MANAGERIAL ENTRENCHMENT AND DIVIDEND PAYOUT POLICY OF MALAYSIAN PUBLIC LISTED COMPANIES

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MANAGERIAL ENTRENCHMENT AND DIVIDEND PAYOUT POLICY OF MALAYSIAN PUBLIC LISTED COMPANIES

By

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AETR	Average Effective Tax Rate
AGE	Firm Age
AMEX	American Stock Exchange
AMFPT	AmFirst Property Trust
ATPs	Antitakeover Provisions
BHCs	Bank Holding Companies
BI	Board Independence
BNM	Bank Negara Malaysia
BOD	Board of Directors
BTS	Bartlett's Test of Sphericity
BZ	Board Size
CAPM	Capital Asset Pricing Model
CEOs	Chief Executive Officers
CFOs	Chief Financial Officers
CO	Concentration Ownership
DCO	Dummy Concentrated Ownership
DFO	Dummy Foreign Ownership
DMO	Dummy Managerial Ownership
DY	Dividend Yield
ENT1	Managerial Entrenchment Index 1
ENT2	Managerial Entrenchment Index 2
EPF	Employees Provident Fund
EPS	Earnings per Share
ESOP	Executive Stock Ownership Plan

FBM	Foreign Board Members
FEM	Fixed Effect Model
FFO	Funds From Operations
FITC	Foreign investors tax credit
FMPT	First Malaysia Property Trust
FO	Foreign Ownership
FZ	Firm Size
GLCs	Government Linked Companies
GLS	Generalized least squares
GMM	Generalized Method of Moments
GO	Government Ownership
IOS	Investment Opportunity Set
IPO	Initial Public Offering
IRRC	Investor Responsibility Research Center
ISE	Istanbul Stock Exchange
KLSE	Kuala Lumpur Stock Exchange
KWAP	Kumpulan Wang Amanah Pencen
LEV	Leverage
LIQ	Liquidity
LPTs	Listed Property Trusts
LTAT	Lembaga Tabung Amanah Tentera
MARC	Malaysia Agency Rating Corporation
MAS	Malaysia Airline System
MCCG	Malaysian Code of Corporate Governance
MHCs	Mutual Holding Companies

MICG	Malaysia Institute of Corporate Governance
MO	Managerial Ownership
MOF	Ministry of Finance
NASDAQ	National Association of Securities Dealers Automated Quotations
NED	Nonexecutive Director
NPP	Normal Probability Plot
NPV	Net Present Value
NYSE	New York Stock Exchange
OTC	Over-the-counter
OV	Ownership Voting
PCA	Principal Component Analysis
PNB	Permodalan Nasional Berhad
R&D	Research and Development
RAM	Rating Agency Malaysia
RC	Restrictive Covenants
RE/BE	Retained Earnings to Total Book Equity Ratio
RE/TE	Retained Earnings to Total Equity Ratio
REIT	Real Estate Investment Trust
REM	Random Effect Model
RK	Risk
ROA	Return on Assets
ROE	Return on Equity
SR	Share Repurchase
TP	Total Payout
TR	Total Remuneration

KEKUKUHAN PENGURUSAN DAN DASAR PEMBAYARAN DIVIDEN SYARIKAT AWAM TERSENARAI MALAYSIA

ABSTRAK

Tesis ini meneliti pengaruh kekukuhan pengurusan terhadap pengagihan dividen syarikat. Ini termasuk kesan pengurusan berkekukuhan tinggi ke atas peluang pelaburan, tadbir urus dalaman (saiz lembaga pengarah, ahli lembaga asing, dan undi pemilik terbesar), pemantauan oleh tadbir urus luaran (kebebasan lembaga pengarah), insentif Ketua Pegawai Eksekutif (ganjaran dan opsyen saham) dan jenis pemilikan yang berlainan (pemilikan tertumpu, pemilikan kerajaan, pemilikan asing, dan pemilikan pengurusan). Tesis ini menganalisa 327 syarikat yang tersenarai di Bursa Malaysia dari tahun 2005 hingga 2010. Analisis regresi data panel telah digunakan untuk menganalisis data. Indek kekukuhan pengurusan dibentuk menggunakan kaedah analisis prinsip komponen. Dua indeks kekukuhan pengurusan, iaitu ENT1 dan ENT2, disediakan.

Keputusan kajian menunjukkan bahawa tahap kekukuhan pengurusan mempengaruhi keputusan dividen. Pengurusan berkekukuhan tinggi membayar dividen yang lebih lumayan. Pengaruh mereka kuat dalam sektor keluaran perindustrian dan sektor perdagangan dan perkhidmatan. Bagaimanapun, pengaruh mereka sederhana dalam sektor keluaran pengguna dan lemah dalam sektor hartanah. Pembayaran keseluruhan syarikat (dividen tambah pembelian balik saham) berkurangan atau bertambah mengikut tahap kekukuhan pengurusan.

Di bawah tadbir urus dalaman, saiz lembaga pengarah mempengaruhi pembayaran dividen secara positif di bawah pengurusan yang berkukuh tinggi. Ahli lembaga asing boleh mempengaruhi pengurusan yang kukuh, tetapi hanya dalam kes ENT2 tinggi. Kuasa mengundi pemegang saham terbanyak dan kebebasan lembaga pengarah tidak mempunyai pengaruh yang signifikan ke atas keputusan dividen, di bawah pengurusan ENT2 tinggi. Pengurus berkekukuhan tinggi, ENT1, boleh menentukan ganjaran mereka tidak berkait dengan hasil dividen. Opsyen saham tidak memberi sebarang impak terhadap pembayaran dividen di bawah pengurus yang mempunyai kekukuhan tinggi.

Pemilikan tertumpu dan pemilikan kerajaan kuat mempengarui keputusan dividen apabila syarikat dikawal oleh pengurus berkekukuhan tinggi. Pemilikan asing dalam syarikat mempunyai pengaruh yang kuat ke atas keputusan dividen, jika pengurus berkekukuhan tinggi menguasai syarikat. Pemilikan asing mempunyai hubungan yang negatif dengan pembayaran dividen di bawah pengurus berkekukuhan tinggi, ENT1. Demikian juga, pemilikan pengurusan tidak mempunyai pengaruh yang kuat di bawah pengurus berkekukuhan tinggi.

Sebagai kesimpulan, mekanisme urus tadbir korporat mungkin tidak berfungsi dengan secekapnya dalam syarikat di mana pemilikannya di bawah pengurusan berkukuhan tinggi. Oleh yang demikian, agensi-agensi kawalan harus memperbaiki lagi mekanisme urus tadbir korporat di Malaysia ke arah penguatkuasaan perlindungan lebih baik untuk pemilik saham.

MANAGERIAL ENTRENCHMENT AND DIVIDEND PAYOUT POLICY OF MALAYSIAN PUBLIC LISTED COMPANIES

ABSTRACT

This thesis examines the influence of managerial entrenchment towards companies' dividend distribution. This includes the effects of high managerial entrenchment on investment opportunities, internal governance, monitoring by external governance, CEO incentives, and different types of ownership. The thesis analyzed 327 companies listed on Bursa Malaysia from 2005 to 2010. Panel data regression was used to analyse the data. The managerial entrenchment Index was developed using Principal Component Analysis (PCA). There are two indexes developed in this thesis, namely ENT1 and ENT2.

The results showed that the level of managerial entrenchment strongly influenced dividend decisions. Highly entrenched managers pay better dividends. Their influence was noted to be particularly strong in the industrial products and trading and services sectors. However, their influence was moderate in the consumer products sector and weak in the property sector. Entrenched managers preferred dividend payout instead of share repurchase. It is evident that company's total payout (dividend plus share repurchase) decreases or increases with the level of managerial entrenchment.

Under internal governance, board size positively influenced dividend payout when there is a highly entrenched manager. Foreign board members could influence dividend payout if high ENT2 exists. When a company is managed by a highly entrenched manager, ENT2, voting power of the largest shareholders as well as

board independence has no significant influence on dividend decisions. Highly entrenched managers, ENT1, could ensure that their remuneration is unrelated to dividend yield. Granting stock options has no impact on dividend payout if company is controlled by highly entrenched managers. Concentrated and government ownership companies strongly affect dividend decisions, if highly entrenched managers control the company. Foreign ownership had a negative relationship with dividend payout under highly entrenched managers, ENT1. Similarly, managerial ownership had no influence on dividend payout in the presence of highly entrenched managers.

In conclusion, corporate governance mechanisms might not function efficiently in concentrated ownership companies under entrenched managers. Therefore, regulatory agencies should improve the mechanisms of corporate governance in Malaysia to enforce better protection for shareholders.

CHAPTER 1

INTRODUCTION

1.0 Introduction

In present times, given the separation of ownership and management in companies, the owners do not normally manage the companies themselves. They appoint professional managers or CEOs to run the companies on their behalf. Managers are among the critical people responsible for the success of companies. They implement the strategies laid out by the board of directors. To some extent, the manager entrenches his or her position. At this stage, some managers misuse their power for their own benefits, creating what is commonly termed as agency problems. The manager might make decisions that are not in the interest of the shareholders (Jensen & Meckling, 1976). The shareholders are more concerned about their wealth, be it in the form of dividends, share repurchase, or total payout.

1.1 Background of Study

Managerial entrenchment is closely related to the action and power of managers of companies. According to Weisbach (1988), managerial entrenchment occurs when managers gain so much power that, they are able to use the company to pursue their own interest rather than that of the shareholders. Berger, Ofek, & Yermack (1997) defined entrenchment as the extent to which managers fail to be disciplined, even with the full range of corporate governance and control mechanisms in place, including monitoring by the board, the threat of dismissal or takeover, and stock- or compensation-based performance incentives. In a company with weak board of directors, and strong antitakeover provisions, managerial entrenchment is most likely to take place. With a low probability of being fired for poor performance, the manager could generally influence the company to guarantee his/her employment with an attractive salary (Morck, Shleifer, & Vishny,1988), enjoy perquisites at the expense of shareholders (Bertrand & Mullainathan, 2003), and even stop payment of dividends without triggering shareholders' response (Wang, 2011).

Generally, there are two decisions of a manager that have significant impact on stock price, as suggested by Healy and Palepu (1990). First, the manager decides on the amount of debt in the company's capital structure. Second, he or she decides on how much earnings to be paid out as dividends, if any. Whenever changes in the company's business get risky or earnings are foreseen, the manager devises new corporate policy. Moreover, the manager evaluates the company's investment projects based not only on the goal of maximising shareholder wealth, but also on the personal benefits to be gained from it (Shleifer & Vishny, 1989).

The owners and shareholders consider it costly to fire the managers even if they do not agree with what he or she is doing. Depending on the situation, the shareholders simply sell out their interest. If the CEO is also the chairman of the board, it would be even more difficult for the majority shareholders or institutional owners, to fire him or her.

The probability of selecting an external CEO arises with the level of stock ownership of large shareholders and the fraction of the board seats being held by outsiders (Park & Rozeff, 1986). Managerial entrenchment increases as the company size increases, and its performance improves. Shareholder value gets higher when an external CEO is hired, in lieu of appointing one through internal promotion.

Additionally, shareholder value reduces if the new CEO has a higher level of ownership relative to the level of ownership of the outgoing CEO, unless the company has large external shareholders.

According to Rath (2007), there are three implications when a CEO has greater influence on the corporate infrastructure. First, the information asymmetries provide CEOs greater discretion in decision making in all corporate policies. Thus, it creates difficulties for companies to continuously monitor their CEOs. Second, companies face difficulties in finding the right new CEOs. As such, with fewer suitable candidates in the managerial labour market to replace the existing CEOs, there would be a disequilibrium between pay and performance. Third, a CEO who exhibits greater risk-aversion in his or her decision making further entrenches himself or herself in the company. This happens since high investment in company-specific human capital leads to problem of adverse selection in corporate decision making. When companies have high level of managerial entrenchment and low leverage, it helps to improve board control (Rosenstein & Wyatt, 1990), while monitoring by shareholders could lead to an increase in the value of companies (Gillan & Starks, 2000).

1.2 Corporate Governance in Malaysia

In Malaysia, since 2001 (revised 2007), the Code of Corporate Governance was gradually enforced on companies listed on Bursa Malaysia to improve the monitoring mechanism**.** The MCCG outlined certain conditions on the structures and functions of board of directors, audit committees, and external auditors to safeguard shareholders' interest. The MCCG 2012 focuses on strengthening the board structure and composition, including recognizing the role of directors as active and responsible fiduciaries. The Minority Shareholders Watchdog Group was established in 2001 to protect minority shareholders' interest and promote shareholder activism. Though this shows that Malaysia has strong legal protections, the MCCG appears to be effective only outwardly. In fact, enforcement remains weak. Managerial entrenchment still exists and expropriation of minority interest continuously takes place in Malaysia (Mohamed Yunos, Smith, Ismail, & Ahmad, 2011). To avoid this conflict, dividend payments could be used as one of the company's monitoring devices (Rozeff, 1982). Companies could limit the cash available for managers if high dividend payments are paid to shareholders based on the free cash flow hypothesis (Jensen, 1986).

The ineffectiveness of corporate governance continues to surface around the world with scandals such as Enron, WorldCom, Tyco, and some other companies in the US; and Transmile Bhd., Megan Media Holding Bhd. and recently Sime Darby in Malaysia. As a result, many believe that existing corporate governance devices are unable to fully control the behaviour of managers. As suggested by numerous authors, dividend is a good mechanism to control the behaviour of the manager, therefore, it is important to address this issue in the Malaysian market.

As stated under MCCG (revised 2007), companies should examine the size of the board to ensure the effectiveness. Board of directors is the internal governance mechanism that the company could use to monitor and control the agency problem. However, in Malaysia, companies with large shareholders (through voting rights) have significant power to influence the appointment of board members. Moreover, the appointed members tend to serve the interests of major shareholders (Satkunasingam and Shanmugam, 2006). Malaysian family owned companies prefer to elect family members or their close friends to sit on the board. They are reluctant to appoint independent directors as they could lose control of company decisions (Meng, 2009). It is not the role of audit committees to control the agency problem faced by Malaysian companies. Most of the time they act as a 'rubber stamp' and committees are formed to comply with the requirements (Zulkarnain & Shamsher, 2007). Hence, board of directors, independent directors or audit committees are ineffective as monitoring devices to control managers who have entrenched themselves. As the abovementioned mechanism fails to reduce agency conflict in Malaysian companies, this thesis intends to evaluate the effectiveness of dividend payout policy as a control mechanism.

Dividends play an important role in achieving business objectives. Fowdar, Subadar, Lamport, and Sannassee (2007) indicate that no single economic rationale could possibly explain the dividend phenomenon, or capture the puzzle about the reality of corporate dividend behaviour. Based on section 365 of the Companies Act 1965 "no dividend shall be payable to the shareholders of any company except out of profit or pursuant to section 60." Under section 60, "the share premium account may be applied in the payment of dividends if such dividends are satisfied by the issue of shares to members of the company." As shown in Figure 1.1, earnings per share (EPS) for the plantation and trading/services sectors appear to be higher than the finance sector. However, between them, the finance sector pays higher dividend per share. Hence, in Malaysia, different sectors have different dividend per share ratios, regardless of their earnings.

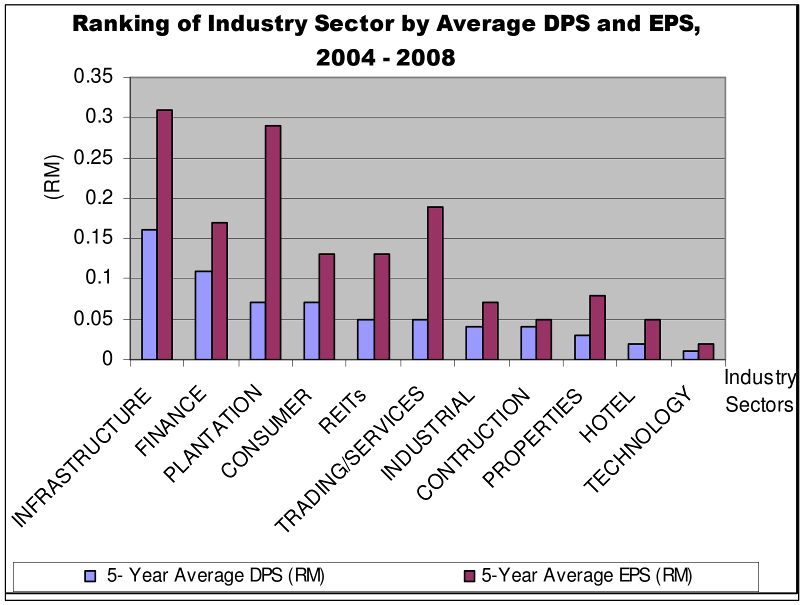

Figure 1.1: Ranking of industry sector by average DPS and EPS: 2004-2008. Adapted from *Dividend Survey Report 2009;* MSWG 2009.

During the period 1994-1996, among the five Asian countries, Malaysia recorded the highest rating for corporate governance at 3.85 and Thailand, the lowest at 2.12. Unfortunately, despite the high rating, Malaysia had the lowest dividend payout of 23.3% compared with other Asian countries. Mismanagement by managers, fraud and poor governance led to losses or bankruptcy during the Asian financial crisis (Noordin, 1999). During the crisis, Malaysian companies were among the top three dividend payers, after Hong Kong and Singapore. They distributed dividends to retain shareholder confidence towards company's performance. The lack of effectiveness of the governance mechanism and frauds by managers still continue to be reported. Since the period of study used in this thesis falls within the financial crisis years 2007-2008, it is considered essential that this thesis address the managerial involvement in setting dividend payout under different economic periods.

Therefore, this thesis investigates the effects of managerial entrenchment during three stages, namely pre, during and post financial crisis.

1.3 Ownership structure in Malaysia

Asia is characterized by a concentrated shareholding system. It has non-competitive product markets, weak legal protection, governance by large shareholders rather than by managers, low opportunities for management to specialize, poor diversification in investments, and increased risks of expropriation of external shareholders by insiders. The concentrated shareholding system results in the equity market becoming less-developed, though in Malaysia, the equity market is very sizeable (Colin & Fancis, 2003).

In the Malaysian context, the traditional agency conflict between manager and shareholders is not relevant as the companies are highly controlled by larger shareholders (Claessens, Djankov, & Lang, 2000; Tam & Tan, 2007). Dividend payment, as cash distribution, might be useful to reduce agency problem between the majority and minority shareholders. Malaysia is typically characterized as concentrated shareholdings in the hands of individual investors and large block shareholders. They hold at least 5% of equity ownership (Mohd Ghazali & Weetman, 2006). Large block shareholders are normally families or financial institutions. The agency costs in family companies are more complex due to managerial entrenchment and information altruism (Gomez-Mejia, Nunez-Nickel, & Gutierrez, 2001). Hence, this thesis focuses on the dividend payout policy, because empirical studies show that it has a significant role in reducing agency conflict under weak governance mechanism and entrenched manager control of management.

As Table 1.1 shows, in Malaysian companies, families hold around 44.7% of their shares. Examples of Malaysian companies with family ownership are Tan Chong Motor Holdings Bhd., YTL Group, and the IOI Group. With such a high level of concentration, there would be a strong monitoring power over company managerial decisions. In Indonesia, Korea, Malaysia, Singapore, Philippines, and Taiwan, 15% to 80% of companies have managers who are family members, as the controlling owners (Claessens et al., 2000). Family CEOs easily get entrenched since family status conveys additional power. They are less likely to be removed from the position, even though they perform poorly compared to non-family CEOs (Dahya, Lonie, & Power, 1998). In Malaysia, family CEOs with ownership control of above 30% show greater entrenchment. They tend to set low dividend payout and have a high tendency to expropriate minority shareholders (Huei, Ken, Kwong & Philip, 2012).

Table 1.1
The Control of Publicly Traded Companies in East Asia, 2008 (20% Cut off)

	Widely held (%)	**Family (%)**	**State (%)**	**Widely held Financial (%)**	**Widely held Corporation (%)**
Malaysia	13.2	44.7	33.5	0.6	4.3
Indonesia	13.1	50	13.5	2.2	13.3
Thailand	38.6	33.3	12.1	2.3	7.8
Philippines	7.6	76.5	3.4	1.9	5.9
Singapore	18.5	51.9	19.6	1.7	3.9

Note. Adapted from "Changes to the Ownership and Control of East Asian Corporations between 1996 and 2008: The primacy of Politics," by R. W. Carney & T. B. Child, 2013, *Journal of Financial Economics*, *107*, pp. 494–513.

Government-controlled institutions also hold significant shares in the Malaysian listed companies. Government ownership is established when company shares are held by federal/state institutions, agencies, and government-linked companies (GLCs). However, instead of placing more emphasis on their social objective, government-controlled companies in Malaysia appear to be more closely politically connected (Mohd Ghazali & Weetman, 2006). Nevertheless, agency costs still arise in government-controlled companies (Eng & Mark, 2003). They face conflicting objectives, between pure profit goals as commercial businesses and goals related to the interest of the nation. Thus, maximization of shareholder wealth might not be the priority for GLCs. Managers of these types of companies are less likely to face disciplinary action from the market for corporate control. This is because the government, a long-term investor of the GLCs is unlikely to support unsolicited takeover offers. Hence, with less governance, there is a greater potential for misuse of company funds by managers.

Foreign ownership equity is a significant component of Malaysian total corporate holdings. In Malaysia, foreign-controlled companies use a significant portion of their earnings to pay dividends (ROSC, 2005). In terms of dividend payment, foreign companies recorded the highest payouts in Malaysia. British American Tobacco (Malaysia) Berhad was the highest dividend payer for the year 2008, at RM2.63 per share, followed by DiGi.Com Berhad, and Nestle (Malaysia) Berhad (MSWG, 2009). Among these top three dividend payers, two are producers of consumer products. Foreign ownership companies monitor more closely the management and put pressure for profits on self-interest managers. There is lesser tendency for the entrenched manager to choose projects with negative NPV (Megginson & Netter, 2001).

1.4 Development of Share Repurchase in Malaysia

Share repurchase was initiated around 14 years ago after the Malaysian stock market was seriously hit by the Asian Financial Crisis in 1997. This programme was introduced to regain investors' confidence. By allowing companies to exercise buyback of their shares, investors receive capital gains that would encourage them to reinvest in the same company or in other companies. Companies would normally buy back shares when their share prices are perceived to be undervalued. In fact, share repurchase would drive up share prices and decrease the number of shares outstanding (Nadarajan, Ahmad, & Chandren, 2009). Under Section 67A of the Companies (Amendment) Act 1997, with proper application, public-listed companies in Kuala Lumpur Stock Exchange (KLSE), currently known as Bursa Malaysia, are allowed to buy back their own shares. In addition, the Malaysian Accounting Standard Board (MASB) in April 1999, through a "share-buyback accounting and disclosure" circular, stated that companies engaged in repurchasing their own shares should report all such transactions in their financial statements.

Table 1.2 shows that public-listed companies in Bursa Malaysia are increasingly using share repurchase as a way to attract investors. Share repurchase started to grow in 2001 and continued to increase with the highest level recorded in 2008 with 204 companies. However, it decreased to 196 companies in 2009. The repurchase mechanism only caught attention in recent years, as many companies are still arguing about the quality and effectiveness of this programme, learning from more matured markets, such as the United States.

Table 1.2
Executive Summary of Share Buyback in Bursa Malaysia between 1999 and 2009

Year	**Total number of companies**
1999	12
2000	13
2001	26
2002	32
2003	62
2004	70
2005	127
2006	145
2007	154*
2008	204*
2009	196*

Note. Adapted from Ramakrishnan, Ranindran, and Ganesan, 2007, *The Star,* January 30, 2010*

Companies use dividends instead of share repurchases to signal that the company is well managed (Allen, Bernardo, & Welch, 2000). Paying dividends increase the chances of the company being noticed by institutions for its quality. Thus, companies are prepared to make their shareholders pay dividend taxes for signalling their quality. Markets do not react significantly different from zero when companies decrease dividends, when they engage in repurchase programmes. However, the share price drops if the company does not make share repurchase (Grullon & Michaely, 2002) and market reaction is positive for both payout methods initiated by IPO companies (Jain, Shekhar, & Torbey, 2009).

Based on the Malaysian practice, a company might repurchase its own shares for various purposes, such as for employee option plans, and reissuance or redemption without any time limits (Sabri, 2003). Hence, if a company has executive stock options plans, there is a lesser likelihood of payout in the form of dividends (De Jong, Van Dijk, & Veld, 2003) since stock price decrease during ex-dividend date (Kahle, 2002). Another purpose of the share repurchase plan is to discourage unfriendly takeovers (Gitman, 2006). With repurchase, the company value increases and consequently, the potential acquirer would have to pay a higher price in order to pursue the takeover activities (Bagwell, 1991).

Managerial entrenchment is reflected from the combination of dividend and share repurchases in the company (Hu and Kumar, 2004). Managers who are concerned about shareholder wealth in the long term tend to buy back shares (Ikenberry & Vermaelen, 1996). On the other hand, entrenched managers usually choose dividend payout or a mix of payout (dividend and share repurchase). Since there is an increasing trend in Malaysian companies towards using share repurchase, it is important to examine the manager payout preference.

1.5 Problem Statement

Malaysia is ranked among the countries with high anti-director rights. It has strong legal minority shareholders protection against decisions made by managers or major shareholders (La Porta, Lopez-De-Silanes, Shleifer & Vishny, 1998). However, the enforcement of this legal protection is still poor in Malaysia, as agency problems are unable to be resolved (Krishnamurti, Sevic, & Sevic, 2005). Hence, Malaysian companies still face high agency problems (Kallunki, Sahlstrom, & Zemi, 2007).

Debt financing could be used to monitor company’s management (Agrawal & Knoeber, 1996), though this mechanism is not suitable to be implemented in

Malaysia to discipline managers, as the financial market is still immature (Suto, 2003; Tam & Tan, 2007). Another problem faced in Malaysia is the function of hostile takeovers to monitor managers. As stated by Haniffa and Hudaib (2006), the hostile takeover mechanism almost did not exist, because the large shareholder group might also include the CEO, or the group might be affiliated with the top management. Due to this weakness, managers in Malaysia are able to easily entrench their positions. Easterbrook (1984), Jensen (1986), and Farinha and Lopez-de-Foronda (2009), suggested the use of dividend policy as a disciplinary mechanism for controlling managers. The role of managerial power in dividend policy remains mostly unanswered (Welch, 2004). Therefore, this thesis is keen to identify the usefulness of dividend payout policy as a monitoring device of entrenched managers in Malaysia.

Managerial entrenchment by itself represents a sign of agency problem (Zwiebel, 1996 and Hu & Kumar, 2004). Entrenched managers ensure that their positions are secure if the company fails to attain its objectives. Most of the previous literature negatively views managerial entrenchment when the managers try to preserve their position. Even in Malaysia, numerous authors (e.g., Haniffa & Hudaib, 2006; Sulong & Mat Nor, 2010; Sulong and Ahmed, 2011) examined the relationship between ownership structure or board structure on dividend payout policy and indirectly linked it with the influence of entrenched managers. Unfortunately, only few researchers (e.g., Gompers, Ishii & Metrick, 2003; Bebchuk, Cohen & Ferrell, 2009; Florackis & Ozkan, 2009) examined the process of how managers are able to entrench themselves in the company. By understanding the way and the level of managerial entrenchment, the issue between entrenched manager and their impact on company decisions.

The country's legal and judiciary system, the board of directors and ownership structure are the three important factors that determine the effectiveness of corporate governance (La Porta, Lopez-de-Silanes, & Shleifer, 1999). However, in Malaysia, mechanisms to monitor entrenched managers and controlling shareholders are still lacking (Satkunasingam & Shanmugam, 2006). Minority shareholders cannot depend on the board of directors in Malaysian companies to secure their wealth, as it is dominated by the large shareholders. Apart from that, Malaysian companies with political patronage have selective privileges to impose rules and regulations (Gomez, 2006). To some extent, they yield to the appointments of less experienced staff due to political influence. Top managers are able to entrench their positions since they are less likely to be fired and replaced even though they show poor performance, as the appraisal process involves state and party bureaucrats (Tam, 2000; Tenev, Zhang & Brefort, 2002). Unfortunately it is difficult to predict the relationship between manager and dividend payout in companies with political influence (Bushee, 1998; Gul, 1999a; Pound, 1988).

Minority Shareholder Watchdog Group Survey (2009) reported that the infrastructure sector showed an inconsistent dividend payout pattern, even when the EPS increases. Plantations and trading/services sectors pay almost the same dividends despite the differences in their earnings. Surprisingly, the construction and hotel sectors, which incurred losses, were still distributing dividends to their shareholders. According to Moh'd, Perry, and Rimbey (1995), this is due to maturity and information capacity in those sectors. In addition, each sector has its own level of free cash flow problems and this is reflected in the level of dividend payment (Zechauser & Pound, 1990). This results in the managers behaving differently in performing their tasks. Malaysian plantation and consumer products companies pay the highest dividend, since they are less involved in growth opportunities and hold high cash surpluses (Pandey, 2001). Meanwhile, due to the capital intensive nature, Malaysian property sectors have low payout policy (Yahya & Mahmood, 2011). Thus, many are questioning the manager's role and influence in dividend payout decisions, that is, whether an increase or decrease in their earnings has any influence on their payout decisions. Nevertheless, there is still no research conducted on the managerial entrenchments in different sectors.

Malaysian managers have low incentives to disclose information in their financial reports, especially for losses. Among the four common law countries, Malaysia was ranked third in terms of transparency (Ball, Robin & Wu, 2003). Therefore, to reduce asymmetric information between manager and shareholders, the company could reduce cash in the hands of entrenched managers by including both dividends and share repurchases (Kim, 2010). In the presence of entrenchment, companies with weak governance prefer to choose dividend payout or mixed payout (dividend and share repurchase). However, managers with better governance tend to choose stand alone share repurchase (John & Kynazeva, 2006). Corporate governance in Malaysia does not function effectively. If an entrenched manager is able to influence share repurchase, then it indirectly protects the entrenched managers despite their poor performance. When a company continuously experiences a decrease in stock price, one alternative is to use share repurchase to prevent a hostile takeover. This indirectly protects the manager from being replaced in the takeover. However, in Malaysia, not many studies have been done on evaluating the entrenched manager's payout preference, either dividends only, mix of dividends and share repurchase or stand alone share repurchase.

Further, a board's structure would encourage entrenchment. A large number of members sitting on the board would provide more voice regarding the intuitive decisions on dividend payout. However, it is not easy to persuade all the members to make similar decisions. Jensen (1993) suggested that a small number of board members could help companies to improve on their performance. A company would be less effective, while the CEO gains easier control of the board, if the board of directors consists of more than seven or eight people. In Malaysia, a number of companies have more than eight members on the board, such as Sime Darby Berhad, Ajinomoto (Malaysia) Berhad, Berjaya Corporation Berhad, and Hiap Teck Venture Berhad.

Logically, the board recommends the CEO's remuneration and the final dividend decision belongs to the same board of directors after appraising the company's performance (Hanh, 2007). Managers would not voluntarily give up their positions even when they are not performing, since a lot of private rents and high salaries are at stake (Wang, 2011). According to Tharuman Rajah (Head of Hay Group Human Resource), some companies show a weak relationship between remuneration and performance. To hold onto their power and to be entrenched in the company, the managers make investments that reduce the probability of them being replaced, that allow them to get higher wages, and enjoy better perquisites from shareholders (Shleifer & Vishny, 1989).

Table 1.3
Remuneration of CEOs and Top Executives in 2007 in Malaysia

Name	Company	Total Remuneration (RM million)
Tan Sri Lim Kok Thay	Genting Bhd	86.50
Datuk Nazir Razak	Bumiputra-Commerce Holdings Bhd	9.35
Tan Sri Rozali Ismail	Puncak Niaga Holdings Bhd	5.20
Ralph Marshall	Astro All Asia Network Plc's Group	3.40
Tan Sri Amirsham Abdul Aziz	Maybank	2.71
Datuk Seri Ahmad Zubir Murshid	Sime Darby Bhd	2.05
Datuk Yusli Mohamed Yusoff	Bursa Malaysia Bhd	1.97

Notes: Adapted from *The Star*, December 13, 2008

For example, Table 1.3 shows that the CEO of Sime Darby was among the top highly paid CEOs in 2007. Yet, despite enjoying such high remuneration with a large board (13 members), it did not inspire him to continuously give his best for the company. He invested in a few unprofitable projects that caused his company huge losses of almost RM1 billion in 2010. This indicates that Malaysian corporate governance best practices are ineffective, if non-performing directors are being rewarded with sufficient level of remuneration, while the agency problem is not effectively controlled.

In summary, this study proposes to examine the influence of managerial entrenchment towards companies' dividend distribution from the perspective of different types of ownership (concentration, government, foreign, and managerial ownership). Due to many uncertainties and doubts, the "dividend puzzle" is an ongoing issue and worth being explored.

1.6 Research Objectives

Current knowledge shows that the prediction on dividend payout in Malaysia are those done by researchers who only make connections between the different types of company ownership structure, such as government, foreign or family and dividend payout. Each type of company ownership must have a manager, especially a CEO, who implements the BOD's strategy, manages the day-to-day operations, and indirectly influences dividend payout decision. The gap that this dissertation attempts to answer is whether a manager's holding power and entrenched position could influence the company's payout decision. Companies' dividend payout policy is affected by various market imperfections, such as agency cost, asymmetric information, and transaction cost.

Thus, the following are the main objectives of this research:

(1) To examine the influence of managerial entrenchment on the dividend payout policy of the Malaysian public-listed companies in Bursa Malaysia.

This would indicate the influence of managerial entrenchment on dividend payout selection. The managerial influence on dividend payout is examined in pre, during and post crisis periods. This thesis also specifically addresses the influence of governance mechanism on dividend payout decisions in companies where the highly entrenched manager controls the management. The pertinent question is: Will managerial entrenchment be inversely related to dividend payout?

(2) To investigate the relationship between managerial entrenchments and dividend payout decisions in different sectors.

Different companies pay different payouts. Some industries follow their earning patterns to make payout distribution. This study intends to identify the manager's influence on dividend distribution in the Malaysian listed companies from different sectors.

(3) To determine the main preference of managerial entrenchment, either dividend payout or stock repurchase.

Share repurchase is on an increasing trend, substituting or combining with dividend payout as total payout to shareholders. This research objective would determine the direction of such preference.

Researchers recognized this and hence, assessed the correlation between managerial entrenchment and dividend payout policy with the involvement of agency cost. This study intends to extend the earlier research in the Malaysian context.

1.7 Research Questions

The following research questions are explored:

RQ1: Does managerial entrenchment influence the direction of dividend payout policy in the Malaysian public listed companies?

RQ2: Does managerial entrenchment influence dividend payout decision in the different sectors?

RQ3: Does an entrenched manager prefer dividend payout or stock repurchase?

1.8 Significance of the Study

This study makes several contributions to the existing literature on dividend payout policies. First, this research includes ownership and other variables in a framework compared with previous studies that researched them separately concerning dividend payout policy. A number of researches were conducted regarding managerial entrenchment. For example, Berger et al. (1997), De Jong and Veld, (2001), and Wang (2011) studied the relationship between managerial entrenchment and capital structure; Collins and Huang (2010) examined the cost of equity; Kaoru, Takizawa, and Tsuru (2011) looked at antitakeover provision in Japan; Surroca and Tribo (2010) examined corporate social performance; and Brochet and Gao (2004) investigated earnings smoothing. Studies regarding managerial entrenchment and dividend payout could be seen in Hu and Kumar (2004); Jo and Pan (2009); Jiraporn and Chintrakarn (2009); and Lee (2011), who based his study on the U.S. data for the period 1990 until 2004. However, the similarity in all these papers is that they did not include ownership as one of important components in measuring managerial entrenchment. Florackis and Ozkan (2009) based their study on U.K. panel data and included ownership in measuring managerial entrenchment. However, their study was on agency cost, not dividend payout.

Jensen in 1986 stated that separate ownership entities result in agency problem with the manager working for his or her personal interests. Since ownership in Malaysia varies with concentration, managerial, government, and foreign ownership, the results are expected to show different dividend payments policies with agency problems of type I and type II. Yet, there are not many empirical studies on managerial entrenchment and dividend payout policy in Malaysia. Most of studies in Malaysia are more focused on studying the relationship between ownership structure and dividend payout (Ameer, 2007; Chu & Cheah, 2004; Mat Nor & Sulong, 2007; Ming and Gee, 2008; Mohd Hassan Abdullah, Ahmad, & Roslan, 2012; Ramli, 2010; Sulong & Ahmed, 2011; Sulong & Mat Nor, 2008). Thus, based on the Malaysian context, this research contributes to the growing literature on ownership structure and dividend payout, filling the research gap by including managerial entrenchment as one of key components that influence payout distributions. The results might vary with different countries due to differences in corporate cultures, management, and norms.

Most prior studies relied on Governance Index Scores (G index) constructed by Gompers, Ishii, and Metrick (2003) and Entrenchment Index Scores developed by Bebchuk, Cohen, and Ferrell (2009) to measure the level of managerial entrenchment. To construct these indices, all the information is gathered from companies with antitakeover provisions (ATPs). Nevertheless, this information is more focused on external governance. However, instead of only based on external governance to measure the level of managerial entrenchment, it is important to consider both internal and external governance. Therefore, this research applies the Principal Component Analysis (PCA) to construct entrenchment index by including information on both internal and external governance. By including both the information, the measurement of the level of managerial entrenchment would be more accurate.

Each industry has different laws and regulations that the manager has to comply with, different features, and different composition of optimal capital structure. For example, the construction industry is capital intensive, while the services industry relies more on human labour. Thus, the manager behaves differently to influence his or her company's dividend payment. This study examines the significance of ownership structure and managerial entrenchment towards dividend payout decision in different industries. Most prior studies were more focused on overall industry data, such as SAP 500 companies, (Collins & Huang, 2010; Jiraporn & Chintrakarn, 2009), or only on one particular sector like the industrial sector (Berger et al., 1997; Jo & Pan, 2009) to examine the impact of dividend payout distribution with managerial entrenchment. This research extends on four individual sectors namely, properties sector, consumer sector, industrial sector, and trading and services sector to see the impact of managerial entrenchment on dividend payout. It is important to examine this issue in determining the seriousness of managerial entrenchment in different sectors in Malaysia.

Investigating these issues is important to determine to what extent a manager is able to influence the dividend payout decisions. Understanding the entrenched manager who is involved in setting the dividend policy contributes towards helping policy makers and companies to appropriately address the issues on why a company decides to pay or not to pay dividend and make stock repurchases. The evidence in identifying the direction of managerial entrenchment and dividend payout policy would present the norm for listed companies in Malaysia. This research would also add to the body of knowledge in regard to the factors that influence managerial decision making in the payout mechanism of listed companies in Malaysia.

1.9 Scope of the Study

This research focuses on public listed companies in Bursa Malaysia (previously KLSE) main board. The study tests the influence of managerial entrenchment on payout decision based on ownership structure in different industries. This study includes all companies that made payout distribution to all shareholders during the period from 2005 to 2010.

1.10 Outline of the Study

This study is organized into six chapters. The first chapter presents the introduction to the study. It includes an overview and trend of managerial entrenchment and dividend payout in Malaysia. In addition, it also discusses the problem statement, objectives and research questions, as well as the significance of the study. The second chapter covers the theoretical review, relevant literature conducted abroad and in Malaysia, followed by discussion on the theoretical framework of the study. The third chapter provides details of the methodology and data including sample selection, empirical framework and description of variables. Subsequently, the hypothesis development is also presented in this chapter. In the fourth chapter, the results and analysis are presented. The fifth chapter cover the discussions of major study. The conclusions of the study are discussed in the final chapter.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

This chapter reviews the relevant journal articles related to this research. It helps to identify the important variables used in gathering evidence for managerial entrenchment and payout decision, to learn from significant findings of past studies, and to develop a theoretical framework for further investigation as well to formulate the hypotheses to be tested.

2.1 Theoretical Review

Under theoretical review, a few theories related to a manager's decision and dividend payout are discussed. Previous studies provided contradicting arguments about the function of dividend payment towards shareholder wealth. Some researchers believe that dividends are able to signal a company's performance (Bhattacharya, 1979; Lintner, 1956) while others believe that dividends could monitor the agency problem (Jensen & Meckling, 1976). Dividend and monitoring are substitutes and optimal to mitigating agency and transaction costs (Rozeff, 1982).

2.1.1 The Dividends' Signalling Theory

Recent events have shown that even well performing companies are reluctant to increase dividend payment. However, there are also some companies, that despite their lower net income, continue to announce constant or an increase in their dividend payments. Prior to the Miller and Modigliani's (1961) dividend theory, Lintner (1956) presented a model based on stylized yield of the specific