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Impact of Corporate Governance on Dividend Pay-out Policy of Malaysian Insurance Companies

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Abstract:

The purpose of this research is to test the impact of corporate governance on dividend payout policy of Malaysia insurance companies. The relationship between size of the board, board independence and CEO duality with dividend yield is tested. The control variables applied in this study are size of the firm, company profitability and company growth as well. To carry out the research, secondary data of nine insurance companies listed on Bursa Malaysia from 2013 to 2017 are collected by referring to their Annual Reports. Based on the regression results, it is found that the size of the board and board independence have significant positive relationship with the insurance firms' dividend yield. On the other hand, insignificant negative relationship was found between CEO duality and dividend yield. The findings enable understanding and increased exposure to the relationship between corporate governance and dividend payout especially for the insurance industries in Malaysia.

Keywords: Board independence, board size, bursa Malaysia, CEO duality, corporate governance, dividend yield, insurance companies

1. Introduction

Asian financial crisis (1997) directed the companies of Asian countries to start focusing on the significance of corporate governance. Most of the companies in Asia were hit badly by the crisis, causing financial or economic losses. Failures of many companies including the blue-chip companies like UEM were observed where the weak corporate governance is one of the attributed causes. For this reason, corporate governance is becoming more relevant, and the companies started to apply corporate governance codes in their daily management. Corporate governance in different countries is generally different in terms of its codes and regulations. The best corporate governance mechanism in other countries which had been concluded in research may not as suitable as in Malaysia (Haniffa and Hudaib, 2006). However, Asian Financial Crisis 1997 drives and motivates the development and importance of corporate governance. Many companies had been negatively impacted by the crisis. Therefore, in 1998, Finance Committee on Corporate Governance (FCCG) was formed by the government. The members of FCCG were responsible in looking and evaluating the practice of corporate governance as well as providing the legal suggestions to improve the former practice.

Brunzell et al. (2013) defined dividend policy as the monetary scheme revolving around profit payout to maintain the reputation of the firm and protect the interest of shareholders. Jensen and Meckling (1976) stated that there is a relationship between dividend and the company's value due to agency cost. A firm's value can be greatly impacted by dividend payout, and this makes payout policy an important decision to be made. Investors also look at the dividend change pattern of a firm before investing. Finally, dividend payout is one of the methods to maximize shareholder's wealth. Figure 1 shows a continuous decreasing trend in annual dividend payout in Malaysia. There is an approximate 43% of the decrease in dividend payout from 2013 (\$7.7 billion) to 2017 (4.4\$ billion). Despite the increasing dividend payout of emerging markets in 2017, an approximate decrease of \$1 billion in Malaysia was noticed in 2017 compared to 2016. This may be due to the slow export performance, rising labor cost and comparatively weaker purchasing power. The firms are thus having a hard time to manage their business and increase revenues at the same time.

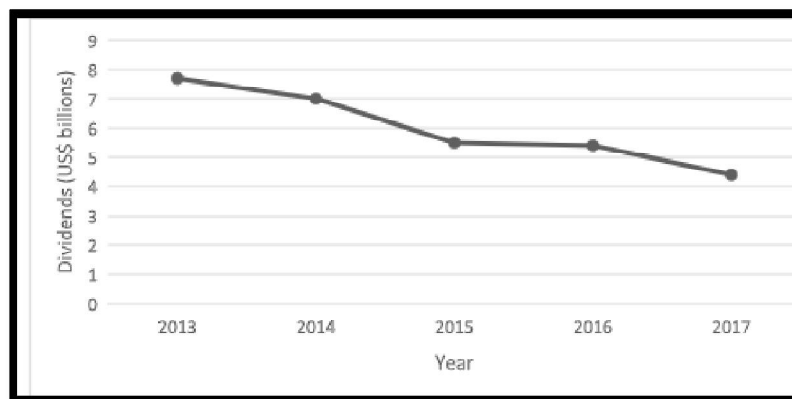


Figure 1: Annual Dividend Payout Trend in Malaysia
Source: Janus Henderson Global Dividend Index (2018)

The purpose of this research, therefore, is to test the impact of corporate governance on dividend payout policy in Malaysian insurance companies. Shailer (2004) defines corporate governance as the established methods and processes to manage and control the firm. Each member of the company including shareholders, board managers, and stakeholders is assigned specific role and they adhere to the set of rules when deciding. Being as one of the crucial elements to achieve effective management, corporate governance is employed by the large extent of countries and every nation has their own unique governance codes and regulations. Corporate governance also helps in making sure that the firms and outside resources are used in a right and productive way. The Companies (Amendment) Act 2007 is enforced on 15 August 2007 which affects the corporate governance mechanism in Malaysia. For instance, the interested directors are not allowed to take part or give votes. Hence, a right-abusive director who may affect the shareholders' right in receiving the dividend is not allowed. The next relevant regulatory framework is the enforcement of Capital Market Services Act (2007). It proposes to protect the investors. The Securities Commission Malaysia is given the right to remove any directors who abuse the rights and no longer eligible to direct the firm. According to section 320, the listed firms' employees and auditors must notify the authorities of any breaking of laws regarding the securities and stock exchange. Securities Commission Malaysia is also empowered to take actions against the person who falsified the financial statement. In addition, enforcement of Bursa Malaysia's Listing Requirement in 2007 request that the members of the Audit Committee must be non-executive directors. According to the previous research, most of the researchers chose developed countries to investigate the relationship between corporate governance and dividend payout. United States and United Kingdom firms are among the preferred research background. There are few country-based research which focuses on the emerging markets like Malaysia except for India, China, and Korea. The phenomenon in the highly regulated insurance industry in Malaysia is not addressed properly by previous studies. It is shown that the literature review could not sufficiently explain whether the dividend payout policy in Malaysian insurance companies has any relation with the different corporate mechanism in industry. To summarize these hypothetical arguments, this study targets to test the impact of corporate governance on dividend payout policy.

2. Literature Review

By applying regression analysis fixed effect model, Mansourinia et al. (2013) found a positive relationship between board size of a firm and its dividend payout based on 140 companies listed on Tehran Stock Exchange from the year 2006 until 2010. A positive association between these two variables is also proved by Subramaniam and Susela (2011) and Uwuigbe (2013). By applying ordinary least squares method, Subramaniam and Susela (2011) conducted their study on top 300 Bursa-listed Malaysian companies from the year 2004 until 2006. Meanwhile, from the year 2006 to 2011, 50 companies listed on the Nigerian Stock Exchange were chosen by Uwuigbe (2013) to test the determining factors on dividend payout. Moreover, Maniagi et al. (2013) supported the findings by concluding that dividends increase with the increase of the size of the board. They carried out the research on Nairobi-listed banks from the year 2007 until 2011. Yarram and Dollery (2015) were of the view that decision making by a smaller board is not as effective as a larger board, therefore produce a weaker dividend payout policy. This result was based on their study on 413 non-financial Australian firms from the year 2004 to 2009. On the other hand, Mehdi et al. (2017) ran a panel regression model on a sample of 362 non-financial listed companies in Malaysia, Indonesia, Taiwan, Thailand, Bahrain, Saudi Arabia, Oman, and Kuwait to test the effect of ownership structure and board governance on payout decision in the emerging markets. The findings generated are that size of the board have a negative relationship with the payout of an emerging market's firm during financial crisis.

The number of independent directors does not have a significant impact on a firm's payout policy based on the research done on 140 Tehran-listed firms through fixed effects model (Mansourinia et al. 2013). They used board size, CEO duality and board independence to test their impacts on payout decision. Abdelsalam et al. (2008) also found no significant relationship between these two variables by conducting a binary logit regression model on top 50 listed companies in Egypt ranging from the year 2003 until 2005 to examine emerging markets' payout policies. However, Sharma (2011) proved a positive association between board independence and dividend payout policy in his study on 944 listed companies by applying binary logistic regression analysis. Board independence is found to be positively related with the dividend payout policy in other research as well (Uwuigbe, 2013; Yarram and Dollery, 2015). Yarram and Dollery (2015)

selected 413 Australian non-financial companies as the sample from the year 2004 to 2009. By conducting pooled Tobit regression analysis and random effects panel Tobit analysis, positive relationship between these two variables was concluded.

To test the effect of board size, CEO duality and board independence on payout decisions, Mansourinia (2013) concluded that there is no clear relationship between CEO duality and payout policy based on the research on 140 firms listed in Tehran Stock Exchange. It is also found that the probability to distribute dividend is rare when the CEO holds two positions at one time (Chen et al. 2011). Collecting data from the year 2001 until 2007, they conducted their study on 1056 China firm's public-listed in Shanghai and Shenzhen Stock Exchanges. When a CEO is the board chairman, the functionality and duty of other members cannot be conducted well. Arshad et al. (2013) selected 12 companies in information, communication, and transportation industry listed in Karachi Stock Exchange firms for the period of 2007-2011. They concluded a negative relationship between the duality of a CEO and dividend payout. On the other hand, a positive relationship between these two variables is shown in the study by Obradovich and Gill (2012). The independent variables in this study are CEO duality, internationalization of firm, board size and institutional ownership. They used 296 American companies which are publicly listed on New York Stock Exchange from the year 2009 until 2011. It is proved that CEO duality impacts the dividend payout positively through bivariate correlation analysis and ordinary least square analysis.

3. Data and Methodology

The purpose of this study is to investigate the impact of corporate governance on dividend payout of insurance firms. A total of 9 insurance firms have been listed on Bursa Malaysia as of 2017. All the 9 insurance firms are selected from the year 2013 until 2017 and panel data approach is applied. All these data are gathered from the company's Annual Report obtainable on the website of Bursa Malaysia and Data Stream Database available from the University of Malaysia Sarawak. To carry out the analysis, use of E-views software is involved. The 9 insurance firms are Allianz Malaysia Berhad, LPI Capital Bhd, MAA Group Berhad, Manulife Holdings Berhad, MNRB Holdings Berhad, MPHB Capital Berhad, Pacific & Orient Berhad, Syarikat Takaful Malaysia Berhad, and Tune Protect Group Berhad. All these companies have operated in Malaysia for years and are considered stable. Board size, board independence, and CEO duality are the independent variables and dividend yield acts as the dependent variable with the control variables including company size, profitability, and company growth. All values of these variables are computed by putting the data from financial reports into the formula.

Nickell (1981) stated that the correlation between error term and lagged dependent variables are ignored in the fixed effects model. Constant slope and not constant intercepts are its characteristics. In some cases, there may be factors that are failed to be observed and they are correlated with the regression variables. Otherwise, the regression model fails to include all the constant variables. This can lead to the bias of omitted variables. Fixed effects model removes this kind of bias. However, the effects of variables that vary in a very small degree cannot be assessed and evaluated. On the other hand, Clark and Linzer (2015) mentioned that the random effects model is one that supposes random drawing of data from a large population which has constant mean. To put it simply, this model considers the differences existed between individual study effects. Estimation of coefficients with smaller variability from sample to sample is possible under this model (Clark and Linzer, 2015). However, the weakness of the random effects model is that it may lead to bias due to partial pooling in the estimation of coefficients value. Clark and Linzer further elaborated that zero correlation between interest as well as unit effects can help to avoid the bias. Since the dummy variable is not included, independent variables tend to be less and multicollinearity problem can be reduced. Clark further stated that the complexity of random effects can be smaller than a fixed effects model.

Baltagi (2001) stated the usefulness of panel data in removing heterogeneity that one may fail to notice makes it an approach better than time-series data approach. Particularly, i is referred to the companies for cross-sectional data while t is the range of years from 2013 until 2017 for time series data. After conducting Hausman test using eViews, the preferred model for this study is Fixed Effect Model (FEM). Following Alkurdi et al. (2017) and Riaz et al. (2016), the proposed regression model is modified and formulated as presented below:

$$DY_{it} = \beta_0 + \beta_1 \text{LOG_BS}_{it} + \beta_2 \text{BI}_{it} + \beta_3 \text{CEOD}_{it} + \beta_4 \text{LOG_FS}_{it} + \beta_5 \text{CP}_{it} + \beta_6 \text{CG}_{it} + \varepsilon_{it}$$

Where, DY = Dividend Yield

LOG_BS = Natural Logarithm of Board Size

BI = Board Independence

CEOD = CEO Duality

LOG_FS = Natural Logarithm of Firm Size

CP = Company Profitability

CG = Company Growth

ε = Error Term

3.1. Operational Definition of the Variables

3.1.1. Dividend Yield (DY)

Dividend yield is the dependent variable in this study. Being as a controversial issue in finance most of the times, dividend payout is one of the popular studies due to its crucial role in reducing agency cost. Brunzell et al. (2014) defined dividend policy as the monetary scheme revolving around profit payout to maintain the reputation of the firm and protect the interest of shareholders. For instance, the board of directors is impacted on the number of dividends supposed to pay to the shareholders and decided whether to focus on shareholders' wealth maximization or increase the wealth of the firm.

On the other hand, the firm's managers will choose between dividends payout or retain the dividends as the earnings for this year instead. Dalbor et al. (2004) concluded the decisive role of boards of directors in keeping the balance of the shareholders' interest and the firm's wealth.

Many researchers had adopted this variable in their studies to act as the dividend policy's measurement (Abdul Wahab et al. 2008; Ammer, 2007; Hooi et al. 2015; Huang et al. 2012; Sulong and Nor, 2010). Sulong and Nor (2010) stated the appropriateness of dividend yield in measuring dividend policy on account of usage of share price instead of inclusion of net income. Schooley and Barney (1994) also emphasized that a negative value can be obtained in earnings computation but there is no negative value in the share price in the case in which the firms suffer loss. Therefore, the dividend yield is computed as followed:

$$\text{Dividend Yield (DY)} = \text{Dividend per Share} \div \text{Price per Share} \times 100$$

3.1.2. Board Size (BS)

The most popular mechanism of corporate governance is the board of directors. This is significant in controlling agency problems (Fama and Jensen, 1983). Amran (2011) stated that the size of a board is represented by the number of directors on a company's board. Amran further claimed that a larger board is more powerful than smaller board due to its accessibility to resources and pooling of various resources.

In the past studies by Germain et al. (2014) and Chen (2014), the sum of the number of board directors is the board size. Ning et al. (2010) stated that the selection of board size can depend on maximizing the value, dependency of the resource as well as benefits brought. Lipton and Lorsch (1992) was of the view that there should be 8 to 9 members to constitute an ideal board size where 7 to 8 is recommended by Jensen (1993). Romano and Guerrini (2014) squared the number of board directors to determine board size while the natural logarithm of board directors' numbers is used by Chen and Al-Najjar (2012) and Garg (2007). The use of natural logarithm in computing board size is due to the non-zero nature of directors' number (Romano and Guerrini, 2014). In this study, the board size is computed by using the formula below:

$$\text{Board Size (BS)} = \text{Log (Sum of Number of Board Directors)}$$

3.1.3. Board Independence (BI)

Board independence is also one of the features of corporate governance. With the exclusion of sitting fees, an independent director is the one has no relationship directly with the firm (Deb, 2013). SCM (2012) stated that independent directors should occupy at least 33% of the total board size in Malaysia. Independent director is largely responsible for monitoring a firm's operation (Gregory, 2000). The independent director helps to make sure the completeness and accuracy of the financial statement and at the same time assure good internal control. Shareholders have a stronger power of control in terms of board independence which in turn leads to a decrease in usage of dividend payout policy.

Division of independent non-executive directors' numbers by size of the board is applied to determine board independence (Muniandy and Hiller, 2015). However, Lu and Wang (2015) took the outside directors' percentage, separation of CEO-Chairman as well as nominating committee independence into account while computing board independence. Independent directors' proportion is utilized by some of the researchers to define board independence (Chen and Al-Najjar, 2012; Germain et al. 2014; Ramdani and Witteloostuijn, 2010; Rashid, 2018). Thus, board independence is determined as followed:

$$\text{Board Independence (BI)} = x \times 100$$

3.1.4. CEO Duality (CEOD)

Duality power is worth studying as one of the independent variables. CEO duality indicates that the CEO is assigned another role like board chairman at the same time. CEO duality, acting as a dummy variable, is applied in many research in which one is assigned when CEO is also the board chairman at the same time (Chen and Al-Najjar, 2012; Davidson et al. 2005; Mohamad and Sulong, 2010). Tang (2017) also applied the same way in which zero is given to variable if the CEO does not serve as the board chairman. For this research, the CEO duality is derived as followed:

$$\text{CEO duality (CEOD)} = 1 \text{ when CEO holds board chairman position; } 0 \text{ if otherwise (dummy variable)}$$

3.1.5. Firm Size (FS)

Some different methods are described by Dalbor et al. (2004) including natural logarithm of the quantity of owners, sales, employees' number as well as total assets. De and Nagaraj (2013) claimed that there is a lack of appropriates to use the number of employees since the data of employment in a firm is difficult to access. Setiadharm and Machali (2017) mentioned that the firm size can be determined through total sales, assets or market capitalization but they used total assets. Natural logarithm of total assets, as well as sales are also applied to determine the size of a firm (Niresh and Velnampy, 2014).

It is found that many researchers applied natural logarithm of sales to determine the firm size (Huang and Song, 2006; Sheikh and Wang, 2011; Xie, 2014). Huang and Song (2006) further explained that they used this formula because there may be a high correlation between sales and total assets if two of them are used. Natural logarithm of total assets has also been adopted widely (Kouser et al. 2012; Rafique, 2012; Sahudin et al. 2011). Due to the easy accessibility to assets of a firm, the following formula is used to determine firm size:

$$\text{Firm Size} = \text{Log (Total Assets)}$$

3.1.6. Company Profitability (CP)

Luca (2018) mentioned that there are three methods to evaluate a firm's profitability namely economic and financial dynamics, financial ratios, and growth rate analysis. The financial ratio which is the return on assets is applied in this study. Income from operating activities, comprehensive income or net income can be utilized in calculating return on assets (Soutes and Schvirck, 2006). Soutes and Schvirck suggested using net income in computing return on assets. The reason given is that only the activities that can impact the firm directly and lead to corrective actions are included in net income. This reason is supported by Almazari and Almumani (2011) who also applied the same formula. Therefore, the company profitability is computed as followed:

$$\text{Company Profitability (CP)} = \text{Return on Assets} = \frac{\text{Net Income}}{\text{Total Assets}} \times 100$$

3.1.7. Company Growth (CG)

The growth of a company acts as one of the vital prospering economy indicators (Zhou and De Wit, 2009). In this study, the formula as shown above is used to determine the growth of a company. This method had been widely used in different research (Bei and Wijewardana, 2012; Deo, 2013; Jang and Park, 2011).

$$\text{Company Growth (CG)} = \frac{(R_1 - R_0)}{R_0} \times 100$$

Where R_1 = this year's revenue; R_2 = last year's revenue

4. Findings and Analyses

A minimum of two or more variables are highly correlated is identified as multicollinearity. Vatcheva and Lee (2016) emphasized that one interprets the results in a false direction if the multicollinearity problem is failed to be addressed. There is multicollinearity if a value of more than 0.8 is obtained for the correlation coefficient. Based on results of Pearson's correlation matrix (table 1), board independence (BI) and CEO duality (CEOD) is the highest correlated pair compared with other variables pairs. They show a correlation coefficient of 0.32316 (32.32%). Meanwhile, the lowest correlated pair is CEO duality (CEOD) and company growth (CG) which is 0.018361. Since the benchmark of serious multicollinearity is 80 percent, there is no serious multicollinearity problem in the variable's pairs.

	DY	BS	BI	CEOD	FS	CP	CG
DY	1						
BS	0.923024	1					
BI	0.934000	0.01987	1				
CEOD	0.067773	0.111452	0.32316**	1			
FS	-0.185441	-0.251332*	-0.267394*	0.044106	1		
CP	0.189740	0.033145	0.137460	-0.046714	-0.021814	1	
CG	0.083113	0.138429	0.118214	0.018361	0.052338	0.349561	1

Table 1: Pearson's Correlation Matrix of Variables

* 10% Significance Level ** 5% Significance Level *** 1% Significance Level

4.1. Empirical Result

Table 2 depicts the results of regression equation of fixed effect estimation model. There is a significant positive relationship between board size (BS) and dividend yield (DY) at 5% significance level. This implies that as the board size gets bigger, the dividend yield increases. This result is consistent with Maniagi et al. (2013) and Uwuigbe (2013) findings. Board independence (BI) also has a significant positive association with dividend yield (DY) at 5% significance level. The significant positive result between board independence and dividend yield is consistent with previous studies (Belden et al. 2005; Jiraporn and Ning, 2006; Uwuigbe, 2013; Yamran and Dollery, 2015). On the other hand, CEO duality is insignificant but negatively related with a firm's dividend yield. This negative result is consistent previous studies (Arshad et al. 2013; Chen et al. 2011; Ghosh and Sirmans, 2006).

Variables	Fixed Effect
Intercept	-10.61216**
Board Size (BS)	12.34887**
Board Independence (BI)	0.058773**
CEO Duality (CEOD)	-0.520345
Firm Size (FS)	0.021375
Company Profitability (CP)	-0.017559
Company Growth (CG)	-0.003104
R-squared	0.967238
Adjusted R-squared	0.944557
F-statistic	42.64487***
Hausman's Test: Chi-Square Statistic: 17.91***	

Table 2: Regression Results of Panel Fixed Effect Model

* 10% Significance Level ** 5% Significance Level *** 1% Significance Level

Among the control variables, firm size has an insignificant positive relationship with firm's dividend yield. There is an insignificant negative relationship between company profitability and company growth with dividend yield of a firm based on the result of fixed effect model regression. Since the F-statistic (42.64487) is significant at 1% level, 42.64% of the independent variables explains the dividend yield's variation.

5. Discussion and Conclusion

This study is conducted to test the impact of corporate governance on dividend yield of Malaysian insurance firms. Board size, board independence and CEO duality are chosen to be the independent variables according to the previous literature established. A total of 9 Malaysian insurance firms are selected to run the panel data regression model, particularly fixed effect model. Results of fixed effect panel data regression show that there is a positive relationship between board size and dividend yield which is significant at 5% significance level. Therefore, for the insurance firms to increase their dividend yield, they should increase current board size. Meanwhile, board independence and dividend yield produced a positive significant relationship based on the regression results. Thus, Malaysian insurance firms should increase the degree of board independence by involving more directors who are not participating or being the company's top executives. On the other hand, the relationship between CEO duality and dividend yield is found to be negative. CEO duality signals that the CEO holds the position as chairman of the board simultaneously. To maximize the dividend yield, the company is advised to have different people in holding the position of CEO as well as board chairman each. Since the impact of the Corporate Governance variables on firms' dividend policy is tested in this study, the policy makers are encouraged to pay attention to the research results while making the policy regarding corporate governance codes. For example, the board independence is found to be having significant association with dividend yield. Therefore, the policy makers may emphasize the role of board independence in good corporate governance code. The insurance industry is believed to benefit from decent or fitting policies.

The study enables the readers to understand better on the impact of corporate governance on the dividend yield of a company. The beneficial parties consist of insurance companies, investors, regulators policy makers together with the researchers in the future. The companies benefit from decreasing agency cost by considering the size and independence of board. Meanwhile, for the investors, they can make wise investment decision by looking at the Corporate Governance variables that affect the payout decision of a firm. This implies that the investors are encouraged to understand the board structure including size before investing to maximize their wealth. As this research only focuses on the listed Malaysian insurance companies, it is recommended that the researchers in the future have their study conducted on other sectors like manufacturing or healthcare companies. Consequently, the results among different sectors can be compared and the reasons behind the difference are learned.

Shortcomings or limitations of this study focus on the collection of data from nine Bursa Malaysia listed insurance companies ranges from 2013 until 2017. Data collected on a range of five years is considered short and it may not explain the corporate governance measures on dividend payout sufficiently. Since it may be difficult to collect the data from insurance firms not listed on Bursa Malaysia, these companies are not included in this study. Thus, future researchers can expand their study to encompass the other insurance companies operating in Malaysia but not yet listed on Bursa Malaysia. Moreover, the researchers can have their study conducted on other specific industry such as plantation, healthcare or telecommunications industry. The results obtained from this study is only targeted to the insurance industry, and this may not apply the same to other industries in Malaysia. This study examined the impact of board size, board independence as well as CEO duality on a company's dividend payout policy. Other researchers in the future can modify the regression model by including more independent variables in the study such as CEO tenure.

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