CHAPTER 1

OVERVIEW OF RESEARCH

1.1. INTRODUCTION

The question of why companies pay out dividends has continued to puzzle researchers (Adjaoud & Ben-Amar, 2010; Farinha & Lopez-de-Foronda, 2009; Denis & Osobov, 2008). Two strands of such research are clearly discernable. First strand focuses on "signalling" explanations for dividends that are based on the desire by companies to communicate information to shareholders (Lintner, 1956; Farinha, 2003). Dividends are perhaps the most reliable indicators of the current and future earnings of a company. According to Aivazian et al. (2003), revisiting the dividend puzzle only leads to discovery of some important questions being unanswered and the issue becomes more controversial. Generally, an increase in dividend implies that the company is expected to perform better in the future and a reduction in dividend payment signals that management is concerned about the future prospects of the company. Dividend signals are "real" because they require actual cash payouts unlike earnings where they could be manipulated (Farinha, 2003).

The second strand of this research is based on an agency theory which focuses on the relationship between growth opportunities (also used interchangeably as Investment Opportunity Set (IOS), debt, performance and dividend policy decisions (Smith & Watts, 1992; Gaver & Gaver, 1993; D'Souza & Saxena, 1999; Gul & Kealey, 1999; Mitton, 2004; Alonso *et al.,* 2005 and Amidu & Abor, 2006). Evidently, although several theories exist to explain firms' dividend payout policies, none of these theories fully answer the question why firms pay dividends to their shareholders although it is opined that the agency theory seems to offer the most promising theoretical framework (Adjaoud & Ben-Amar, 2010). As Jensen (1986) argues, dividends are expected to attenuate agency costs that result from the separation of ownership and management of public listed firms. Dividends reduce free cash flows that could otherwise be spent by managers on their private benefits (Adjaoud & Ben-Amar, 2010). Likewise, dividend payments compel managers to raise funds more frequently and hence increasing capital market monitoring (Easterbrook, 1984 as cited in Adjaoud & Ben-Amar, 2010).

Generally, these studies concentrated on the more developed Western countries. There have been limited studies in Asian and less developed economies except for China, Korea and Ghana (Gul & Kealey, 1999 and Gul, 1999). However, the question is whether the models used in the more developed countries are applicable in different institutional settings such as in the Asian and emerging economies (Chen et al., 2010).

Furthermore, increasingly research has explored the relation between a firm's corporate governance quality and its dividend payout. However, there are two opposing views. On one hand, La Porta et al. (2000) claim that corporate governance quality should be positively related to dividend payouts as better governed firms offer stronger protection rights to their shareholders. Consequently, shareholders will pressure managers to pay higher dividends rather than using the excess cash for their own private benefits (Adjaoud & Ben-Amar, 2010). On the other hand, it is also contended that governance quality is a substitute for dividends payments such that better governed firms are associated with lower agency costs resulting from the separation of ownership and control. As a result, such firms are less likely to use dividends as a device to mitigate agency conflicts (Adjaoud & Ben-Amar, 2010). This study revisits the question of what determines dividend policy. It is argued here that the Malaysian capital market, an emerging economy in Asia offers an interesting setting in which to empirically investigate the determination of dividend policy. More specifically, this study examines the two related issues i.e corporate governance quality should be positively related to dividend payout and governance quality is a substitute to dividend payout. Three primary factors motivate this study. First, it examines relationship between growth opportunities and dividend policies. Additionally, this study examines whether corporate governance variables such as board size, board composition and corporate ownership structure moderate the relationship between Investment Opportunity Set (IOS) and dividend policy. Second, the role of government linked companies, a unique feature in Malaysia, has not been examined in the context of dividend policy. Third, Malaysia is an emerging economy with a relatively under developed capital market, a better understanding of corporate finance issues, such as dividend policies will be useful for both academicians and policy makers. These issues are further discussed later.

The remaining discussion in this chapter is structured as follows. Section 1.2 discusses the gaps in the extant literature on growth opportunities and dividend policies. Section 1.3 describes the problem statement whilst Section 1.4 lists out the research questions. Section 1.5 provides research objectives while Section 1.6 discusses the theoretical framework. Section 1.7 discusses the methodology and research design whereas Section 1.8 elaborates on the research motivation and contribution. Section 1.9 highlights the significance of the study and lastly Section 1.10 describes the structure of the thesis.

1.2.BACKGROUND FOR THE STUDY

In Malaysia, although there are broad similarities in the accounting and regulatory environments with the United States, and the United Kingdom, there are, however, some important institutional differences. Malaysia as an emerging country is compounded by its legacy from the British colonial rule which ended in 1957. A major factor that contributes to the Governments involvement in the corporate sector is the new economic policy (NEP) (Jomo, 1990). This in return has spearheaded a direct controlling link of Government linked companies (Mitchell & Joseph, 2010). Further, this has shaped the economy with the close identification between racial and economic functions (Mohammad et al., 2006). With regard to close identification with racial and economy, the family controlled firms are generally related to Chinese ethnic community and Malaysia seems to have a measurable wedge between ownership and control in firms controlled by widely held corporations and the largest separation is held in small firms.

However with respect to Board composition (such as a number of independent non-executive directors representing the board) it is envisaged by many as an appointment merely to fulfill listing requirements rather than as a measure at improving corporate governance or to improve the performance of the firm (Sing & Ling, 2008). On the aspect of legal system, Malaysia comes under the common law system, much like the UK, in contrast to most other European and Asian countries. Interestingly, the role of the dividend policy has been established as a disciplining mechanism in countries distinct agency problems (Farinha & Lopez-de-Foronda, 2009).

1.2.1. Gaps in Extant Literature on Investment Opportunity Set (IOS) (or growth opportunities) and Dividend Payout.

There are primarily two strands of research with respect to dividend payout i.e the signaling theory and the agency theory. The signaling theory focuses on external drivers (for example, research on how firms use dividends as a signalling device, to communicate to shareholders) and the Agency theory focuses on internal drivers (for example, research on internal factors that are associated with dividend payouts such as growth opportunities). This thesis is focused on the second strand, i.e., specifically on the association between growth opportunities and dividend payouts. In this section, the gap in extant growth opportunities and dividend payout literature is discussed. The research gap is identified in two aspects. Firstly, theoretical arguments are still inconsistent and there is limited evidence on the applicability of extant theories in the context of emerging economies. Secondly, there is limited evidence on positioning dividend payout research within the context of corporate governance research.

The rest of the discussion in this section is organized as follows. The next section discusses the ambiguity in extant literature on defining and measuring investment opportunity set (or growth opportunities). This is followed by a discussion on the theoretical arguments for dividend payout practices. Next, the extant research on corporate governance related to dividend payouts is addressed. Final section summarises the research gap which leads on to the statement of problem in Section 1.3.

1.2.1.1. Definition and measurement of Investment Opportunity Set

Investment Opportunities Set (also known as growth opportunities) is defined in terms of assets in place, the lower the fraction of firm value represented by assets-in-place, the more the growth opportunities (Myers, 1977). However, investment opportunity set is difficult to observe and measure because of the uncertainty attached to the outcomes of the managerial decisions that affect their value of the investments (Smith & Watts, 1992; Gaver & Gaver, 1993; Skinner, 1993).

Basically, IOS includes virtually any kinds of further expenditures like capacity expansion projects, new product lines, maintenance and replacement of existing assets. Further, because the firm's investment opportunity set consists of projects which allow firm to grow, the investment opportunity set can be thought of as the growth prospects of the firm (Myers, 1977). As investment opportunities are typically unobservable by outsiders, a common practice is to rely on proxy variables that can be generally classified into three types: the price-based proxies, investment based proxies and variance measures (Adam & Goyal, 2008). Hence, in this study, the market to book value (MBE) has been selected as a proxy variable to measure IOS.

1.2.1.2. IOS and dividend policy: Theoretical arguments

There are several theories used in the extant dividend payout (DPP) literature to explain the relationship between the external and internal drivers and dividend payout polices. In this section, we focus on the internal drivers and the related theoretical arguments. The more common ones are the related (i) contracting theory and agency theory that includes (ii) free cash flow theory (FCF). However, as discussed below the empirical evidence of these theories are mixed. These two theories are discussed next.

(i) Contracting Theory

Contracting theory is typically applied in circumstances where individuals and businesses construct and develop legal agreements. Contract theory analyzes how parties to a contract make decisions under uncertain conditions, and when there is asymmetric information, it draws upon principles of financial and economic behaviour, as principles and agents often have different incentives to perform or not (Hart & Moore, 2007).

Contracting theory in the context of firms with more growth opportunities or higher IOS posits that such firms are less likely to issue debt or pay dividends. This theory depicts that generally growth firms are less likely to issue debt because of the underinvestment and asset substitution problem. Underinvestment occurs when managers acting on behalf of shareholders decide not to undertake positive return projects simply because debt holders have a senior claim on the projects cash flow and subsequent payoff (Myers, 1977). As such, firms issue debt only when they are confident that the debt can be supported by assets in place. Likewise an asset substitution problem arises when managers use available opportunity to substitute high variance assets with lower variance assets when the debt has already been issued.

Rozeff (1982) and Easterbrook (1984) reinforced the contracting theory argument, that the issuance of new market shares lowers the agency costs by providing an effective monitoring system. Firms with more profitable investment opportunities can control dividend payouts before the expected cost of forced negative net present value projects outweigh the benefits of controlling dividend payouts (Rozeff, 1982 & Easterbrook, 1984).

Further, Smith & Warner (1979) also evidence contractual arrangements that encourage managers to pay higher dividends rather than undertake negative return projects. Hence, firms with low growth opportunities tend to pay higher dividends to remove resources from the firm.

(ii) Agency and Free Cash Flow Theory

Jensen (1986) argues that firms with high growth opportunities have lower free cash flow (FCF) and hence pay lower dividends. As a result, there should be a positive relation between the proportion of assets in place and dividend yield. According to Jensen (1986), continuing dividend payments is seen as helping to dissipate cash which might otherwise have been wasted in non-value maximising projects and hence reduced over-investment by managers. There in a link between Contracting Theory and Free Cash Flow Theory.

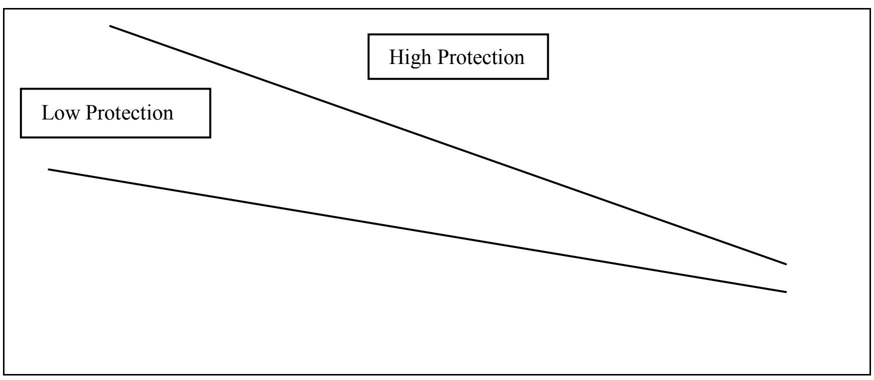
Jensen (1986) defines free cash flow as cash flow in excess of that required for funding all projects that have positive net present value (NPV). If these free cash flows are invested in sub-optimal projects, it will result in poor future profitability. Jensen (1986) also suggests that, in the presence of free cash flow and in the absence of shareholders monitoring, managers have a tendency to over-invest to gain the financial and non-financial privileges of larger firms. The managers invest in projects with a negative net present value as long as the interest of the managers is taken care off. According to FCF theory, managers of firms with low growth opportunities and high FCF, pay out more dividends since they have fewer opportunities to invest in positive net present value projects. However, firms with high growth opportunities pay out lesser dividends since these firms need the cash for growth opportunities (Smith & Watts, 1992).

Vogt (1994) also finds evidence of free cash flow behavior in the capital investment of large firms however the agency-related overinvestment problem is more serious in mature firms with low growth perspectives (Jensen, 1986 & Carpenter, 1995). On the other hand, low growth firms suffer from shortage of positive NPV projects as the extra cash flow generated are squandered by their managers on value-destroying projects (Vogt, 1994). However, one problem in obtaining empirical confirmation of this relationship is identifying free cash flow.

La Porta *et al.* (2000) introduce the idea of strong legal protectionism that reduces agency costs and suggest that this agency approach is highly relevant to an understanding of corporate dividend policies around the world. Firms operating in countries with better protection of minority shareholders, pay higher dividends. Moreover in these countries, high growth firms pay lower dividends than low growth firms, consistent with the idea that legally protected shareholders are willing to wait for dividends and are willing to take their dividends when the investment opportunities are good. Figure 1.1 depicts the scenario.

Figure 1.1
Outcome model of dividends

Dividend/Earnings



Growth Opportunities

Source: La Porta et al. (2000)

1.2.1.3. Theoretical arguments: A Summary

As can be seen from the discussion above, the theories are interrelated. The relationship between IOS and dividend policies is explainable from a multifaceted viewpoint. The predominant theory is the contracting theory and FCF set in the context of the agency theory. However, none of these studies focus explicitly on the link between a firm's IOS and dividend policy. Furthermore, these theories have been empirically examined in the context of the more developed western capitalism. Evidence is limited from the east, for example Asia, where relationship capitalism is more evident. This poses a concern as to whether such theories are applicable in an emerging economy context such as Malaysia.

The hypotheses formulated in this study are based on important factors affecting the relationship between corporate governance variables, growth opportunities and dividend policy. The corporate governance variables cover both the internal and external aspects of corporate governance. These corporate governance variables and the control variables are used to test these hypotheses. The reason for the selection of these corporate governance variables are based on Malaysia's unique feature as a multiracial developing country with its different levels of investor protection, legal regime, corporate policies and ownership structure.

1.2.2. Corporate Governance and Dividend Payouts

Increasingly, recent research suggests that when the economic environment in that firms operate differs, agency problems will also potentially differ and accordingly, the corporate governance mechanisms are also likely to be different (Farinha & Lopez-de-Foronda, 2009).

The distinct legal and institutional environment support different types of corporate governance by favouring a particular level of ownership concentration (La Porta et al., 1997). In particular, from an agency theory perspective, in the Asian economies, the agency problem is not between managers and shareholders, but rather, it is between the majority and minority shareholders (Faccio et al., 2001).

La Porta et al. (2000), evidence that firms pay higher dividends in countries with stronger legal protection of minority shareholders. They showed that for firms with low growth and higher investor protection, they are forced to pay out free cash flow as dividends. So firms with high growth opportunities and high investor protection are able to expropriate lesser dividends (Gul, 1999). Interestingly, Farinha & Lopez-de-Foronda (2009) show that in the case of Civil Law countries, due to highly concentrated ownership and lower protection of minority shareholders rights, dividend payout increase as insider ownership increases so as to compensate the greater likelihood of minority expropriation. This, they claim, is to entice external shareholders to invest in the firm as firms compete for funds in the capital markets. However, they posit that when higher level of ownership concentration is reached, firms curtail dividends which signify attempts by the entrenched majority shareholders to expropriate minority shareholders' wealth, especially when those minority shareholders have not only reduced voting power but also little protection of legal rights as well as are largely irrelevant for the firm's capital funding needs.

Corporate governance is important as it is deemed pertinent to the long term corporate performance of a company. For instance in the Malaysian context, the family controlled firms are primarily controlled by the primary founders (Miles, 2009) and in the context of public listed companies, it has been found that institutional shareholders have failed in their monitoring role and principle agent problem would not be solved by merely increasing the directors shareholding (Ming & Gee, 2008).

In this context, given that much of the evidence on the application of agency theory, corporate governance and dividend payouts arise out of the western common law regimes with much less concentrated ownership (Farinha and Lopez-de-Foronda, 2009). There is a need to extend empirical evidence to regimes with different institutional settings. Clearly, there is no prior study that has examined whether corporate governance variables such as government ownership, family ownership, board size and board composition moderate the relationship between IOS and dividend payouts.

Chapter 4 provides a detailed discussion of the institutional setting in Malaysia, specifically on the existence of Government Linked Companies (GLCs) and predominantly Chinese family owned businesses.

1.3. PROBLEM STATEMENT

Prior studies for example, Fama & French (2001), Benito & Wurgler (2001) and Hutchinson & Gul (2004) which report on the relationship between corporate governance and firm performance are premised on the notion that in theory, there is a direct association between corporate governance and firm performance. However there are also other studies that have given contradicting and mixed results on corporate governance and firm performance such as Brickley *et al.,* (1997), Abdullah (2004), Bonn (2004) and Zubaidah *et al.,* (2009).

Hutchinson & Gul (2004), evidence the role of corporate governance variables in firm performance and argue that these should be evaluated in the context of a firm's external environment which is measured in terms of growth opportunities. Studies using numerous corporate governance variables are increasing, however, the impact of such corporate governance variables is still mixed, particularly, in the Malaysian context (refer to Table 4.1 and Table 4.2 in Chapter 4 on the summary of studies relating to IOS and dividend, evidenced from developed and developing countries).

Another issue with respect to the problem statement is that this study is grounded in the context of an emerging economy that exhibit differences in the level of economic development, stages of growth opportunities and governance system. These differ considerably from those of United States (U.S) or the United Kingdom (U.K), from where a majority of the past studies originated such as Smith & Watts (1992), Gaver & Gaver (1993), D'Souza and Saxena (1999), Mitton (2004), and Alonso *et al.,* (2005). Further, there are implicit differences with regards to corporate ownership structure and legal systems, and the different factors influencing the dividend payout decisions and policies of Malaysian corporate managers compared to their counterparts in the US and UK (refer to detailed discussion in Chapter 2).

Therefore, Malaysia provides an interesting institutional setting to examine whether extant theorising using Free Cash Flow (FCF) and IOS such as Jensen (1986); Smith

&Watts (1992); Gaver & Gaver (1993) and Gul (1999), based on developed countries' experience, is applicable.

Furthermore, there is limited investigation in the context of developing economies on the relationship between growth opportunities and dividend policy and whether corporate governance variables such as ownership (government and family), board size, and board composition moderate the relationship. As mentioned earlier, Malaysia is examined as a case due to its high concentration of ownership and its unique government policies, legal system and capital structure that differ with other Asian counter parts in the region (refer to detailed discussion in Chapter 3). The question is, will the different institutional setting impact the relationship between growth opportunities and dividend policies? Therefore, the purpose of this study is to investigate the extent to which the corporate governance variables such as ownership structure, board composition and board size, moderate the relationship between growth opportunities and dividend policy.

1.4. RESEARCH QUESTION

The research question serves as a guide to the selection of the methodological approach that best address the research problem and accomplish the research objectives. Answering the research question provides an understanding of the corporate governance variables and their influence on the dividend policy of the companies. The main research question is: Do board size, board composition, ownership structure and the interactions of growth opportunities influence the dividend payout of public listed companies in Malaysia?

i) Does the relationship between investment growth opportunities and dividend payout observed in prior studies exist in the Malaysian context?

ii) Does board size and board composition of the company moderate the relationship between investment opportunities and dividend payout?

iii) Is there a relationship between investment opportunities and dividend payout for government linked companies?

iv) Is there a relationship between investment opportunities and dividend payout for family controlled firms?

1.5. RESEARCH OBJECTIVE

The primary objective of this study is to examine the moderating effect of board size, board composition, government ownership and family ownership on the relationship between growth opportunities (IOS) and dividend payout in the Malaysian context. The other objectives are as stated below:

- To investigate and ascertain whether the relationship between investment opportunities and dividend payout of listed companies observed in the western economies with market capitalism exists in the Malaysian corporate context.
- To examine whether board size and board composition have an impact on the relationship between investment opportunities and dividend payout of public-listed companies, in other words does monitoring reduce the agency cost of FCF.
- To examine whether there is a relationship between government linked company and dividend payout.
- To examine whether there is a relationship between family controlled firm and dividend payout policy.

1.6. THEORETICAL FRAMEWORK AND HYPOTHESES

The theory used in this study is based on contracting and Jensen's free cash flow theory. This study examines the relationship between the growth prospects of companies (high and low growth firms measured using proxy variables) which are independent variables and dividend policy as the dependent variable. Board composition, board size, government ownership and family ownership are the moderating variable respectively. The control variables used are return on assets (ROA), duality (DUAL), industry dummies, year dummies, debt to total assets (DTA) and logarithm of market capitalisation (LOGMKTC).

The hypotheses examined are:

H1: There is a significant negative relationship between high growth firms and dividend payout *ceteris paribus.*

$H2_a$: The negative relationship between firms' IOS and dividend payout is weaker for firms with more independent directors.

$H2_b$: There is a positive association between dividend payout and board composition.

$H3_a$: The negative relationship between firms' IOS and dividend payout is weaker for firms with a larger board size.

$H3_b$ There is a positive association between dividend payout and board size

H4: There is a positive relationship between government linked company and dividend payout.

$H5_a$: The negative relationship between IOS and dividend payout is weaker for family controlled firms.

$H5_b$: There is a negative relationship between family controlled firm and dividend payout.

The hypotheses development is discussed in detail in Chapter 6

1.7. METHODOLOGY AND RESEARCH DESIGN

The methodology, research model and research design used in this study are outlined in this section. The methodology used in this mode of inquiry is by way of positivist paradigm Chua (1986), whereby it attempts to be objectively descriptive in the specification of theories connected with an objective function.

1.7.1. Research Model

The research model used in this study is similar to that used in studies conducted by (Gaver & Gaver, 1993; Gul & Kealey, 1999; Gul, 1999) as it examines the relationship between corporate governance variables, growth opportunities proxied by IOS and dividend payout.

See below the model with the explanations for each of the variables.

$$DPP = \alpha_0 + \beta_1\ MBE_{it} + \beta_2\ BSIZE_{it} + \beta_3\ BCOM_{it} + \beta_4\ FLYC_{it} + \beta_5\ GLC_{it} + \beta_6 DUAL_{it} +$$

$$B_7 LOGMKTC\ _{it} + \beta_8 DTA_{it} + \beta_9\ ROA_{it} + \sum_{i=1}^{n} \beta_{10}\ INDTYPE + \varepsilon_{it}$$

Where:

DPP	= Dividend payout
MBE	= Market to book value of equity at the end of year t
BSIZE	= Board size
BCOM	= Board composition
FLYC	= Value '1' for family & '0' otherwise
GLC	= Value '1' for government linked & "0" for otherwise
DUAL	= Role duality '1' dual & '0' non-dual
LOGMKTC	= Log of market capitalisation
DTA	= Debt to Total Assets
ROA	= Return on assets
INDTYPE	= Industry type
ε,i and t	= Error term, company and time respectively
α_0	= Intercept of the model

1.7.1.1. Measurement of dependent variable

The dependent variable is measured via dividend payout ratio. The dividend payout ratio in this study is computed as dividend per share divided by primary earnings per share before extra ordinary items. It is noted that the dividend yield is sensitive to share price whereas the dividend payout is not. For this reason the dividend payout ratio is taken as the primary measure of financing and dividend policy

1.7.1.2. Measurement of independent variable: investment opportunity set (IOS)

The independent variable is IOS. Evidently there is much dispute regarding IOS as proxy for growth and its measurements. However, in line with prior studies, IOS is measured in this study as MBE (Market to Book Equity)/MKTBKEQ. The MBE ratio is a combination of cash flow from assets in place and future investment opportunities. The MBE ratio does not require information on the market value of debt and the estimation of replacement values. However the MBE ratio is affected by leverage and much of the literature argue that leverage is a function of investment opportunities (Rajan & Zingales, 1995; Frank & Goyal, 2005).

1.7.1.3. Measurement of corporate governance and control variables

The corporate governance variables are the board-size, board composition, government ownership and family ownership (Refer to Chapter 5, Table 5.3). The control variables are return on assets (ROA), log of market capitalisation (LOGMKTC), industry type based on KLSE classifications, role duality (DUAL) and debt to assets (DTA) (Refer to Chapter 5, Table 5.3).

1.7.2. Research design

The study sample comprises three hundred of the highest capitalised companies listed on Bursa Malaysia for the years ended 2004 till 2006. All the information obtained is published data as the companies are listed in the Bursa. E-views are used to compute the cross-sectional data. After elimination of missing data, the sample size is reduced to 409 companies. Data on CEO duality, board size (BSIZE) and board composition (BCOM) is collected from the Malaysian stock performance guide books. Data on financial information such as return on total assets (ROA), market capitalization (LOGMKTC), MBE and DPP are obtained from the OSIRIS and BANKSCOPE.

1.7.3. Data Analysis

Statistical tests are used to perform and to check whether the tests are substitutes or complements and to test the relationship of these variables with growth opportunities. The relationship between the corporate governance variables and independent variables is tested by way of a cross-sectional analysis using panel data via fixed effects and random effects. Cross section data consist of observations on a given economic units at a given point of time and the economic units may be individual, households, firms, provinces, countries etc. Different statistical and econometric tests are used to test the relationship between the IOS, moderating corporate governance variables and the control variables. The data used for these tests varied from a combination of panel data regression and cross sectional observations.

The tests are performed to investigate the validity of the alternative hypotheses and also the relationship between the IOS measures and dividend policy. The econometric tests such as multiple regressions are used to accept or reject the alternative hypotheses put forth. The significance of the value is used to accept or reject the alternative hypothesis and hence, to subsequently establish the relationship between the IOS and dividend policy. Additional tests for heteroscedasticity, multicollinearity, and autocorrelation is also carried out to make the results more accurate and objective.

1.8. RESEARCH MOTIVATION AND CONTRIBUTION

The motivation behind this study is to establish evidence on the relationship between growth opportunities and dividend policy and the moderating effects of corporate governance elements such as ownership structure, board size and board composition on the proposed relationship of public listed companies in Malaysia. This is because a review of the extant dividend policy literature reveals that there have been no prior studies on the moderating effect of corporate governance variables on the relationship between IOS and dividend policy from an emerging economies context.

Further, as prior studies are primarily focused on developed economies, especially the western market-based capitalist and limited prior studies related to developing economies which are more relationship-based capitalist, an understanding of the applicability of the extant theories relating to the association between IOS and dividend payout in the context of the Malaysian firms will contribute to extending the empirical evidence beyond that which is obtained almost exclusively in US, UK or EU firms.

Given the different institutional setting, the application of contracting theory based on Jensen's FCF theory needs careful consideration for Malaysian firms. This study contributes to extant dividend payout literature is two ways. Firstly, the study broadens the dividend payout literature by providing evidence from an emerging economy with different institutional characteristics. Despite the numerous prior studies conducted in developed countries, on IOS and dividend payout, the overall results have been both mixed and inconclusive due to the differing ownership structure, political affiliations, legal and the regulatory environment of the countries.

Hence, the study evidences the importance of institutional context in terms of levels of investor protection, corporate policies, capital structure and ownership structure (Pryor, 2002; Claessens & Fan, 2002; Haniffa & Hudaib, 2006 and Sawicki, 2009) and the impact on the dividend policy and IOS in order to provide a more meaningful study. Furthermore, prior studies have linked IOS to other variables such as performance, debt, accounting procedure choice and compensation (Mahmud *et al.,* 2005; Baber *et al.,* 1996; Kallapur & Trombley, 1999; Skinner, 1993) but not in the context of its overall corporate governance.

Secondly, despite the extensive literature discussing the role of ownership structure in corporate governance around the world (Shleifer & Vishny, 1997; La Porta *et al.* 1999), there is limited prior research that empirically examines the relationship between ownership structure and dividend policy outcomes in the context of emerging countries. Except for prior studies that examine the relationship between ownership structure and performance (Mitton, 2004; Claessens *et al.,* 2000; Tam & Tan, 2007) and dividend payout (Farinha & Lopez-de-Foronda, 2009), little is known about the relationship between ownership structure, dividend policy and IOS. Hence, this study extends the literature on the theoretical and empirical evidence from a developing country context.

Consistent with expectations, this study finds a negative significant association between IOS and dividend payout in the context of government linked companies. The results obtained in this study extend the literature on the contracting theory based on Jensen's Free Cash Flow Theory which suggests that high growth firms pay lower dividends due to their heavy investments and the expectation of a better return by shareholders in the near future. Importantly, this study also found a significant negative association between family ownership and dividend payout and hence, highlights that Malaysian family controlled firms pay lesser dividend and appear to maximise sales and shareholders' value. With regard to Board size (BSIZE), it is found to have no significant association with dividend payout and is consistent with other prior studies which show no significant difference on the relation between board size and performance. Further, on board composition (BCOM) it is found to have insignificant association between board composition (BCOM) and dividend payout.

1.9. SIGNIFICANCE OF STUDY

This study is significant as it brings forth two key implications, namely, theoretical, and policy making.

1.9.1. Implications for theory

The study evidences the applicability of the contracting theory and Free Cash Flow theory, where managers of firms with more growth opportunities or higher IOS are more likely to pay less dividends since these firms need the cash for growth opportunities and likewise firms with low growth opportunities pay out more dividends since these firms have few opportunities to invest in positive net present value projects. However, given the unique political economy in Malaysia, it is clear that the theory is applicable only to the non-government linked companies and non-family controlled companies. Hence, the study makes a significant contribution in evidencing the role of ownership structure in dividend payouts albeit an economy that is evidently a relationship-based capitalism.

The non-applicability of the contracting and FCF theories to GLCs in Malaysia is an interesting phenomenon. This contributes to extant literature on political connection and firm performance.

1.9.2. Implications to Policy Makers

Dividends policies are guided by Malaysian Companies Act, 1965 and established case law. The Companies Act 1965 (section 365) only stipulates that dividend should be distributed from profits but does not indicate whether it should be current profits or accumulated profits. In Malaysia, there have been no standard rules governing the distributability of dividend (Chan & Susela, 2009). By examining the association between growth opportunities and dividend policy, this study provides a basis to determine the behaviour of high growth and low growth firms on their distribution of dividends. The findings of this study is useful to the regulators in deliberating policies on issues related to dividend policy and corporate governance, thus determining the direction of future dividend rules for Malaysian companies.

1.10. STRUCTURE OF THE THESIS

The discussion in this thesis is organised in seven chapters.

Chapter One: Overview of Research

This chapter discusses the background of the study, gaps in the literature on Investment opportunity set (IOS) (or Growth opportunities) and dividend payout, theoretical framework, problem statement, research question, methodology and research design, research motivation and contribution and significance of the study.

Chapter Two: A review and synthesis of the IOS and dividend payout literature

This chapter provides the background of dividend growth as well as introduces the concept of Dividend growth. This chapter also provides extensive discussion on the contracting hypotheses, given that high growth firms pay lower dividends and low growth firms pay higher dividends. Further, this chapter focuses on extant dividend literature and identifies gaps in the dividend payout literature.

Chapter Three: A review and synthesis of Corporate Governance literature

This chapter reviews the effects of cultural differences with regard to family and government ownership, board-size and board composition that have been shown to influence business practices and organisations. Malaysian corporate environment offers clearly identifiable capital segments divided among ethnic lines. This division can clearly be observed in the listed firms whose board membership and share ownership are predominantly controlled by two main ethnic groups. This section reviews the relevant literature on governance mechanisms and summaries the empirical evidence on determinants of corporate governance mechanism.

Chapter Four: A review and synthesis of Dividend Payout, growth and corporate governance

This chapter briefly reviews the impact of various factors on dividend policy and payout ratios in the emerging market of Malaysia. The focus is mainly on whether there is a link to the contracting theory which states that high growth companies pay low dividends while low growth firms pay high dividends. This chapter summarises the weaknesses of the mainstream theories before engaging in the analysis of the motivations identified earlier by previous researcher in order to locate appropriate theoretical explanation. Lastly, this chapter concludes by generating a framework on the contracting theory based on Jensen's Free Cash flow Theory and prior literature on the determinants of dividend policies.

Chapter Five: Methodology and Research Design

The variables identified from the data are integrated into the preliminary framework developed in Chapters: two, three and four. The hypotheses are developed based on the discussion of the relationship between the IOS, dividend policy and corporate governance variables. Further, this chapter also discusses the need for the formulation of specific procedures to compute IOS and growth options. Finally, a complete set of framework is presented at the end of the chapter. The results are derived from the models of the corporate governance and used to establish either acceptance or rejection of the hypothesis. On the area of Research Methodology and Data Analysis, this chapter begins by discussing the research approach and type of analysis adopted in the study. It follows with a discussion on the quantitative research design. It elaborates and focuses on the research design, sampling plan, data sourcing, and data measurement method and data analysis techniques. The data obtained is then analysed to locate the theme's that are summarized into a matrix table. This chapter also encompasses data interpretation and data analysis comprising data screening, descriptive analysis and inferential analysis.

Chapter Six: Results and Discussion

This chapter presents the findings of the study. It also discusses the application of the contracting theory based on Jensen's FCF theory in the Malaysian context and implications for corporate governance and dividend studies in a developing country perspective.

Chapter Seven: Summary and Conclusion

In this last chapter, the contribution, limitation and suggestions for future research are discussed.