

**INVESTMENT OPPORTUNITY SET AND DIVIDEND POLICY
IN MALAYSIA:
SOME EVIDENCE ON THE ROLE OF GOVERNMENT
OWNERSHIP, FAMILY OWNERSHIP, BOARD SIZE AND BOARD
COMPOSITION**

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ABSTRACT

Prior studies show that there is a negative association between IOS (Investment opportunity set) or growth opportunities and dividend payout. While there are several theories such as the signalling hypothesis, the tax hypothesis, free cash flow (FCF) hypothesis and the contracting hypothesis that maybe used to explain this relationship, the main theory suggested in the extant literature was Free Cash Flow Theory (FCF) by Smith and Watts (1992). According to the free cash flow theory, managers of firms with more growth opportunities or higher IOS (prospective investment opportunities and associated payoff distributions) are more likely to pay lesser dividends since these firms need the cash for growth opportunities. However, firms with low growth opportunities pay out more dividends since these firms have few opportunities to invest in positive net present value projects.

In this study I re-examine whether this negative relationship exists in the Malaysian corporate sector. I examine Malaysian firms because it is a developing country and also because of the existence of a global decline in the propensity to pay dividends especially among firms incorporated in common law jurisdictions. Further I investigate whether corporate governance variables such as (1) government ownership (2) board-size, (3) board composition and (4) family ownership affects the association between growth opportunities and dividend policies. I examine government ownership because there seemed to be a high concentration of government link companies among public listed companies. Board-size and board composition is examined to evaluate to what extent those corporate governance monitoring have an impact on dividend payouts.

No known prior study has investigated whether these variables moderate the relationship between growth opportunities and dividend payout. Several hypotheses are developed to test these relationships. Using data from annual reports of Malaysian companies I expect to find that there is a negative association between growth opportunities and dividend payout in Malaysian firms thus confirming prior findings and FCF theory. Further I expect that the relationship should be weaker for government owned as there is some anecdotal evidence suggesting a positive association between ownership and dividends since firms with government ownership have relatively less difficulty raising funds to finance investments and can therefore afford to pay dividends. As for family owned businesses, the relationship would be weaker because of the high concentration of family ownership as family members are concerned about wealth transfer. The relationship for board-size and board composition is envisaged to be negatively related to growth opportunities.

The study will contribute to the literature in two ways. Firstly, there has been no known prior study that has evidence on the role of corporate governance mechanism such as government ownership, board-size, board composition and family ownership and the association between investment opportunities and dividend policies and secondly, to re-establish the fact as to whether the prior studies' finding on the negative relationship which exist between investment opportunities and dividend payout also prevails in the Malaysian corporate sector.

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ABSTRACT	i
ACKNOWLEDGEMENTS	ii
LIST OF FIGURES	ix
LIST OF TABLES	x
LIST OF ABBREVIATIONS	xi
CHAPTER 1	1
OVERVIEW OF RESEARCH	1
1.1. INTRODUCTION	1
1.2. BACKGROUND FOR THE STUDY	4
1.2.1. Gaps in Extant Literature on Investment Opportunity Set (IOS)	5
1.2.1.1. <i>Definition and measurement of Investment Opportunity Set</i>	5
1.2.1.2. <i>IOS and dividend policy: Theoretical arguments</i>	6
1.2.1.3. <i>Theoretical arguments: A Summary</i>	10
1.2.2. Corporate Governance and Dividend Payouts	10
1.3. PROBLEM STATEMENT	12
1.4. RESEARCH QUESTION	14
1.5. RESEARCH OBJECTIVE	15
1.6. THEORETICAL FRAMEWORK AND HYPOTHESES	16
1.7. METHODOLOGY AND RESEARCH DESIGN	17
1.7.1. Research Model	17
1.7.1.1. <i>Measurement of dependent variable</i>	18
1.7.1.2. <i>Measurement of independent variable: investment opportunity set (IOS)</i>	18
1.7.1.3. <i>Measurement of corporate governance and control variables</i>	18
1.7.2. Research design	19
1.7.3. Data Analysis	19
1.8. RESEARCH MOTIVATION AND CONTRIBUTION	20
1.9. SIGNIFICANCE OF STUDY	22
1.9.1. Implications for theory	22
1.9.2. Implications to Policy Makers	23
1.10. STRUCTURE OF THE THESIS	24

CHAPTER 2	27
A REVIEW AND SYNTHESIS OF THE IOS AND DIVIDEND PAYOUT LITERATURE	27
2.1. INTRODUCTION	27
2.2. PRIOR STUDIES ON DIVIDEND PAYOUT	27
2.2.1. Prior empirical studies on the determinants of dividend payout	28
2.2.1.1. <i>Current profits and past year profits</i>	29
2.2.1.2. <i>Market risk</i>	30
2.2.1.3. <i>Cash flow/Liquidity</i>	30
2.2.1.4. <i>Financing and Investment Decisions</i>	32
2.3. GROWTH AND DIVIDEND PAYOUT	35
2.3.1. Definition of IOS	35
2.3.2. Characteristics of High growth & Low growth firms	36
2.3.2.1. <i>Characteristics of High growth firms</i>	37
2.3.2.2. <i>Characteristics of Low growth firms</i>	39
2.4. EXTANT THEORIES ON DIVIDEND PAYOUT	40
2.4.1. Informational asymmetry and signalling: External Drivers Perspectives	43
2.4.1.1. <i>Signalling Theory</i>	43
2.4.1.2. <i>Catering theory</i>	45
2.4.1.3. <i>Tax clientele hypothesis</i>	46
2.4.2. Free Cash Flow & Contracting Theories: Internal Drivers Perspectives	47
2.4.2.1. <i>The free cash flow theory (FCF)</i>	47
2.4.2.2. <i>FCF Hypothesis</i>	49
2.4.2.3. <i>Pecking Order (PO) theory</i>	49
2.4.2.4. <i>Contracting theory</i>	51
2.4.3. Extant theories in dividend payout research: an evaluation	52
2.5. INSTITUTIONAL CONTEXT AND DIVIDEND PAYOUT	53
2.6. MALAYSIAN INSTITUTIONAL ENVIRONMENT	57
2.6.1. Malaysian Political Economy	58
2.6.2. Ownership structure	59
2.6.3. Concentration of ownership	60
2.6.4. Board composition	60
2.6.5. Legal System	61
2.7. RESEARCH GAP IN EXTANT LITERATURE ON IOS	62
2.8. CONCLUSION	63

CHAPTER 3	64
CORPORATE GOVERNANCE: A REVIEW OF LITERATURE	64
3.1. INTRODUCTION	64
3.2. OVERVIEW OF CORPORATE GOVERNANCE	65
3.3. CORPORATE GOVERNANCE DEVELOPMENT AND FRAMEWORK IN MALAYSIA	68
3.3.1. Securities Commission (SC)	69
3.3.1.1. <i>The Malaysian capital market master plan (CMP)</i>	70
3.3.1.2. <i>Companies Commission of Malaysia and (CLRC)</i>	70
3.3.2. Malaysian Accounting Standard Board (MASB)	71
3.3.3. The High Level Finance Committee on Corporate Governance	71
3.3.4. The Malaysian Code of Corporate Governance (MCCG)	72
3.3.5. The Malaysian Institute of Accountants	74
3.3.6. Minority shareholder watchdog group (MSWG)	75
3.3.7. Malaysian Corporate Governance Reforms: A Summary	75
3.4. CORPORATE GOVERNANCE ISSUES IN THE ASIAN MARKETS	77
3.4.1. Corporate governance and company performance	77
3.4.2. CG and Asian institutional features	79
3.4.2.1. <i>Political economy</i>	79
3.4.2.2. <i>Ownership structure</i>	80
3.4.2.3. <i>Concentration of ownership</i>	81
3.4.2.4. <i>Board composition</i>	82
3.4.2.5. <i>Legal system</i>	83
3.4.2.6. <i>Shareholder protection</i>	84
3.4.2.7. <i>Minority Shareholder protection</i>	85
3.4.3. A Summary	85
3.5. CONCLUSION	86
CHAPTER 4	87
DIVIDEND PAYOUT, GROWTH AND CORPORATE GOVERNANCE: A REVIEW AND SYNTHESIS OF LITERATURE	87
4.1. INTRODUCTION	87
4.2. BACKGROUND: DIVIDEND PUZZLE	88
4.3. DIVIDEND PAYOUT AND GOVERNANCE LITERATURE:	90
4.3.1. Gaps in the Internal Corporate Governance Mechanism Research	91
4.3.1.1. <i>Board size</i>	92
4.3.1.2. <i>Board composition</i>	96
4.3.1.3. <i>Duality</i>	100
4.3.2. Gaps in the External Corporate Governance Mechanism Research	102

4.3.2.1. <i>Evidence on Government linked Companies</i>	103
4.3.2.2. <i>Family Controlled firms</i>	105
4.3.2.3. <i>Evidence on Family Controlled firms and performance</i>	108
4.3.2.4. <i>Corporate governance, dividend payout</i>	111
4.3.2.5. <i>Dividends as a substitute for corporate governance mechanism</i>	113
4.3.2.6. <i>Protection of minority interest</i>	114
4.3.3. Growth, governance and dividend payout	114
4.3.4. Research Gaps: A Summary	117
4.4. CONCLUSION	119
CHAPTER 5	127
METHODOLOGY AND RESEARCH DESIGN	127
5.1. INTRODUCTION	127
5.2. RESEARCH METHODOLOGY	128
5.3. RESEARCH QUESTIONS, OBJECTIVES AND THEORETICAL MODEL	129
5.3.1. Research Questions	129
5.3.2. Research Objective	129
5.3.3. Theoretical Model	130
5.4. HYPOTHESES DEVELOPMENT	132
5.4.1. Investment Opportunities Set (IOS)	133
5.4.2. Board Composition	134
5.4.3. Board size	139
5.4.4. Ownership structure	142
5.4.4.1. <i>Government linked company</i>	142
5.4.4.2. <i>Family Ownership</i>	145
5.5. SAMPLE SELECTION	147
5.6. MEASUREMENT, CONCEPTUALISATION , OPERATIONALISATION	148
5.6.1. Measurement of the Independent Variable: IOS	149
5.6.2. Measurement of the Dependent Variable: Dividend Payout	154
5.6.3. Measurement of the Moderating variables	154
5.6.3.1. <i>Board Size</i>	154
5.6.3.2. <i>Board Composition</i>	155
5.6.3.3. <i>Government linked companies</i>	155
5.6.3.4. <i>Family ownership</i>	156
5.6.4. Measurement of the Control Variables	157
5.6.4.1. <i>Firm Size</i>	157
5.6.4.2. <i>CEO Duality</i>	158
5.6.4.3. <i>Return on Assets</i>	158
5.6.4.4. <i>Leverage</i>	158

5.7. REGRESSION MODEL	Error! Bookmark not defined.
5.7.1. Regression Model and Discussion	161
5.7.1.1. <i>The Fixed Effects model</i>	162
5.7.1.2. <i>The Random Effects model</i>	163
5.7.1.3. <i>Fixed Effect or Random Effect?</i>	163
5.7.1.4. <i>Autocorrelation</i>	165
5.7.1.5. <i>Heteroscedasticity</i>	166
5.7.1.6. <i>Correlation</i>	166
5.7.1.7. <i>Descriptive statistics</i>	167
5.7.1.8. <i>Endogeneity</i>	167
5.8. CONCLUSION	168
CHAPTER 6	169
RESULTS AND DISCUSSION	169
6.1. INTRODUCTION	169
6.2. DESCRIPTIVE STATISTICS	169
6.3. CORRELATION ANALYSIS	176
6.4. MULTIVARIATE ANALYSES	180
6.4.1. Basic model with control variables	182
6.4.1.1. <i>Investment opportunity set</i>	182
6.4.1.2. <i>Family controlled firms</i>	184
6.4.1.3. <i>Industry type</i>	184
6.4.1.4. <i>Control variables and dividend policy</i>	184
6.4.2. Basic model with control variables specifically on government linked	192
6.5. ADDITIONAL ANALYSES	194
6.6. DISCUSSION	196
6.6.1. Board of Directors' characteristics and dividend policy	196
6.6.1.1. <i>Board size</i>	196
6.6.1.2. <i>Board composition</i>	197
6.6.2. Ownership structure and dividend policy	202
6.6.2.1. <i>Government ownership</i>	202
6.6.2.2. <i>Family ownership</i>	203
6.6.3. Growth opportunities and dividend policy	205
6.7. SUMMARY AND CONCLUSION	206

CHAPTER 7	207
SUMMARY AND CONCLUSION	207
7.1. INTRODUCTION	207
7.2. SUMMARY OF FINDINGS	207
7.2.1. Board size (BSIZE)	209
7.2.1.1. <i>Interaction between IOS and board size (IOSBSIZE)</i>	209
7.2.2. Board Composition (BCOM)	209
7.2.2.1. <i>Interaction between IOS and board composition (IOSBCOM)</i>	210
7.2.3. Government Ownership (GLCs)	211
7.2.4. Family control (FLYC)	212
7.2.4.1. <i>Interaction between IOS and family control (IOSFLYC)</i>	212
7.2.5. IOS and dividend payout	213
7.3. IMPLICATIONS OF STUDY	213
7.4. LIMITATIONS OF THE STUDY	219
7.5. SUGGESTIONS FOR FUTURE RESEARCH	219
7.6. CONCLUSION	222
REFERENCES	224
LIST OF PUBLICATIONS	250
APPENDIX A: List of Hypotheses	251
APPENDIX B: List of Companies	252

LIST OF FIGURES

Page

Figure 1.1 Outcome Models of Dividends

9

Figure 2.1 Extent Theories on Dividend Payout

42

Figure 5.1 Theoretical Representation of relationship

131

LIST OF TABLES

Tables		Page
Table 4.1	Measures of Corporate Governance	92
Table 4.2	Total Market Capitalisation by Government Linked & non-Government Linked Companies in Malaysia	103
Table 4.3	Summary of studies relating to IOS and Dividend: Evidence From Developed Countries	121
Table 4.4	Summary of studies relating to IOS and Dividend: Evidence From Developing Countries	124
Table 5.1	Sector representation of the sample companies	147
Table 5.2	Derivation of sample, 2004 -2006	148
Table 5.3	Summary of the Operationalisation of the Research Variables	159
Table 6.1	Descriptive statistics of Continuous Variable (Panel A)	170
Table 6.1	Descriptive statistics of Dichotomous Variable (Panel B)	174
Table 6.1	Descriptive statistics of Skewness and Kurtosis (Panel C)	175
Table 6.2	Market Capitalisation by Sector	176
Table 6.3	Correlation	178
Table 6.4	Multiple Regression Results (Panel A)	183
Table 6.4	Multiple Regression Results (Panel B)	188
Table 6.4	Multiple Regression results on GLC and Non-GLC (Panel C)	193
Table 6.5	Summary of the Results	200

LIST OF ABBREVIATIONS

BOD	Board of Directors
CaPERS	California Public Employees Retirement System
CCM	Companies Commission of Malaysia
CEO	Chief Operating Officer
CG	Corporate Governance
CLRF	Corporate Law Reform Committee
CLRFC	Singapore Company Legislation and Regulatory Framework
CMP	Capital Market Master Plan
DBR	Disclosure Based Regulation
FASB	Financial Accounting Standard Board
FCCG	Finance Committee on Corporate Governance
FFCF	Founding Family Control Firms
FRA	Financial Reporting Act
GDP	Gross Domestic Product
GLC	Government Link Companies
GLCC	Government Link Construction Companies
GLS	Generalised least Squares
KLSE	Kuala Lumpur Stock Exchange
LTAT	Lembaga Tabung Angkatan Tentera
LTH	Lembaga Tabung Haji
MASB	Malaysian Accounting Standard Board
MBS	Merit Based System
MCCG	Malaysian Code on Corporate Governance
MICG	Malaysian Institute of Corporate Governance
MOF	Ministry of Finance
MSWG	Minority Shareholders Group
NED	Non-executives Directors
NEP	New Economic Policy
OECD	Organisation for Economic Co-operation and Development
PNB	Permodalan Nasional Berhad
PWC	Price Waterhouse Coopers
ROC	Registrar of Companies
SC	Securities Commission
SCA	Securities Commission Act
SEDC	State Economic Development Corporation
SIA	Securities Industries Act
SME	Small and Medium Scale Enterprise (SME)