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Determinants of Dividend Payout Ratios in Malaysia

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ABSTRACT

This study seeks to examine the determinants of dividend payout ratios of listed companies in Malaysia. The analyses were performed using data derived from the annual reports of companies listed on the Kuala Lumpur Stock Exchange (KLSE) during a three-year period.

The result of the study indicated that dividend payout ratios are related to profitability and growth. Conversely, risk and cash flow is not significant predictor for dividend payouts during the three periods under study. The results suggested that despite of low or negative cash flow the companies continue to pay dividends to their shareholders. Companies that increase dividend payouts have lower risk. From the study it can be concluded that profitability and growth on sales influencing dividend payout in the period of study. Factors like risk and cash flow are not significant in determining dividend payout.

Keywords: Dividends, Determinants, KLSE,

CHAPTER 1

INTRODUCTION AND SCOPE OF RESEARCH

1.1 INTRODUCTION

Dividends are payments that a company makes to its investors on its outstanding shares. A company pays dividends on both its common and preferred shares. Dividends are made out of a company's profit or retained earnings and the amount is set by a company's "dividend policy". Dividends are also one of the best and the most reliable indicator of the current and future earnings of a company. An increased in the dividend implies management's confidence that future earnings will be strong enough to support the new and higher dividend, while dividend cut is a signal that management is worried about the level of future earnings.

A dividend policy provides a framework for relations, with principles governing dividend determination and distribution, as well as the company's responsibility for dividend payout. Easterbook (1984) views dividend payments as a potential solution to agency conflicts. Dividend payments force managers to raise funds in the external financial markets and thus subject managers to scrutiny by outside professionals such as investment bankers, lawyers, and public accountants. Recognizing the monitoring value of external financial markets, shareholders will insist that managers pay dividends.

Also Jensen (1986) points out that manager have incentive to grow their firms beyond optimal size as growth increases managers power by increasing the resources under their

control. Dividend payouts can be used to reduce discretionary cash under manager's control that could be wasted in negative NPV projects.
The controversy that surrounds dividends policy is how much cash should firms give back to their shareholders? And what form should payment take? Firms must make these important decisions over and over again (some must be repeated and some need to be reevaluated each period), on regular basis. Because these decisions are dynamic they are labeled as payout policy. The word "policy" implies some consistency over time, and that payout, and dividends in particular, do not simply evolve in an arbitrary and random manner (Allen and Michaely, 2002). Payout policy is important not only because the amount of money involved and the repeated nature of the decision, but because payout policy is closely related to, and interact with, most of the financial and investment decisions firm make.

Management and board of directors must decide the level of dividends and other considerations include the company's goals and situational factors such as current and anticipated future earnings, risks and cash availability. The payment of cash dividends to shareholders is premised on the substantial net income and satisfactory cash position. There are several number of factors identified in the previous empirical studies (Higgins, 1981; Rozeff, 1982; Lloyd et al., 1985;; Pruitt and Gitman,1991 ; Jensen et al, 1992; Alli et al., 1993; Green at.al., 1993; D'Souza, 1999 ; Pandey, 2001; Zeng, 2003 ; Arnott and Asness, 2003; Amidu and Abor, 2006) to influence the dividend payout ratios of companies including profitability, risks, cash flow , corporate tax and growth in sales .

Lintner (1956) uncovered the first time that firms maintain a target dividend payout ratio and adjust their dividend policy to this target. The long term sustainable investment and growth objectives determine the firm's target payout ratios. Further, Lintner finds that firms pursue a stable dividend policy and gradually increase dividend payout ratios. This implies that that firms set speed to move towards the full achievement of payout. A number of studies of dividend behaviour of companies in Malaysia support Lintner's