

CHAPTER 1: INTRODUCTION

1.1 Purpose and Significance of the Study

Despite widespread research on dividend policy, we still know little about how companies set their dividend policies.

Researches about dividend decisions did not provide a general theory of dividend payments. The dividend policy pattern is also different not only over time but even between developed and emerging markets.

According to a study done by La Porta et Al. (2000), differences in dividend policy across countries can be explained by the variation in legal systems in these countries (La Porta, Lopez de Silanes, Shleifer, & Vishny, 2000).

Many theoretical and empirical researches have attempted to explain why firms are paying dividends. However, there is no unanimous agreement on what factors influence a company's payout policy. This topic becomes even more complicated when it comes to emerging markets.

Fama and French (2001) reported a considerable reduction in dividend payments by publicly traded companies in the US over a 25 year period time. The reason for the decline in dividend payouts is that small, less profitable firms with more growth opportunities never paid dividends (Fama & French, 2001).

Based on previous surveys, the pattern of dividend payments is different not only over the countries, but also between developed and emerging markets. The results indicated that firms in emerging markets pay lower dividends to

shareholders compared to those in developed countries (Ramcharran, 2001).

Emerging markets are different in many aspects from developed capital markets. For example, they have less information efficiency, more volatility and they are smaller in size. Additionally, firms in emerging markets have limited financial resources to invest, which may result in lower payout ratios (Kumar & Tsetsekos, 1999).

In order to have more developed models of dividend policy, a number of theories had been proposed by financial economists, but no consensus has been reached. The determinants of dividend payments, especially in emerging markets, have received little attention.

Emerging markets are growing in size, quality and transparency. They attract investors and fund managers to invest, but the behavior of dividends in these markets have not been studied extensively (Reddy & Rath, 2005).

Dividend policy is not a new subject, but it is still one of the most attractive topics for research in today's corporate finance.

The incentive to do this research is there is a lack of examination about factors influencing dividend payments in the emerging markets. The emerging markets are smaller, more volatile and have less information efficiency; thus, they are different from developed countries. The current researches on how the emerging markets define their dividend policy have had inconsistent results.

Glen et al. (1995) found that emerging markets have targeted dividend payments. However, over time they showed high volatile dividend pay outs, with

the shareholders and government having a significant impact on the dividend strategies.

Aivazian et al. (2003a) examined the country risk on dividend policy of firms in the emerging markets and found that the country factor have had a significant influence on dividend strategies in emerging markets.

Finally, a small number of the studies in the field of dividend policy have used panel data analysis, particularly in case of Malaysia. The limited evidence about dividend decisions in Malaysia is a good justification to do this research. This study intends to examine the determinants of dividend strategy of public listed companies in Malaysia as a case study of an emerging market.

1.2 Research Objectives

The objective of this study is to examine the dividend policies of public listed companies in the context of Malaysia. In particular, this study will investigate the determinants of dividend payouts of public listed companies, by establishing the relationship between dividend payments (the dependent variable) and five independent variables, namely: (i) agency costs, (ii) firm size, (iii) profitability, (iv) financial leverage, and (v) growth opportunities.

As mentioned above, this study explores the dividend policy of companies in Malaysia, which is an emerging market. Although emerging markets may have different dividend payout policies, the factors that influence dividend decisions in developed stock markets may be relevant for this emerging market. Hence, the relationships between factors mentioned above are examined empirically. Based

on the results, this study will suggest new areas of research to be conducted in emerging markets particularly in Malaysia.

1.3 Research Hypotheses

Five research hypotheses were developed to achieve the research objectives. In this study a time series and cross-section (TSCS) panel data was constructed to test the following hypotheses:

H₁: There is a positive relationship between dividend payments and agency costs.

H₂: There is a positive relationship between dividend payouts and firm size.

H₃: There is a positive relationship between paying dividends and profitability.

H₄: The relationship between dividend payments and financial leverage is negative.

H₅: There is a negative relationship between dividend payments and growth opportunities.

1.4 Organization and Scope of the Study

The study is presented in five chapters. The first chapter provides an overview about dividend policy and the purpose and significance of this study, as well as the research hypotheses. In the next chapter, previous work and literature on dividend decisions will be presented. Chapter two will cover some of the important theories about dividend policy, starting with the dividend irrelevancy hypothesis by Miller and Modigliani.

Chapter 3 will present the sample data and the way data will be compiled and organized. This chapter also provides details about proxy variables used to test the research hypotheses. Additionally, time series and cross section panel data

analysis will be used to test the hypotheses.

Chapter 4 will explain and discuss the results and provide the descriptive statistics of all variables in the study, followed by the regression analysis. To test the regression model, *EViews version 7* is used.

Finally, chapter five provides a summary of the research results and explains the implication of the results, as well as includes suggestions for future studies.