world. The development of agency theory and the associated agency problem caused by the difference of opinion between the management and shareholders has given rise to the need for a set of rules, regulations and standards that work to protect the interests of shareholders.

Corporate governance therefore aims to encourage investment by maintaining the rights and interests of all involved parties and, as a result, receives the attention of a lot of international, regional, and local organizations. The firms more able to maintain stable dividend payments are those that are also able to finance their growth opportunities. Thus knowing whether differences in dividend policy across firms can be explained by differences in their corporate mechanisms will help to find out how the implementation of corporate governance can be efficient.

As regards agency theory, Jensen (1986) indicates that, if good investment chances are missing, companies can then relieve issues between the outside and inside stakeholders, meaning that shareholders use this method to manage the discipline. Zwiebel (1996) and Easterbrook (1984) claim the same thing: that the managers' power can be minimized through dividend payouts. Rozeff (1982) examines if agency problems can be minimized by a high level of dividend payouts, as well as if it would be helpful to increase the outside financing at an earlier stage. Faccio et al. (2001) provide proof that dividends can be used by shareholders as a tool to acquire funds from outside shareholders. They advise that payout policies can minimize the misuse of the funds of minority shareholders.

Using the U.S. data, Chae et al. (2009) show that the companies which have greater restraints on external financing move towards decreasing the payout ratio when they have a chance of improvement in the corporate governance. Almeida et al. (2011) suggest that companies having good corporate governance also have a high firm value and better payout policy than the companies with bad corporate governance. Research shows that the companies having good corporate governance very rarely face the cost of taking loan, and that the cost is very low. Bhojraj and Sengupta (2003) examine how the companies with the greatest level of organizational ownership as well as strong external board control gain higher ratings when they issue new bonds on the market. Bae et al. (2012) examine how the shareholders who control the business have a substantial advantage in changing the company's funds into their own funds.

1.1 Problem Statement

The focus here is on investigating the impact of corporate governance on dividend policy. How will corporate governance affect the dividend payout policy in textile firms? When a company makes dividend policy, how do leverage and CGI affect the decision on dividend policy? How can the largest shareholders have impact on the distribution of dividend among the shareholders, and how can we calculate dividends from leverage, profitability and firm size? The firm decides on its dividend payout ratio after covering all expenses and taxes. Domestic investors always prefer to work as directors rather than ordinary shareholders. They always give preference to opening a new company rather than investing their funds in the existing company. The salaries of the directors are larger than those of the other employees of the same qualifications and experience. Company insiders get many benefits, two of which are the most important: they get executive compensation, and they maintain their control of the firm.

1.2 Research Objective

The purpose of this study is to ascertain the connection between corporate governance variables and dividend payout of textile mills in Pakistan. The objective of the research is to build a relationship among corporate governance, profitability, and leverage and payout policy in textile firms in Pakistan.

1.3 Organization of the Study

The remaining part of the study is divided as follows: section two contains a literature review, while section three focuses on the data and research methodology. Section four presents the results, and section five includes the conclusion of the study.

2 Literature Review and Hypothesis

Corporate governance is a "process whereby suppliers of capital (shareholders) attempt to ensure that managers of the firms in which they invest provide a sufficient return. It addresses the agency problem whereby the shareholders (principals) are the ultimate owners of the firm and want to ensure that managers (agents), who are separate from the shareholders, act in the shareholders' best interests rather than the interests of managers" (Foerster and Huen, 2004).

The decision on dividend payout is one of the most important financial decisions for every business organization. Corporate governance can affect the dividend payout decision. There is a controversy about the relationship between corporate governance and dividend payout. L.S. Hwang et al. (2013) said that corporate governance is a positive practice, though the stakeholders cannot achieve their rights in dependent firms because these rights become weaker. Corporate governance enhances payout policy ratio. The authors said that corporate governance has a positive impact on independent firms. In

those firms the rights of stakeholders become stronger and they get their rights easily. The OLS regression model was used, which showed that corporate governance had a statistically positive effect on payout ratio. H. Zhang (2008) examined the effect of corporate governance on dividend policy. He described how Chinese listed companies pay low dividend to shareholders. The author found that there was a negative relationship between board structure and dividend rate.

J.F. Abreu and M.A. Gulam Hussen (2013) compared dividend payout before, during, and after the financial crisis. They found that the impact of size and profitability on dividend payout was positive before, during and after the crisis. F. Lefort and E. Walker March (2005) examined the relationship between corporate governance and market valuation. They found a constructive connection among corporate governance, dividend payout and firm performance.

Foerster and Huen (2004) scrutinized the links between corporate governance measures and stock returns. They highlighted that high governance ranking firms outperform other portfolios. Moreover, the market reacts significantly to governance related information, which means that good governance does matter to Canadian investors. Similarly, González and Muñoz (2004) investigated price reaction to corporate governance announcements. They confirmed that investors react to these governance practices, but the manifestations of their reaction depend on the extension and nature of these types of announcements. Furthermore, Chavez and Silva (2006) studied the corporate governance mechanisms, market reaction and liquidity impact. They depicted how the market price reaction is significant positive when the firm is in its announcement committed to higher transparency and protection of minority shareholders. In addition, shares that have voting rights experience stronger price reaction and liquidity enhancement than non-voting shares. The authors suggested that corporate governance mechanism could be an effective strategy for the countries that have weak provisions for investor protection.

M.A. Halim and A. Bino investigated the link between dividend policy and corporate governance, which is calculated based on the ownership structure. A significant negative correlation was found between the dividend payout ratio and the percentage of capital owned by block holders. K. Gugler and B. Burcin Yurtoglu (2002) analyzed the dividend change announcements in Germany during a specific time period. They found that dividends signal the harshness of the issue between the large, controlling, small owners and outside shareholders. The dividend change announcements give new information about the issue. They used information on the ownership and control structure of the firm to test the rent extraction hypothesis and separate it from cash flow. They found that there was a significant negative impact of wealth in the order of two percentage points for firms. Bushee, Carter and Gerakos (2008) investigated how governance-sensitive institutions are connected with the improvements in shareholders' rights. They also confirmed that low-turnover institutions with preference for small cap and growth companies are prone to be more governance-sensitive. Furthermore, they suggested that common proxies for governance sensitivity do not measure governance preference clearly. Klapper and Love (2004) demonstrated the relationship between governance and asymmetric information and other imperfections that the firm usually faces. They found that corporate governance is highly related to high market valuation and operating performance. They highlighted that countries with weak legal systems are more prone to firm-level corporate governance mechanisms.

Bill B. Francis et al. (2011) researched managers who strongly prefer cash retention or stock repurchase instead of the payment of dividends. Agency problems between corporate insiders and outside shareholders have an impact on dividend payout policy. Managers prefer not to pay dividends or to cut them down. Firms which pay high dividends have a high business level. Allen Michael (1979) studied an important though neglected issue in corporate finance, namely the relationship between firm valuation and dividend payout policy. ***Hypothesis 1:*** *Corporate Governance has a significant impact on Payout Policy.*

3 Data and Methodology

This study uses the data from the period between 2009 and 2013, gathered from thirty textile firms listed at Karachi Stock Exchange of Pakistan. The data consist of annual financial reports published by the Pakistani firms. The dependent variable is dividend policy, while the independent variable is corporate governance. The study also employs seven controlling variables defined in Table 1.

Table 1 Variable Description

Category	**Variable Name**	**Description**
Dependent	Dividend Payout (DPS)	Cash Dividend / Sales
Independent	a. Corporate Governance Index (CGI) b. Largest Shareholders (LS)	a. The sum of shareholder rights, board, disclosure, audit, and payout indices b. Percentage share ownership by largest shareholder
Controlling	a. Operating Profit Margin (OPM) b. Gross Profit Margin (GPM) c. Return on Assets (ROA) d. Return on Equity (ROE) e. Leverage (LEV) f. Stock Value (MBV) g. Size of Firm (LTA)	a. Operating Profit / Net Sales b. Gross Profit / Net Sales c. Net Income / Total Assets d. Net Income / Shareholder Investment e. Total Debts / Total Assets f. Market Value of Common Stock / Book Value of Common Stock g. Logarithm of Total Assets

Regression model is used to analyze the effect of corporate governance on payout policy.

3.1 Model

$$\mathbf{DPS_{it}=\beta_0+\beta_1CGI_{it}+\beta_2LS_{it}+\beta_3LEV_{i,t}+\beta_4ROA_{it}+\beta_5ROE_{it}+\beta_6OPM_{it}+\beta_7GPM_{it}+\beta_8MBV_{it}+\beta_9Size_{it}+\varepsilon_{it}} \ldots$$

DPS is cash dividend divided by sales and CGI is corporate governance index, which is the sum of audit, disclosure, board, payout indices and shareholder rights. LS is largest shareholders, LEV is leverage, ROA is return on assets, ROE is return on equity, OPM is operating profit margin, GPM is gross profit margin, MBV is market value of common stock divided by book value of common stock, and Size is the logarithm of total assets.

4 Empirical Results and Discussion

In this section the study will explain descriptive statistics, Pearson correlation and regression results to analyze the effect of corporate governance on payout policy.

4.1 Descriptive Statistics

Table 2 provides the descriptive statistics results of textile firms listed at Karachi Stock Exchange of Pakistan. The mean value of corporate governance index (the sum of corporate governance variables) is 0.8606 with the maximum value of 1.00 and minimum value of 0.50 for all the sample firms.

The maximum CGI value shows the firms with best practice in corporate governance, and minimum value of CGI indicates the firms with worst practice of corporate governance. The mean value of DPS and LS is 0.3970 and 6.7349 respectively.

Table 2 Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
DPS	0.00	4.00	0.3970	0.8365
GPM	-0.32	0.75	0.1222	0.1333
OPM	-0.06	0.78	0.1158	0.1399
ROA	-0.21	0.61	0.0695	0.1448
ROE	-0.22	3.00	0.4580	0.6118
LS	0.17	4.279	6.7349	5.3481
MBV	0.01	6.161	3.0682	1.1390
CGI	0.50	1.00	0.8606	0.1382
LTA	8.54	10.91	9.5551	0.5637
LEV	0.10	7.03	0.7188	0.8328

The maximum and minimum value of ROA is 0.61 and -0.21 respectively, with mean value being 0.0695. The maximum value of ROA shows firms with good financial performance. The mean value of GPM is 0.1222 and OPM is 0.1158. The mean value of MBV is 3.0682, with the maximum value of 6.1616 and minimum value of 0.010. The minimum and maximum value of LEV is 0.10 and 7.03, with mean value of 0.7188. The LS has the maximum value of standard deviation (5.3481). The mean value of ROE is 0.4580 with the minimum and maximum value of -0.22 and 3.00 respectively.

4.2 Pearson Correlation

Table 3 shows the Pearson correlation among all the variables.

Table 3: Pearson's Correlation Matrix

	DPS	GPM	OPM	ROA	ROE	LS	MBV	CGI	LTA	LEV
DPS	1.000									
GPM	0.231	1.000								
OPM	0.127	-0.080	1.000							
ROA	-0.127	0.190	-0.173	1.000						
ROE	0.077	0.002	0.086	0.829**	1.000					
LS	-0.023	0.025	0.014	-0.008	-0.051	1.000				
MBV	0.859**	0.091	-0.111	-0.122	0.031	-0.033	1.000			
CGI	0.124	0.177	0.296*	0.258*	0.215	0.082	-0.021	1.000		
LTA	-.393**	-0.192	0.053	0.108	0.149	0.032	-.415**	0.306*	1.000	
LEV	-0.051	-0.232	-0.028	-0.142	-0.100	-0.018	0.015	-0.126	0.165	1.000

Note: *Correlation is significant at the 0.05 level and **Correlation is significant at the 0.01 level.

The highest correlation is between the MBV and DPS, which is significant at the 0.01 level of significance. ROE has significant association with ROA at the significance level of 0.01. The CGI has significant correlation with ROA and OPM at the 0.05 level. Firm size has significant negative correlation with DPS and MBV and positive correlation with CGI.

4.3 Regression Analysis

In order to move on to further analysis, the study has considered the major assumptions which are very important in panel data analysis. Table 4 shows the regression outcomes of all the sample firms.

Table 4 displays in regression model that the stock valuation (MBV) (Coef. = 0.779, t= 10.912) has positive relationship with dividend payout at the significance level of 0.01. The results are consistent with F. Lefort and E. Walker March (2005).

Table 41 Regression Results

Dependent Variable: Dividend Payout (DPS)			
Variables	**Coefficient**	**t-statistics**	**p-value**
(Constant)		0.584	0.562
CGI	0.112	1.586	0.119
LS	0.002	0.002	0.971
MBV	0.779	10.912	0.000***
LEV	0.000	-0.150	0.986
GPM	0.190	3.048	0.004***
OPM	0.126	1.727	0.090*
ROA	-0.295	-2.131	0.038**
ROE	0. 275	2.106	0.040**
LTA	-0.083	-1.166	0.249
R^2	0.400		
F-statistics	30.35		

Note: *Significant at 0.10; **Significant at 0.05; ***Significant at 0.01

There is a positive relationship between gross profit margin (Coef. = 0.190, t= 3.048) and dividend payout at the 0.01 level of significance. The interaction between operating profit margin (Coef. = 0.126, t= 1.727) and dividend payout is found to be positive at the level of significance of 0.10. Return on equity (Coef. = 0.275, t= 2.106) has significant positive impact on dividend payout policy, and these results are consistent with J.F. Abreu and M.A. Gulam Hussen (2013). Return on assets (Coef. = -0.295, t= -2.131) has significant negative impact on dividend payout policy, where the results are inconsistent with J.F. Abreu and M.A. Gulam Hussen (2013). Size of the firm has no impact on dividend payout, which is not consistent with J.F. Abreu and M.A. Gulam Hussen. Moreover,

corporate governance index, largest shareholder and leverage have no effect on the payout policy of the firms. The coefficient of determination (R^2) is 0.40 and F statistics is 30.35.

5 Conclusion

This study has empirically observed the impact of corporate governance index on dividend payout policy by using the data of thirty textile firms listed at Karachi Stock Exchange. The data cover the five-year period from 2009 to 2013. The data were gathered from financial statements of all the sample firms. Regression analysis was used to check the impact of corporate governance on dividend policy.

The present study has mainly focused on two issues of corporate governance: first, how the legal environment affects corporate governance instruments and the relationship between corporate governance and firm value; second, what the determinants of corporate governance practices are. No effect of corporate governance on firm dividend policy is found, and the largest shareholders also have no impact on dividend payout policy. A significant positive relationship is found between payout policy and stock value. Gross profit margin and operating profit margin have significant positive impact on the firm's dividend payout policy. There is a significant correlation between the firm's performance and payout policy. Firm size and leverage have no impact on the dividend policy of textile firms. Firms should focus on improving their corporate governance in order to increase the payout policy. Dividend payments reduce the amount of free cash flow available for use at the discretion of corporate insiders, so they help alleviate the exploitation of minority shareholders.

5.1 Policy Implications

Corporate governance index has no impact on dividend policy. Therefore, policy makers should focus on other factors while making their strategic policies to attract investors, and not focus solely on corporate governance.

5.2 Limitations and Future Directions

In further studies, more variables could be incorporated to investigate the impact of corporate governance index on dividend policy. This relationship should be generalized within different economies in order to validate the outcomes.

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