J. Basic. Appl. Sci. Res., 4(2)277-283, 2014

ISSN 2090-4304
Journal of Basic and Applied Scientific Research
www.textroad.com

The Relationship between External Mechanisms of Corporate Governance and Dividends Policy (Companies Accepted in TSE)

Seyyed Milad Fathi Choubeh[1], Zahra Khorramdel Masouleh[2], Atena Hazrati Talami[3]

[1,2]Department of accounting, Sowmesara Branch, Islamic Azad University, Sowmesara, Iran
[3]Student of Islamic Azad University, Rasht, Iran

Received: November 24 2013
Accepted: December 31 2013

ABSTRACT

This paper investigates the effects of corporate governance mechanisms on dividends policy. Corporate governance is examined by external corporate governance variables such as government influence, the amount of minor shareholder (flow share), the ownership percentage of major shareholder and the amount of institutional shareholders. Panel data method is used on 101 companies which are accepted in TSE (Tehran Security Exchange) during 2004-2011. The results show that government influence, the amount of minor shareholder (flow share) and the amount of institutional shareholders have an inverse and meaningful relationship with dividends policy but the number of institutional investors has no meaningful relationship with dividends policy.

KEY WORDS: Corporate governance, dividends policy, flow share, institutional investor, government influence

INTRODUCTION

From all the important issues that have been considered by researchers about financial scandals in large companies level, and also as an important issue to the investors, corporate governance pay a great attention to the necessity of supervising management and separating economic units from their ownership and finally keeping investors and stockholders' rights. On the other side, many researches have been done on dividends policy but still there are some questions unanswered that why companies do not distribute profit or why investors pay attention to dividends. This is known as "dividends puzzle" in financial affairs. (Adaoglu, Cahit 2000)

According to Jenson and Mac ling (1976) the base of corporate governance studies is the agency theory and agency affairs are resulted from the separation of ownership from its control. In Common Corporation, shareholders (employer) give decision making option to their managers (agencies) (Mashayekhi and Abdolahi 1385). This separation has caused discussions about owners' affairs and their managers. According to the financial theory, the managers should make their efforts for owners' interest. In common corporation structure can be either diffused (existence of many small shareholders) or centered (existence of a few major shareholders). When ownership is in the hand of major shareholders, the control system is centralized and in the time of ownership distribution, the control system will be decentralized. Since the ownership centralization is one of the important determinants in corporate governance mechanism, it seems centered owners identities have a great role in relation with corporate ownership (Gursoy, Gner 2003)

The amplification of accountability and social responsibilities of corporation management has caused introducing of corporate strategy principle in the beginning of twenty-first century. In recent decades financial and economical circles have worked on the subject of internal control systems and how to participate and contribute all shareholders or in the other words the interest of all stakeholders. Without any doubt, corporate strategy principle is a small component in the society reign and strategy. Corporate strategy is only a part of a greater economic environment which corporations act in it. The strategy framework of each corporation depends on the legal, regulatory and institutional environment. An appropriate corporate strategy principle seeks a compiled framework and a suitable mechanism in order to create a modified relationship between small shareholders' and major shareholder's interests. In newer viewpoint, a serious consideration has been tended to the right of all interested groups including society, capital market and all the corporations (HassasYegane). Corporate strategy principle focuses on the declaration of information and omitting internal information. It tries to keep shareholders' interests equally, separate management from ownership and decentralization by using some scheme power in corporations (HassasYegane).

Corresponding Author: Seyyed Milad Fathi Choubeh, Department of accounting, Sowmesara Branch, Islamic Azad University, Sowmesara, Iran. Email: f.c_milad@yahoo.com

LITERATURE REVIEW

Walsh and Horkinz (1971) found that there is a conflict in shareholders' tendency to dividend and manager's need of investing retained earnings. Managers consider current and expected earnings, past dividends, dividends stabilities, cash flow, investing opportunities and shareholders' desire in the level of earning payment (Frankfuture, George 2002). According to this, corporations should take a dividend policy which balances current dividends and future growth and with the increase in the stock price, it makes the most value for the shareholders (Barker et.al 2006).

Baba and Nashiko (2008) investigated the increase of foreign investors on dividend policy. The result showed that the increase in foreign investors with high possibility (low) increased (decreased) earning distribution and in fact it caused decrease (increase) in information asymmetric among managers and shareholders.

Mitton (2004) with a sample of 365 companies from 19 different countries showed that companies with stronger corporate governance pay more dividends. The findings matched agency models which justify dividends payment. In addition in corporations with stronger corporate governance there is a negative relationship between dividend payment and growth opportunities. Corporation with stronger governance are more profitable but more profitability explains only a part of high dividend payment.

Chae et al (2009) showed that corporations with efficient corporate governance pay less dividends under high external financing limits whereas corporations with weak corporate governance pay more dividends under less external financing limits.

Pornsit et al (2008) found that there is a positive relationship between the quality of corporate governance and dividends. This result doesn't change after controlling corporate elements such as size, profitability, tax effects and growth opportunities. Garay and Gonzalez (2008) also found a positive relationship between the mechanism of corporate governance and firm value.

Kowalewski and Talavera (2007) did a research in Poland by the name of corporate governance and dividend policy. Their work is summarized into two parts. The first part investigates the determinant elements in dividend payment and the second part tests the corporate governance methods in non-financial firms. Their results showed that big and more profitable firms which are more risky and in debt tends to pay less dividends.

Gue and Ni (2009) investigated the relationship between institutional ownership and firm's dividend policy. They chose a sample of American industrial firms from 1980 to 2002 and the results indicated there was a direct relationship between dividends payment and the measure of institutional ownership.

Kouki and Guizani (2009) tested the effect of ownership structure on dividend policy in Tunisian Stock Market. They found out companies with centralized ownership, pay more dividends and there is a negative and meaningful relationship between institutional ownership and the level of dividend payment, and the relationship between dividend policy and governmental ownership is positive.

Harada and Nguyen (2006) investigated the effects of ownership structure on dividend payment in Japanese companies. The findings showed an inverse relationship between ownership concentration and paid dividends. There was also a less possibility that corporations with centralized ownership raise the dividends at the time of profitability and there was a high possibility that companies with improvement in investing opportunities might not pay any dividend.

Zanjirdar and Mousavi (2010) investigated the relationship between internal and external mechanism of corporate strategy and earning management. The results indicated that internal audit, the percentage of major shareholder and the ratio of non-board directors have an inverse relationship with earning management. There was no meaningful relationship between other internal and external mechanism and earning management.

Mehrani and Bagheri (2009) investigated the relationship between earning management and free cash flow using Jenson theory. They investigated the effect of institutional shareholder as an external controller on adjusting the mentioned relationship. Findings showed a direct and meaningful relationship between earning management and high free cash flow in companies with less growth but there was no meaningful relationship between earning and institutional shareholders.

Research hypothesis

The main hypotheses: there is a relationship between external mechanism of corporate governance and dividend policy.

Sub- hypotheses 1: there is a relationship between the amounts of ownership and government influence and dividend policy.

Sub- hypotheses 2: there is a relationship between the percentage of free flow share and dividend policy.

Sub- hypotheses 3: there is a relationship between the amount of institutional investors and dividend policy.

Sub- hypotheses 4: there is a relationship between the ownership percentage of major shareholders and dividend policy.

Research variables

In the main hypotheses the effect of each external elements of corporate strategy was tested separately on dividend policy. There are 4 variables in the external mechanisms: government influence, the amount of minor shareholder (flow share), the ownership percentage of major shareholder and the amount of institutional shareholders.

$$DVI = \alpha i + \beta\ CG + \beta 2\ fSIZE\ e + \beta 3\ Profitability + \beta 4\ Leverage + \beta 5\ Q + eit$$

Dividend policy (dependent variable): from different method of dividend payment, variable dividend is chosen.
Corporate governance elements (independent variable): in this paper external mechanisms of corporation strategy are tested which corresponds with financial and economic environment of our country.

External mechanisms

1. The amount of ownership and government influence in corporation: government shares in the corporation can be examined as this variable. We seek the answer of this question that whether the major shareholder is government or not. This variable is presented by so-top 1.
2. The percentage of free flow share: it refers to an amount of share which it's expected to be traded in near future. It means these shares are owned by these who are ready to sell them in a suitable time and at a reasonable price. It's presented by Indiv.
3. The number of institutional investors: it refers to the number of shares held by institutional investors. Institutional investor is either a person or an institute that buys and sells a major amount of share. Such as retirement fund, bank or insurance companies. It is presented by Fiisown.
4. The ownership percentage of major shareholders: it refers to the percentage of share held by major shareholder. Major shareholders are those who owned more than 5% of a corporation's shares. It is presented by Sppo.

Controlling variables:

A. Firm's size: we use the logarithm of the sum of assets as the representation of the firm's size.
B. Profitability: to control profitability we use EBIT ratio.
C. Firm's growth: Q-Tobin (economic index of firm's growth) is used to control the firm's growth. In other word Q-Tobin is the sum of present market value of the share , the value of its debt on the sum of book value of firm's assets.
D. Financial leverage: the proportion of long term debt on the sum of assets is used to present financial leverage.

DATA AND METHODOLOGY

Research statistical society includes all companies listed in Tehran Stock Exchange and the hypothesis will be tested and studied in relation to the statistical society. Because of expansion of statistical society size and the existence of some inconsistency among community members lead to following criterion for selecting the sample, so the sample was selected using systematic removal. These conditions include:
1. Companies were accepted in the Tehran stock exchange before 2004.
2. The end of 20th of March is the end of fiscal year.
3. Not including investment companies.
4. Companies required data; Special notes accompanying financial statements in order to extract the required data should be available.
5. Not including banks and financial institutions (Investment companies, financial intermediaries, holding and leasing companies). Hence the financial disclosure and corporation of governance structures are different they should not have loss in their fiscal year.
This study investigates the relationship between the policy of variable dividends and mechanisms of corporate governance principles. So the analyses were done using simple and multiple linear regressions model. In this research, quantitative efficient relationship and external corporate governance mechanisms (independent variable) including government influence, the amount of minor shareholder (flow share), the ownership percentage of major shareholder and the amount of institutional shareholders are analyzed on the policy of dividends (dependent variable). The gathering data is analyzed using the EVEIWS software.

Sub-Hypotheses tests

Sub-Hypothesis 1 test: Sub-Hypotheses 1 explains that there is an inverse relationship between the amount of ownership and government influence and dividend policy. To test the relationship between dependent variable with each independent variable, H0 and H1 are considered:

H0: there isn't an inverse relationship between the amount of ownership and government influence and dividend policy.

H1: there is an inverse relationship between the amount of ownership and government influence and dividend policy.

We can use statistics to demonstrate the hypothesis:

H0: $\beta \geq 0$

H1: $\beta < 0$

DVI = Â1 + Â ISO-TOP1 + Â2 FSIZE + Â3 PROFITABILITY + Â4 LEVERAGE + Â 5 Q + EIT

This model is estimated using fix annually effects. Y intercept is computed separately for each given year.

In this paper if government or governmental corporations are one of the major shareholders of the corporation and own more than 5% of the corporation's share, they have influence on the corporation.

T-statistic is used for the meaningfulness of independent variable and F-statistic and P-value (prob) are used to test the meaningfulness of the regression.

Table 1- Sub-Hypothesis 1 test

Dependent variable: dividend policy			
Dependent and control variables	Coefficient	T-statistic	T-statistic possibility
the amount of ownership and government influence	0.0553087	2.202152	0.028
Firm's size	-0.01602	-1.56959	0.117
profitability	0.220896	2.970979	0.0031
Firm's growth	0.00197	0.19373	0.8464
Financial leverage	0.0000126	0.57559	0.5651
F statistic	34.43502	f-statistic possibility	0.0000
R^2	0.228145	Modified R^2	0.221519
Durbin-Watson	2.040695	White test	0.414982

As it is shown in table 1 the P-value of the amount of ownership and government influence is more than 0.05 so H0 is rejected and we can conclude that there is an inverse and meaningful relationship between this variable and dividend policy.

Durbin-Watson statistic is used to test the independency of errors from each other. If this statistic is between 1.5 to 2.5 it means the errors are independent to each other and we can use the regression as it is shown this amount is 2.040 so we can use this regression.

White-Test was also used for the inconsistency of variances and as shown in the table it is 0.4149 which is more than 0.05 so we can conclude that there is no problem regarding inconsistency of variances.

Sub-Hypothesis 2 test: Sub-Hypotheses 2 test explains there is an inverse relationship between the percentage of free flow share and dividend policy.

As usual H0 and H1 are considered:

H0: $\beta \geq 0$

H1: $\beta < 0$

DVI = Â1 + Â INDIV + Â2 FSIZE + Â3 PROFITABILITY + Â4 LEVERAGE + Â 5 Q + EIT

We get the free flow share variable from Tehran Security Exchange site. The results are shown in table 2.

Table 2: Sub-Hypothesis 2 test

Dependent variable: dividend policy			
Dependent and control variables	Coefficient	T-statistic	T-statistic possibility
the percentage of free flow share	0.232255	3.12453	0.0019
Firm's size	-0.00856	-0.87448	0.3822
profitability	0.215335	2.935505	0.0034
Firm's growth	0.00324	0.3153	0.7526
Financial leverage	0.0000103	0.468758	0.6394
F statistic	35.44826	f-statistic possibility	0.0000
R^2	0.233292	Modified R^2	0.22671
Durbin-Watson	2.029275	White test	0.356748

The resulted P-value is 0.2322 which is more than 0.05. It means the hypotheses "H0" is rejected therefore there is an inverse and meaningful relationship between the two variables.

This result accords with some recent researches. Among the mechanism of corporate strategies, the amount of minor shareholder (free flow share) has a negative relationship with dividend policy. In other hands, those corporations which have more free shares pay fewer dividends. (Rajabi and Khodabakhshi 2008)

Sub-Hypothesis 3 test: it explains thatthere is an inverse relationship between the amount of institutional investors and dividend policy. We design a regression as follows:

DVI = Â1 + Â NII + Â2 FSIZE + Â3 PROFITABILITY + Â4 LEVERAGE + Â 5 Q + EIT

Table 3: Sub-Hypothesis 3 test

Dependent variable: dividend policy			
Dependent and control variables	Coefficient	T-statistic	T-statistic possibility
institutional investors	-0.00468	-0.88842	0.3746
Firm's size	-0.00761	-0.71693	0.4737
profitability	0.230058	3.050564	0.0024
Firm's growth	0.002792	0.272965	0.785
Financial leverage	0.0000115	0.524251	0.6003
F statistic	333.5605	F-statistic possibility	0.0000
R^2	0.015127	Modified R^2	0.0020556
Durbin-Watson	2.033747	White test	0.090575

As it is shown in table 3, P-value -0.00468 is less than 0.05. Therefore our hypothesis is rejected and there is no relationship between institutional investors and dividend policy.

Generally there are two inconsistent opinions about the relationship between institutional ownership and dividend policy.

1) Negative (inverse) relationship: when there is an interest conflict, external and outside activities are important control elements. Institutional investor is an external observer. If major institutional investors act as external observers and dividends are paid for agency cost, according to agency theory there should be a substitution relationship between dividends and institutional ownership. This condition causes a negative relationship between the percentage of shares owned by institutional investors and dividend policy.
2) A direct (positive) relationship: institutional investors' motivation about free ride in observing activities requires them not to tend to observe themselves. Directly. Instead of observing, these investors force corporations to increase dividends they prefer free cash flow distribute as dividends. (Easter brook 1984)

Sub-Hypothesis 4 test: it explains thatthere is an inverse relationship between the ownership percentage of major shareholders and dividend policy.

DVI = Â1 + Â SPPO + Â2 FSIZE + Â3 PROFITABILITY + Â4 LEVERAGE + Â 5 Q + EIT

Major shareholders mean those shareholders who own more than 5% of the corporation's share. The result table is as follows:

Table 4: Sub-Hypothesis 4 test

Dependent variable: dividend policy			
Dependent and control variables	Coefficient	T-statistic	T-statistic possibility
ownership percentage of major shareholders	-0.15878	-2.5474	0.0111
Firm's size	-0.00927	-0.94256	0.3462
profitability	0.216353	2.89544	0.0039
Firm's growth	0.003521	0.343788	0.7311
Financial leverage	0.0000122	0.554453	0.5794
F statistic	34.80068	f-statistic possibility	0.0000
R^2	0.230518	Modified R^2	0.223894
Durbin-Watson	2.035313	White test	0.421111

The gained P_value prove that there is an inverse relationship between the two variables. The result is parallel with related researches. Some researches such as Shleifer and Vishny (1997) believe that major shareholders can control minor shareholders and other interests and they can collude with the management. Iturriaga and Hofman (2005) showed that major shareholder increase dividends and limit managers of doing their optional behaviors.

Main hypotheses test

There is a relationship between external mechanism of corporate governance and dividend policy. In the regression all four mentioned mechanisms are inserted:

DVI = Â1 + Â1SO-TOP1+ Â2 INDIV+ Â3 NII+ Â4 SPPO + Â5 FSIZE + Â6 PROFITABILITY + Â7 LEVERAGE + Â8 Q + EIT

The result of this regression is shown in Table 5. The meaningful relationship of 3 elements are proved

Table 5: Main hypotheses test

Dependent variable: dividend policy			
Dependent and control variables	Coefficient	T-statistic	T-statistic possibility
the amount of ownership and government influence	0.07152	2.18253	0.0294
the percentage of free flow share	0.3634	1.88996	0.0592
institutional investors	-0.00644	-1.13123	0.2583
ownership percentage of major shareholders	-0.0212	-0.17906	0.8579
Firm's size	-0.00982	-0.91907	0.3584
profitability	0.233446	2.904235	0.0038
Firm's growth	0.0000115	0.199109	0.8422
Financial leverage	0.001938	1.80515	0.0713
F statistic	24.71082	f-statistic possibility	0.000
R^2	0.242687	Modified R^2	0.232866
Durbin-Watson	2.04079	White test	0.23198

To have a general look at the results of all hypotheses, a summery table is provided:

Table 6: summary of results

Statistic components **Research variables**	**R^2**	**Adjusted R^2**	**Durbin-Watson**	**T - statistic**	**number**	**Error level**	**Meaningfulness level**	**result**
the amount of ownership and government influence	0.05308	0.22151	2.04069	2.202152	707	0.05	0.028	Not rejected
the percentage of free flow share	0.23225	0.22671	2.02927	3.12453	707	0.05	0.0019	Not rejected
institutional investors	-0.00468	0.00205	2.03374	-0.88842	707	0.05	0.3746	Rejected
ownership percentage of major shareholders	-0.15878	0.22384	2.03531	-2.5474	707	0.05	0.0111	Not rejected

Suggestions for Future Researches

There are always new ways opened after each research which show the necessity for more researches. Following subjects are suggested for future researches:

1. Banks role as an institutional investors
2. The efficiency of unbound directors in companies accepted in security exchange
3. The structure of capital and the growth opportunities of earning management

Acknowledgment

The authors declare that they have no conflicts of interest in this research.

REFERENCES

1. Adaoglu C (2000). Instability in the dividend policy of the Istanbul Stock Exchange_ISE/corporations: evidence from an emerging market. Emerging Markets Review
2. Ajinkya B, Bhojraj S, Sengupta P (2005). The association between outside directors, institutional investors and the properties of management earning forecast. Journal of Accounting Research. 43(3): 343-376.
3. Blau B, Fuller K (2008).Flexibility and dividends. Journal of Corporate Finance. 14(2): 133-152.
4. Chen Y, Chuang W (2009). Alignment or entrenchment? Corporate governance and cash holdings in growing firms. Journal of Business Research. 11(62): 1200-1206.
5. Chtourou M, Bedard j, Courteau l (2001). Corporate governance and earning management. Working Paper. Available at SSRN: http://ssrn.com/abstract.

6. Fama E (1980). Agency problems and the theory of the firm. Journal of Political Economy. 88(2):288-307.
7. Han K, Lee S, Suk D (1999). Institutional Shareholders and Dividends. Journal of Financial and Strategic Decisions. 12(1):53-62.
8. Harford H, Mansi S, Maxwell W (2008). Corporate governance and firm cash holdings in the US. Journal of Financial Economics. 87:535-555.
9. Jensen M.C (1986). Agency Costs of Free Cash Flow, Corporate Financial and Takeovers. AEA Papers and Proceedings. 76 (2):323-329.
10. Jiraporn P (2007). Dividend policy, shareholder Rights, and Corporate Governance. CFA. Institute. 37(4).
11. Kowalewski O, Stetsyuk I, Talavera O (2007). Corporate governance and dividend policyin Poland. Working Paper 07-09. Wharton Financial Institutions Center.
12. Lopez-Itturiaga F, Saona P (2005). Managers Discretionary Behaviour, earning management and internal mechanisms of corporate governance: Empirical Evidence From Chilean Firms. Corporate ownership and control. 3(1)
13. Mitton, T (2004). Corporate governance and dividend policy in emerging markets. Emerging Markets Review. 5:409-426.
14. Rozeff M (1982). Growth, beta and agency costs as determinants of dividend payout ratios. The Journal of Financial Research. 5(3):249-259.
15. Sawicki J (2006). Corporate governance and dividend policy in Southeast Asia pre- and post-crisis. European Journal of Finance. 15: 211-230.
16. Silva C, Leal R (2003). Corporate governance, market valuation and dividend policy. Working Paper 390, Federal University of Riode Janeiro, Available at SSRN: http://ssrn.com/abstract=477302.
17. Shleifer A, Vishny R (1997).A Survey of corporate governance .Journal of finance. 52(2):737-783.
18. Truong T, Heaney R(2007). Largest shareholder and dividend policy around the world. The Quarterly Review of Economics and Finance. 47(5):667-687.
19. Zeckhauser R.J, Pound J(1990). Are Large Sharholders Effective Monitors? An Investigation of share Ownership and Corporate Performance. In: Hubbard, R. G. (Ed.), Asymmetric Information Corporate and Financial Investment, university of Chicago Press, Chicago, PP.149-180.