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 may be 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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LIST OF ABBREVIATIONS

BOD            Board of Directors
CalPERS        California Public Employees Retirement System
CCM            Companies Commission of Malaysia
CEO            Chief Operating Officer
CG             Corporate Governance
CLR RF          Corporate Law Reform Committee
CLR RFC         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)