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THE IMPACT OF CORPORATE GOVERNANCE ON DIVIDEND POLICY OF PAKISTAN STOCK EXCHANGE LISTED COMPANIES (A CASE OF CEMENT SECTOR)

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Abstract

Dividend ratio is always a debatable term. Researchers have conducted comprehensive studies on the determinants of dividend payout ratio decisions. Also, currently the practices of corporate governance are one of the major determinants of dividend policy of the company. Corporate governance is the practices, mechanism and system to manage and control the company in a way to protect the shareholder’s wealth in long term specifically and all stakeholders in general. This study investigates to fill the gap that whether the companies that are more focused and involved in the practices of corporate governance declare more or less dividend payout ratio for the investors in Pakistan. To gain the objectives of current study the descriptive form of research design is followed in current study A list of 20 firms in the cement sector on the basis of data available were chosen as the population. While sample includes 18 companies which comprise 80% of the population. The time series for the analysis is from 2009 to 2019 on the basis of data availability on state bank of Pakistan website and annual reports on companies’ website. The current study revealed that board, Audit Board, Constitution of the audit board and CEO Dual position are having a positive relationship with the dividend payout ratio while the Constitution of the board, Director’s ownership and Investment growth are having a negative relationship with the dividend payout ratio. While the Size of Audit Board contributes more to the dividend policy ratio and similarly impact of Size of the board, Constitution of the board, Audit Board, Constitution of the audit board, Director’s ownership and Investment Growth on dividend policy ratio was significant while the impact of CEO Dual position on dividend policy ratio was insignificant. Regarding the implications, the fundamental purpose of any company is the creation and delivery of long-term sustainable value in a manner consistent with their obligations as a responsible corporate citizen, then the firms should therefore view corporate governance not as an end in itself but a vital facilitator to the creation of long- term value for all stakeholders.

Key words: Audit Board, Constitution of the audit board, CEO dual position, Constitution of the board, Director’s ownership and Investment growth

Introduction and background study:

Drawing the Dividend signaling Theory and theory of agency, the significance of the Shareholders interest in a firm can be realized from the ultimate goal of the businesses. That is to increase the wealth of shareholders and to protect the interest of other stakeholders (Van Horne & Harlow, 2009). The shareholders invest and expect more in return. In this case the dividend payout is one of the sources of return. This dividend ratio is always a debatable term. Researchers have conducted comprehensive studies on the determinants of dividend payout ratio decisions (Har & Visvanathan, 2018). If governance system of the companies is poor, it will reduce the efficiency and the firm performance. Thus, currently the practices of corporate governance are one of the major determinants of dividend policy of the company (Hashim, Khattak & Kee, 2017). Corporate governance is the practices, mechanism and system to manage and control the company in a way to protect the shareholders wealth in long term specifically and all stakeholders in general (Achchuthan and Kajananthan, 2013).

In 1999 organization for economic development and cooperation (OECD) introduced the guidelines for better system of corporate governance. These basic guidelines help out different countries to develop their own codes of corporate governance to protect the shareholders wealth. According to the research of Hassas Yeganeh (2008), the need for these codes is triggered due to the disclosure and transparencies issues in various companies affecting the interest of shareholders, for example failure of Enron, WorldCom. Different reports have also been issued to clarify the rules and regulation regarding the system of corporate governance. In 1992 the first report on financial matters was issued by Cadbury committee in UK, and then in 1998 Hampel report was issued that ultimately increased the role of corporate governance practices. The code of the corporate governance in Pakistan was launched in the early 2002. The commission of Pakistan which is related to the security exchange has been involved to implement these codes of corporate governance by arranging different training sessions time to time. The code of corporate governance is amended in 2012 and 2014. It is defined by the International Monetary Fund as the governance which is corporate which include the responsibility as well as the relationship structure within a very important group which includes the investors, board of directors' members as well as the chief executive officer which is directed at the optimal promotion of the competitive operation for the sole purpose of achieving the main vital goal of the company.

Research Gap:

This study investigates to fill the gap that whether the companies that are more focused and involved in the practices of corporate governance declare more or less dividend payout ratio for the investors in Pakistan. The corporate governance practices that were considered in the current study included Size of the board, Constitution of the board, Audit Board, Constitution of the audit board, CEO Dual position, Director's ownership and Investment Growth.

Problem Statement

After dividend irrelevance theory of Miller and Modigliani (1961), this subject become mostly discussed in different research. The high dividend payout ratio is usually declared in developed markets but in developing markets this ratio is sometimes lower and at times it is not even declare. Glen, Karmokolias, Miller, & Shah (1995) suggested through his research that in developing countries the dividend ratio is half or a little more than half of the developed markets. Ramcharran

(2001) identified that the payout ratio is less for investors in developing countries. Pakistan stock exchange is also considered as developing and transition economy markets. In this case corporate governance is the system through which investors trust can be developed and attracts more capital to the market. Previous literature shows the conflicting results related to the influence of the corporate governance on the dividend policy of the firm. Few studies result in the positive and significant relationship (Chae, Kim and Lee, 2009; Hassan, 2010; Adjaoud & Amar, 2011) while others are indicating negative and insignificant relationship of them (Hamdouni, 2012). Some evidences are investigated according to them no statistical relationship is amongst the corporate governance of the firm and the dividend policy (Abdel-Halim and Bino, 2007; Ajanthan, 2013). Black (2001) reports a powerful correlation between the market value and corporate governance of Russian firms and concluded that corporate governance can influence the earnings and ultimately the ratio of dividend of the firm. This study further investigates to fill the gap that whether the companies that are more focused and involved in the practices of corporate governance declare more or less dividend payout ratio for the investors in Pakistan.

Research objectives

The general objective of the current study is to determine the impact of corporate governance practices on dividend payout ratio, while below are the specific objectives of current study;

- To determine the impact of size of the board on dividend payout ratio.
- To investigate the impact of constitution of the board on dividend payout ratio.
- To determine the impact of audit Board on dividend payout ratio.
- To analyze the impact of constitution of the audit board on dividend payout ratio.
- To determine the influence of CEO Dual position on the ratio of dividend payout
- To explore the effect of director's ownership on the ratio of dividend payout
- To determine the impact of investment Growth on the ratio of dividend payout.

Literature Review

This section provides a brief details of agency theory and dividend signaling theory. Accordingly, studies related to dividend policy and impact of corporate governance practices on dividend policy have been critically discussed and evaluated.

Agency Theory

According to Rani and Mishra (2008) Agency theory descried that principal and agent relationship where agents (Management) perform on behalf of principal (shareholders). As shareholders are not directly involved in the management of the company so the management is responsible to make decision that leads to their wealth maximization Myers and Majluf, 1984). Hence the manager's behavior need to be according to the demand of the shareholders. Therefore, there is a debate based on few assumptions.

1: Shareholders and manager's relationship
2: Majority and minority shareholder's relationship

According to the literature the tight implementation of corporate governance can reduce this problem (Vojtech, 2013). First the CEO and chairmen of the board should be separate (Fama, 1980; Fama & Jensen, 1983). The second is the more non-executive directors in the board are important in this perspective. Bebchuk and Fried (2003) added further that different committee role is also important to check and balance their actions.

Dividend signaling Theory

The theory of dividend was first publicized by Stephen Ross and Solomon Ezra in 1977. The signaling theory postulated the market reaction towards the dividend declaration that would be positive with more ratio of payout (John and William, 1985). It gives signal that the company has a good financial performance and management of the company to create this profit (Miller and Rock, 1985).

Corporate governance is a system that ensures the protection of shareholder's long term value and builds their interest in the company so the better the corporate governance the better would be the divided provided to the shareholders of the company Gugler, Klaus Yurtoglu, B Burcin, 2003). The only way to increase the dividend is to maintain the cost and benefit from the profitable opportunities to increase the free cash flow (Grossman and Hart, 1980).

Concept of Dividend Policy

The optimal dividend policy of a firm depends on investor 's desire for capital gains as opposed to income, their willingness to forgo dividend now for future returns, and their perception of the risk associated with postponement of returns, therefore management should not retain income unless they can reinvest those earnings at higher rates of return than shareholders can earn themselves (Brigham and Houston 2009). It is therefore important to note that despite the fact that dividend and retained earning move in opposite directions they still go hand in hand since its not possible to formulate one without having an effect on the other, therefore, a company must strike a balance between the two by finding a dividend payout ratio that will provide sufficient equity to support the capital budget without having to sell new common stock or take the capital structure ratios outside the optimal range.

Impact of CG practices on dividend policy

The below section provides the impact of corporate governance practices on the dividend policy. **Size of the board**

Board size is the number of directors sitting on board in the company (Borokhovich et al., 2005). The large board size will bring more expertise and more knowledge to the board to mechanize the system and protect the shareholder's wealth (Klein, 2002; Basheer,2014). Board size has been studied a lot in different research papers i.e., Ling et al. (2016), and Kachouri & Jarboui (2017). Board size has positive significant effect on dividend payout and its ratio, (Abor and faidor). The research explore in Tehran has found significant relationship between the policy of dividend and the number of board of directors in board. Board size has positive and significant impact on dividend policy. The larger board size companies have high ratio of dividend because of the check and balance over the decisions of chief executive officer by the Board of directors (Belden et al., 2005) and Bokpin , 2011).

Other research indicated that board size has negligible effect on dividend payout ratio (Abdelsalam et al., 2008). Similarly, research conducted in Srilanka hotels showed that board size has insignificant and positive relationship with dividend payout ratio research conducted by Ajanthan, (2013).

Constitution of the board

According to the code of corporate governance 2014 there should be a one third ratio of non-executive directors in board. Fama and Jensen (1983) research derived that the directors monitor the activities of the company on behalf of shareholders and increase its effectiveness and efficiency. It also tends to reduce the agency problems and increase the dividend ratio of the company (Belden et al., 2005). Moreover, Yarram and Dollary (2015) found that Board independence have a significant positive influence on the size of dividend payout.

Audit Board and its constitution

Audit committee size is the number of directors in the audit committee. The group of people who can create value of the firm by implementation of rules and regulations in a real sense. They also ensure that company follows the code of corporate governance practices. Aanu, Odianonsen and Foyeke (2014) argued that Independent and nonexecutive directors are crucial and influence the reporting of financial information of the company. The agency problems are one of the impediments removed by this committee through better evaluation of asymmetry information between shareholders and company managers (McMullen, 1990). Klein (2002) found negative relationship between independent audit committee and companies' earnings. Constitution of the audit committee board has two parties one is executive directors and the other is non-executive directors of the company. The non-executive directors in this board ensure the smooth and true financial reporting to the stakeholders of the company. It also plays role to ensure the risk measurement and control over the company assets. Audit committee is one of the major elements to protect the company from worse situation. Code of corporate governance guides the committee to work independently. The study conducted by Klein (2002) that the non-executive members on board counter check the integrity of financial information. Thus, the management announces more dividends if there is earning. Otherwise, the shareholders can force them after disclosure of the information.

CEO dual position

CEO dual position means that the Chief executive officer also retains the chairman post. The CEO dual position files its relationship with dividend in previous researches (Arshad et al., 2013; Mansourinia et al., 2013; Abor & Fiador, 2013). Arshad at el., (2013) declared in his study about the significant impact of CEO dual position on dividend policy of the firm. Another argument in line with the statement by Obradovich & Gill (2013) that the dividend would be declare more if the CEO retains the dual position of the company. Further added by Schen and Suffian (2014) that the CEO will align the interest of both parties'. i.e shareholders and managers to create more value for the firm and long-term benefits. There are arguments in opposition of the system. Researcher Bolbol (2012) found negative significant relationship of the two variables. The same situation iss in the case of Ajanthan (2013) research whose results are strongly in favor of separate position of the two posts in the company otherwise it will affect and reduce the dividend ration. Mansourinia et al. (2013) argued that it has no relationship at all.

Directors' ownership

The Directors ownership is the portion of shares held by board of directors in the company.

The relationship between director ownership and dividend payout has been found in many literatures. Huda and Abdullah (2013) examine the relationship between director's ownership and dividend payout. The findings were significantly and positively associated with each other. The more the ownership the more would be the dividend payout in the firm. Nor & Sulong (2007) and Thanatawee (2012) conducted the study and find consistent results with previous literature that is positive and significant relationship.

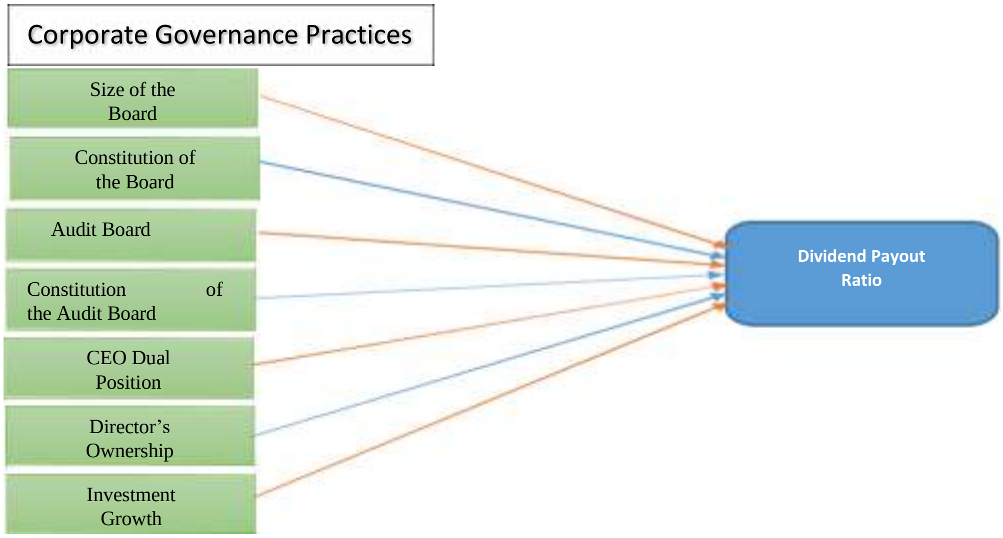
Investment Growth

Investment Growth of the firm can be measured on the basis of the increase in sales as compared to previous year of company (Javid & Iqbal, 2010). Further added that with more investment opportunity the shareholders would prefer investment of the fund instead of dividend payout. La Porta et al. (2000) find in his study that the countries where the investors are fully protected growth have inverse relationship with dividend payout ratio. In case if the investors realize that their wealth are not protected then they would be indifferent about the situations and may creep value wherever they can. This situation depends upon the trust of protection of shareholders rights through better corporate governance practices (Rajan & Zingales, 1998; Durnev & Kim, 2006). Bushman and Smith (2013) pointed out through his research that the better corporate governance with good investment opportunities will lead to lower dividend payout ratio. While studies also provide evidence that dividend payout can reduce the investment opportunity but specifically depends upon the rights of minority shareholders. If they are strong in their rights, they may force the management to declare dividends as much as possible (Kaen, 2003).

Hypothesis

Based on the above discussion, below are the study hypothesis

H1: There is a significant impact of size of the board on dividend payout ratio.
H: There is a significant impact of constitution of the board on dividend payout ratio.
H3: There is a significant impact of audit Board on dividend payout ratio.
H4: There is a significant impact of constitution of the audit board on dividend payout ratio.
H5: There is a significant impact of CEO Dual position on dividend payout ratio.
H6: There is a significant impact of director's ownership on dividend payout ratio.
H7: There is a significant impact of investment Growth on dividend payout
ratio. Conceptual Model based on Theory



Methodology

This part of the article describes the population and sample size of the firm along with the sources and methods of the data to be collected. This part further adds about the dependent and independent variables, proxies, econometric model and statistical techniques to evaluate the data. Since the current study intentions to investigate the influence or impact of the corporate governance practices on the policy of the dividend, therefor the current study adopted the quantitative form of the research to achieve the study objectives. Sample and the population

The study population is linked with the non-financial cement sector companies which is listed on the stock exchange of Pakistan. There are total 22 listed firms in the cement sector of Pakistan, but State bank of Pakistan have provided the list of 20 firms in the cement sector on the basis of data available.

Data collection sources

The secondary data is collected from the annual reports, financial statements, and other relevant documents of the firms and from the website of state bank of Pakistan. The data was collected from the year 2009 to the year 2019.

Research Model

Firms' dividend ratio is evaluated on the basis of corporate governance practices. Thus, that makes the model as follows;

$$= \quad + 1 \quad + 2 \quad + 3 \quad + 4 \quad + 5 \quad + \quad + \quad +$$

Analysis of the Data

The current study aims in investigating the impact of the CG practices on the policy of the dividend. Thus for the reason, the data which was collected from the annual reports and websites of the firms were analyzed via various techniques and statistical analysis.

Correlation Analysis

The correlation analysis depicts that the relationship that is among that of the variables of the study.

Variables	DRatio	SB	CB	SAB	CAB	CEODP	DOwn	IG
DRatio	1							
SB	0.31**	1						
CB	-0.27*	0.32**	1					
SAB	0.33**	0.25**	-0.43*	1				
CAB	0.32*	0.13*	0.54**	0.22*	1			
CEODP	0.31*	-0.19*	0.23**	0.04*	0.43*	1		
Down	-0.10*	0.07**	-0.56*	-0.43**	0.23*	0.23*	1	
IG	-0.11*	0.08**	0.32*	0.12*	0.35	-0.34**	0.33*	1

The above table depicts positive correlation with dividend payout ratio except director's ownership and investment growth indicating a weak negative relationship between the variables.

Regression Analysis

The regression analysis shows the extent of the relationship that is among the variables (Dencker, 2007).

Model Summary

Model	R	R Square	Adj R Square	Std. Error of Estimate	Durbin-Watson
1	0.31	0.24	0.20	0.210	1.61

In the above table, the model summary of the regression analysis is depicted. This tables presents the value of R, R square, the adjusted R square and value of Durbin-Watson. According to the above table, the value of the adjusted R square is 0.20. This value of showing that the corporate governance practices are predicting 20 percent of the variation in the dividend payout ratio.

ANOVA 1

Model	Sum of the Squares	Df	Mean Square	F	Sig.
Regression	14.13	2	3.29	14.2	.000

Residual	15.30	80	0.19	
Total	29.43	81		

a: Predictors: DRatio, SB, CB, SAB, CAB, CEODP, Down, IG

b: Dependent Variable: Dividend Policy Ratio

Coefficients 1

Model	Coefficients	T	Sig	Remarks
(Constant)	.821	4.83	.000	Supported
SB	.064	2.83	.045	Supported
CB	-.053	2.11	.048	Supported
SAB	.085	3.89	.020	Supported
CAB	.071	3.43	.032	Supported
CEODP	.065	3.11	.397	Non-Supported
Down	-.044	1.93	.049	Supported
IG	-.045	1.94	.050	Supported

Conclusion and Recommendations

The current study empirically investigated the impact of the corporate governance practices on the dividend policy ratio. This study revealed that board, Audit Board, Constitution of the audit board and CEO Dual position are having a positive relationship with the dividend payout ratio while the Constitution of the board, Director's ownership and Investment growth are having a negative relationship with the dividend payout ratio. While the Size of Audit Board contributes more to the dividend policy ratio and similarly impact of Size of the board, Constitution of the board, Audit Board, Constitution of the audit board, Director's ownership and Investment Growth on dividend policy ratio was significant while the impact of CEO Dual position on dividend policy ratio was insignificant. These results are also consistent with the precious studies. Board size has been studied a lot in different research papers i.e., Ling et al. (2016), and Kachouri & Jarboui (2017). Board size has positive significant effect on dividend payout and its ratio, (Abor and faidor). The research explore in Tehran has found significant relationship between the policy of dividend and the number of board of directors in board. Board size has positive and significant impact on dividend policy.

Moreover, Yarram and Dollary (2015) found that Board independence have a significant positive influence on the size of dividend payout. This implies that corporate firms in Australia are encouraged by independent directors to pay a higher payout and seek the required funds from capital markets. Aanu, Odianonsen and Foyeke (2014) argued that Independent and nonexecutive directors are crucial and influence the reporting of financial information of the company.

The agency problems are one of the impediments removed by this committee through better evaluation of asymmetry information between shareholders and company managers (McMullen, 1990). Chinese sector companies studied by Pan (2009) on the basis of which it was concluded that the dual position holder will tend to reduce the dividend payout of the company. Other research also suggested negative relationship of the CEO duality and dividend policy of the company (Akram, Amjad, and Usman, 2013). Bushman and Smith (2013) pointed out through his research that the better corporate governance with good investment opportunities will lead to lower dividend payout ratio. While studies also provide evidence that dividend payout can reduce the investment opportunity but specifically depends upon the rights of minority shareholders

Recommendations

In line with the above findings the study recommends that since the fundamental purpose of any company is the creation and delivery of long-term sustainable value in a manner consistent with their obligations as a responsible corporate citizen, then the firms should therefore view corporate governance not as an end in itself but a vital facilitator to the creation of long- term value for all stakeholders. And to enhance the level of influence of Corporate Governance on Dividend Payout Ratio to higher positive level in the Industry, Management equity holding should be increased as this will make the management to protect not only their interest but the interest of all stakeholders.

Theoretical Implications

Agency theory descried that principal and agent relationship where Management perform on behalf of shareholders. As shareholders are not directly involved in the management of the company so the management is responsible to make decision that leads to their wealth maximization. This study contributed the behavior of manager’s need to be according to the demand of the shareholders. Hence the management should focus on the relationship between manger’s and shareholders and importantly the management should maintain the relationship between majority and minority of shareholders in order to flourish the business.

Another contribution relating with the theory of dividend is the market reaction towards the dividend declaration that would be positive with more ratio of payout. This contribution is consistent with the claim of (John and William, 1985). It gives signal that the company has a good financial performance and management of the company to create this profit.

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