EFFECTS OF LARGEST SHAREHOLDERS ON DIVIDEND:

A STUDY ON MALAYSIAN FIRMS

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ABSTRACT

The purpose of this study is to identify the effects of the largest shareholder (LO) and the second largest shareholder (LO2) on the dividend policy in Malaysian firms. The sample consists of Malaysian firms listed on Bursa Malaysia over the period 2008 – 2014. Panel data set were gathered from Bursa Malaysia whereby the sample firms consist of 762 firms for a period of seven years. The results show a statistically significant positive relationship between the largest shareholder (LO) and dividend pay-out for manager owned (MO) firms. As for the corporation owned (CO) firms, this study do not find any significant relationship between the largest shareholder (LO) and the dividend pay-out whilst for the second largest shareholder (LO2), this study notice that there is no significant relationship with the dividend pay-out for both MO firms and CO firms. Other factors which could affect the dividend pay-outs in Malaysian firms are cash, profitability of the firm, firm's size and firm's leverage level. Malaysian firms will have a higher dividend pay-outs when the amount of free cash available in the firm is high and higher profitability of the firm is being recorded. When taking the firm size into consideration, well established and large firms will have a higher dividend pay-out compared to smaller firms. On the other hand, firm's leverage level shows a significant negative relation with the dividend pay-out. This means that a firm with higher debt level will pay a lower dividends or may register a zero dividend pay-out. In conclusion, if the type of firm is manager owned (MO) firm, this study found that the largest shareholder do affect the firm's dividend policy for firms listed in Malaysia and as for corporation owned (CO) firms, this study found no significant relation between the largest shareholder and the firm's dividend policy.

ABSTRAK

Tujuan kajian ini adalah untuk mengenalpasti kesan daripada pemegang saham terbesar dan pemegang saham kedua terbesar mengikut dasar dividen dalam syarikat Malaysia. Sampel kajian terdiri daripada syarikat-syarikat Malaysia yang tersenarai di Bursa Malaysia untuk tempoh 2008 - 2014. Panel set data dikumpulkan daripada 762 syarikat yang disenaraikan di Bursa Malaysia bagi tempoh tujuh tahun. Kajian ini menunjukkan hubungan positif yang signifikan secara statistik di antara pemegang saham yang terbesar dengan bayaran dividen bagi syarikat yang diklasifikasikan sebagai syarikat pemilikan pengurus (*MO firms*). Bagi syarikat yang dimiliki oleh syarikat lain (*CO firms*), kita tidak dapat mencari apa-apa hubungan yang signifikan di antara pemegang saham terbesar dengan pembayaran dividen manakala bagi pemegang saham kedua terbesar, kita juga mendapati bahawa tidak terdapat apa-apa hubungan yang signifikan dengan pembayaran dividen bagi kedua-dua kategori pemilikan syarikat (*MO firms and CO firms*). Faktor-faktor lain yang boleh menjejaskan pembayaran dividen oleh syarikat-syarikat yang disenaraikan dalam Bursa Malaysia adalah jumlah tunai, jumlah keuntungan yang diperolehi, saiz syarikat dan leverage. Syarikat-syarikat di Malaysia akan membayar dividen yang lebih tinggi apabila jumlah wang tunai yang terdapat di syarikat itu adalah tinggi dan syarikat tersebut merakamkan keuntungan yang lebih tinggi. Apabila mengambil kira saiz firma, syarikat yang besar dan mantap akan mempunyai pembayaran dividen yang lebih tinggi berbanding dengan syarikat yang lebih kecil. Sebaliknya, leverage menunjukkan hubungan negatif yang signifikan dengan pembayaran dividen. Ini bermakna bahawa firma dengan tahap hutang yang lebih tinggi akan membayar dividen yang lebih rendah ataupun tidak akan membayar dividen langsung. Kesimpulannya, jenis pemegang saham terbesar sama ada ia adalah seorang pengurus

firma memberi kesan kepada polisi dividen syarikat itu bagi syarikat-syarikat yang disenaraikan di Bursa Malaysia manakala atau bagi syarikat yang dimiliki oleh firma lain, kajian ini tidak menunjukkan apa-apa kesan.

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

A dividend is defined as a payment made to its shareholders by a company listed on the stock exchange. This dividend payment is also commonly known as the distribution of the profits earned by the company to its shareholders. Starting from the emergence of Miller and Modigliani (1961) irrelevance theory, dividend pay-out question remains as a puzzle yet to be solved. Miller and Modigliani (1961) argued that firms operating in a capital market in which it is perfect, the dividend decision is not relevant since it is not able to affect the firms' value. Instead, the firm's earnings and how the firm made their investment are the main determinants of the dividend pay-out policy. This argument is rejected by financial practitioners as well as academicians due to the existence of market imperfections. The market is considered imperfect due to factors such as different taxation rates, asymmetries in the disclosure of firm's information, difference in interest between the firm's managers and shareholders and the illogical investor behaviour.

Since then, numerous studies have been done on the determinants of dividend policy but these studies focused mainly on developed countries like the United States, Germany and Japan. Besides that, past studies which aimed to examine the effect of the largest shareholder on dividend policy are mostly specific country-based. The findings from these developed countries may not be the same for other countries like Malaysia with different corporate cultures, economic frameworks and regulations.

Holderness (2003) state that the role of largest shareholders is not well developed in past literature. For example, in a study done by Claessens et al. (2002), the largest shareholder of a firm is a special class of shareholder. The largest shareholder with the highest voting power is able to affect the firm's decisions by using their rights. If the largest shareholder decision is in line with the firm managers' decisions, there would not be much problem. But unfortunately this is not the case, most firms' managers do not act in line with what the largest shareholder have in mind and this is known as agency conflict. Hence, there are costs or setbacks that a firm need to consider with such a large shareholder in a firm not to forget the benefits arising from having such large shareholder as the firms' managers can tap into the influential power that such shareholders exercise over the firm.

The largest shareholders can put in pressure on the firm's management to implement dividend policy that pays out all the profits earned to reduce or totally eliminate the private consumption of the managers and ultimately reduce the agency conflict. On the other hand, the largest shareholder can also implement a dividend policy that does not pay out a single cent as dividends to the shareholders in order to maximize the private benefits to themselves and neglecting the benefits for the minority shareholders. This is known as expropriation.

Truong & Heaney (2007) found that firms and corporations are very likely to pay good dividends when the largest shareholder is not an insider of the corporation. If the largest shareholder does not have a huge interest in the company invested, there will be a propensity for the shareholders to have continuous active monitoring on the firm's management continuously by external parties. This is similar with the past agency theory which argued that ownership and dividends tend to provide substitute monitoring devices (Easterbrook, 1984; Rozeff, 1982). Aoki (2014) used the same method and divided the largest shareholder into two groups mainly corporation largest shareholder and individual largest shareholder and found a U shaped relationship between shareholding and dividend pay-outs.

In short, since dividend is one of the firm's decision that strongly influenced by corporate ownership structure, dividends can be used to solve agency problems in a company and thus substituting the large ownership as a monitoring tool or it can represent the severity of expropriation in a firm.

1.2 Problem Statements

This study is aimed to investigate how most corporation's largest (LO) and second largest shareholder (LO2) influence the payment of dividends to the firm's shareholders in Malaysia by examining the publicly listed firms on Bursa Malaysia from years 2008 to 2014. Generally, ownership structure of firms in Malaysia are concentrated with a few large shareholders having the total control of the firms and these firms are classified as manager owned (MO) firms. Another common type of firms' ownership structure is known as corporation owned (CO) firms (Aoki, 2014).

Claessens et al. (2000) in their study has proven that a huge portion of the corporate wealth in East Asia are in the hands of few individuals or family members who are also part of the management of the firm and there is a high possibility for expropriation to happen when the firm is being associated with a group of firms which are controlled by the same large shareholder. Hence, the largest shareholder with voting rights and being part of the management team can actually take the opportunities to extract benefits at the expense of minority or other smaller shareholders and this is known as expropriation. Holderness (2003) in his study on the relationships between ownership and control stakes held by the largest shareholder for publicly traded firms in East Asia found that the firm valuation increased with the increase in ownership of the largest shareholder but they also found that an increase in the control rights by the largest shareholder by being part of the management of the firm will cause the firm's value to decrease.

Studies by La Porta et al. (1999) observe that in most Asian countries, especially Malaysia, the firms are closely owned by family members with the largest shareholder having an active role in the firm's management. With this, the monitoring duty has been taken over by the firm's manager instead of using the dividend to reduce the agency conflict. Past studies done on firms in Malaysia did not touch on the aspects of possible expropriation by the largest shareholder by studying the relationship between the ownership structure and the dividend pay-outs. For example, Isa (1992) and Kester and Isa (1996) found that firms in Malaysia tend to follow a steady dividend policy by studying the relationship between P/E ratio and the dividend pay-out ratio.

Annuar and Shamsher (1993), Gupta and Lok (1995) and Pandey (2003) in their study of firms listed in Bursa Malaysia found that the dividend pay-out of the firms are positively related to the firm's earnings which supported the Lintner's model. Tam and Tan (2007) found that Malaysian state firms have the highest ownership concentration. This high level of ownership is expected to decrease the dividend pay-outs for Malaysian firms as the largest shareholder will extract private benefits and hoard the cash in the company for expropriation. Samuel et al. (2015) in their study found that politically connected firms will prefer to pay a lower dividend whilst corporation owned (CO) firms will demonstrate a higher dividend pay-outs.

Interestingly, Ramli (2010) found a different result in her study on how the largest shareholder affect the dividend policy in Malaysian firms. Using panel data from year 2002 to 2006, the study done found that as the shareholding percentage of the largest shareholder increase, the higher the dividend pay-outs will be. This is contrary with the majority of the results obtained by studies done earlier whereby dividend tend to fall with the increase in shareholding percentage of the largest shareholder due to expropriation or due to the increase in corporate governance. Given that Malaysian firms are generally owned by few individuals and are part of the firm's top management, these firm managers have absolute control of the firms in terms of deciding the dividend policy (Claessens et al., 2002).

Ramli (2010) also shown that the dividend pay-out does not change when a substantial second largest shareholder (LO2) exist in the firm without further analysing the type of largest shareholder whether they are corporation largest shareholder or individual largest shareholder and how it affect the dividend policy for firms in Malaysia. Sun and Liu (2012) state that most literatures have commonly emphasize on the dividend problems caused by concentrated ownership and have ignored the differences in dividend policy when the large shareholders are actually assuming a certain position in the firm.

Besides that, past studies on dividend pay-out for firms in Malaysia do not take into consideration of all the firms listed on Bursa Malaysia. Ramli (2010) in her study of dividend pay-outs for Malaysian firms applied a systematic random sampling whereby one firm was chosen for every two firms in the sample population. With this, a larger population sample size is thus needed to achieve a more accurate result of dividend policy in Malaysia. Hence, a full understanding of how the type of largest shareholder will affect the dividend policy in Malaysia need to be carried out.

In a summary, this study is aimed to find the impact of the largest (LO) and second largest shareholder (LO2) on the firm's dividend policy in the Malaysian context with the firms listed on Malaysia's main market being the main subject matter. This study will be carried out by analyzing the 762 sample firms listed on the main market. With this, a clear understanding on the role of the largest shareholder (LO) will be achieved and subsequently the investors are able to predict how different type of largest shareholder (LO) might react in setting the firms' dividend policy.

1.3 Research Objectives

The objectives of this research are to study how dividends are related to the ownership by the type or characteristics of the largest shareholder (LO) and to analyse the effect of the second largest shareholder (LO2) on firm's dividend policy under different type of largest shareholder.

The research objectives are as follows;

1. This research will investigate the relationship between dividend pay-outs among Malaysian firms and the characteristics of the firms' largest ownership whether it is manager-owned firms or corporation-owned firms.
2. This study will investigate the relationship between dividend pay-outs among Malaysian firms and the ownership of the second largest shareholder (LO2) given that the largest shareholder (LO) might be a firm manager or another corporation.

1.4 Research Questions

DeAngelo and DeAngelo (2006) have explained that the optimum dividend pay-out is determined by the requirement to distribute the profits or the free cash flow in the firm. When a corporation or business earns a profit and there is a surplus in cash flow, the business or corporation can re-invest the earning back into the business. Hence, the firm can actually keep the earnings or allocate a part of this earnings to be given out to their shareholders as dividends.

For this study, this study are interested in examining the kind of ownership for firms in Malaysia. If the largest shareholder (LO) is a manager in the firm, the manager will act as a governance mechanism. Any improvement in the aspect of efficiency of corporate governance will shrink the role of dividends being an alternative monitoring mechanism and subsequently lead to a decrease in the dividends pay-out. Dividends can be made used by the largest shareholders to cancel off the minority shareholders' concern in an environment where expropriation by the substantial shareholders prevails (Faccio et al., 2001). Lower dividend payments will be expected when dividends are no longer being required to work as an alternate agency control device (Goergen et al., 2005).

On the other hand, a lower dividend can be expected and obtained due to the increase in the probabilities that firm managers will hoard the cash for expropriation. Daniel Wolfenzon (1999) and Claessens et al. (1999) in their study found that there is a high possibility for expropriation to happen when the firm is being associated with a group of firms and which are all controlled by the same large shareholder. The firm's wealth can be expropriated by the firm managers who have the power and rights to set bias terms and conditions for intra-group sales and transfers of assets.

When the largest shareholder is another corporation, the dividend will be expected to go up in order to reduce the agency conflict (Bohren et al., 2012). The largest shareholder will force the managers to disgorge the extra cash available as dividend pay-outs to improve the corporate governance as these corporations would not have the time to monitor the firms. When the firms need a capital to work on new projects, they will need to seek help from the capital markets and these capital markets will be there to check on the firms' financial condition.

The research questions are thus as follows;

1) Does the dividend pay-out of the firm increase with the largest shareholder (LO) for MO firms?

2) Does the dividend pay-out of the firm decrease with the largest shareholder (LO) for MO firms?

3) Does the dividend pay-out of the firm decrease with the largest shareholder (LO) for CO firms?

4) Does the dividend pay-out of the firm increase with the largest shareholder (LO) for CO firms?

5) Does the dividend pay-out of the firm increase with the increase in shareholdings of the second largest shareholder (LO2)?

6) Does the dividend pay-out of the firm decrease with the increase in shareholdings of the second largest shareholder (LO2)?

1.5 Definition of Key Terms

The independent variables are abbreviated as *LO, LO2* and *MAND. LO* represents the largest shareholder in the firm. *LO2* refers to the second largest shareholder in the firm while *MAND* is the abbreviation for manager owned firms' dummy. Corporation-owned firms are firms whose largest shareholder is another corporation or also known as an outsider. It is being abbreviated as CO firms. Manager-owned firms, whose largest shareholder is an internal firm manager is being abbreviated as MO firms. *DIVD, DIVY, DIVA* and *DIVS* refers to the dividend dummy, dividend yield, dividend to assets and dividend to sales respectively. These are the dependent variables in this study. The control variables are abbreviated as *LEV* for the firm's leverage level, *ITA* for profitability of the firm, *Tobin's Q* for investment opportunities, *SIZE* for the book value (BV) of the total assets, *AGE* for the firm's age and *CASH* refers to the cash and equivalents to total assets of the firm. Other terms include BV which means the book value.

1.6 Significance of the Study

There are a few significant contributions that this paper aim to achieve. Firstly, this study aimed to propose an explanation on how dividends are linked to the type of largest shareholder in the context of Malaysian firms. The largest shareholder can be a firm manager or another corporation. Different type of shareholder will affect the dividend policy differently for certain reasons. For example, the amount of dividend pay-out by the firms will be an indicator of whether the largest shareholder is using the dividend payments as a monitoring and checking mechanism to ensure corporate governance is in place or using the dividend payments as a mean to expropriate other shareholders. The findings from this study can help the Malaysian regulators in preventing expropriation, ensure that minority shareholders rights are not being jeopardized, enhance the firms' values and lastly protect all the shareholders' interest. The regulators can then promote and encourage the participations of foreign and institutional investors. This study has explored on the relation between *LO*, the percentage holdings of the largest shareholder and the amount of dividends being paid out to understand whether the type of concentrated ownership or largest shareholder have an effect on the dividends.

Next, this research will find out the interaction between the largest shareholder (LO) and the second largest shareholder (LO2) in Malaysian firms. Second largest shareholder (LO2) whom are normally outsiders have dissimilar dividend preferences as compared to the largest manager shareholders whom are normally insiders of the firm. Since the manager-owned firms and corporation-owned firms both have different perception towards dividend pay-out, this study aimed to help investors to decide wisely on which firms to invest if dividend pay-out is their primary concern for firms listed on Bursa Malaysia. Besides that, investors who want to increase their wealth through dividend payments will know what financial ratios that they should look for in the firms. The financial indicators may be future investment opportunities, firm's leverage level, profitability of the firm, firm's size, firm's age and the firm's cash level.

1.7 Organization of Study

For this Chapter 1, background of the study will be introduced, the research problem and issues are being identified and the significance of the study will be discussed. In Chapter 2, the related theories will be identified, related literature will be reviewed and appropriate models will be proposed for this study. The proposed research framework and all the variables like the independent variables, dependent variables and the control variables of this study will then be identified. Chapter 3 will mainly focus on the design and methodology of the study followed by the method of analysis. For Chapter 4, data analysis will be carried out and the results will be discussed. The research hypothesis will be tested and explained. Lastly, Chapter 5 highlights the research discussion, impact and limitations of the study, and concluded with suggestion for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

Black (1976) said in his research that “The dividend is like a jigsaw puzzle with pieces that just not able to fit together”. Even after so many years have passed and lots of studies have been carried out around the world, the dividend pay-outs decision is still a subject of interest to financial analysts, academicians and researchers as nobody has yet able to crack the code on dividend payments.

Dividend can be defined as a return from the money invested in the equity shares of a firm. When the firm has made a profit and has the excess cash, it may retain the earnings for future growth or distribute the profits and excess cash to the shareholders. There are two ways that a manager can choose to pay this excess cash to the firm’s owners. The first method commonly used by most firms is dividends pay-outs and the second method which is less common is known as stock repurchases.

Up to today, firms in Malaysia still practice dividend payments as a way to attract the investors and these firms are usually not binded under the regulation on the amount to be given out as dividends. In other words, firms are free to choose the amount of money to be given out as dividend to the shareholders and also free to decide on the time to distribute the dividends. For example, a firm which has made a profit do not necessary need to disburse the earnings immediately. The firm can delay the dividend payments until the firm finds that it is suitable time for the firm to give it out.

Given that factors such as legal requirements, debt level, availability of cash and many other factors may affect the decision on dividend payment, it is not abnormal to see that there are variations in dividend behavior across firms, countries, time, size of firm and the type of dividends being given out to the shareholders. Fama & French (2001) noted the variation in dividend payment among firms and found that most dividend paying firms in the US tend to be large firms and earning a profit while non-paying dividend firms are typically small and less profitable. La Porta et al. (2000) studied more than 4000 firms from 33 countries around the world found out a big variation in the firms' dividend policy.

The types of law being practiced by the countries also plays a role in affecting the dividend policy. Common law countries have been proved to offer greater shareholder protection compared to civil law countries (La Porta et al., 1998). Hence, common law countries tend to give out higher dividend compared to firms operating in countries with weak legal protection on the investors. Hence, this study can only say that one factor which seem to be a primary factor in affecting the dividend policy may not work on another firm or another country.

2.2 Definition of Dividend Policy

Dividend policy is a firm's management long-term decision on how much to reinvest in the business and how much money to be returned to the shareholders. Firms are often in a dilemma when they are required to make a decision in between paying dividends to the shareholders or reinvesting the profits made back into the business. The amount of dividend to be paid out is an important decision that firms need to consider carefully as the ultimate aim for the firms is to maximize the shareholders' wealth and this is normally measured by the share price or refers to the capital gains rather than the periodic payment of dividends only.

Some shareholders are not concerned with a firm's dividend policy as they can sell off their portfolio of shares if the shareholders need the cash. This is known as the "dividend irrelevance theory" which essentially means that the amount of dividend pay-out have little to no impact on the share price or the shareholders' wealth. This dividend irrelevance theory originated from Merton Miller and Franco Modigliani in year 1961. They argued that a firm's value is determined by its basic earning power and its business risk in a perfect capital market with rational behavior and perfect certainty. Dividend policy has no effect on the market value of the firm. With this, the true value of the firm is mainly depend on the net income produced by its assets.

Another group of people is in support of dividend relevance theory. The supporters of this theory argued that the dividend irrelevance theory is based on unrealistic assumptions. The main argument is, periodic payment of dividends will have a positive impact on the stock price of a firm, its market value and its weighted average cost of capital. Many types of dividend policy theories are being used to explain the rationale relating to the payment of dividends by public listed firms around the world but unfortunately firms that ultimately pay dividends do not seem to have a stationary formula in determining the dividend pay-out ratio. Firms that pay dividends may not have a higher market value or higher stock price compared to non-paying firms and on the other hand firms that pay dividends really do have a higher value compared to other similar firms.

2.2.1 Dividend Irrelevance Theories

2.2.1.1 The Residual Theory

The residual theory states that dividends paid by firms are residual. This means that firms will spend the money available on all available positive net present value projects first and the amount of money remained will be given out as dividends. Hence, firms will never forego desirable investment projects just to pay dividends to the shareholders. This theory was trying to say that firms with good future investment opportunities will not pay dividends. Firms will actually spend the money available on projects hoping that it will create a higher future cash flows and subsequently lead to capital appreciation of their stocks and higher dividends pay-outs. Based on this theory, we would expect firms to reduce the dividend pay-outs when they have good future investment opportunities and this is represented by the higher *Tobin's Q* value. Smith (2009) in his study found a strong arguments exist to favour a residual dividend policy as a method to optimize the usage efficiency of corporate resources.

2.2.1.2 The Modigliani and Miller Theory

The Modigliani and Miller Theory states that capital gains and dividends are equivalent in the eyes of an investor. When the investment policy of a firm is held constant and is known to all the investors, the dividend pay-out policy has no consequences for shareholder wealth. The value of the firm is dependent on the firm's earnings which result from its investment policy and the industry background. Aretz and Bartram (2010) states that the market value of firms are not determined by the dividend policies that they pursue. Instead, the firms' investment policies are the ones that really affect the firms' market value. Firms can have a low earnings but having a higher share price actually gained their firms' value from future expansion opportunities.

The wealth of the shareholders do not change if the firm decided to give out a higher dividend pay-outs which will subsequently lower the retained earnings and capital gains. With this, the total wealth of the shareholders remain unchanged no matter how the dividend pay-outs changes. In this theory, the shareholders would not affect the dividend policy as there is no direct benefit or setbacks by doing so since the total wealth remained unchanged. Investors or shareholders can create their own cash inflows from their shares according to their cash needs regardless of whether the firm pay dividends or not. If a firm does not pay dividends, an investor who needs the cash can simply sell his shares to meet his need for cash.

2.2.2 Dividend Relevance Theories

2.2.2.1 Signalling Theory

The dividend signalling theory arises from the unequal distribution of information between the firm managers and the owners. The signalling theory states that the dividend policy is able to communicate information about the existing or expected level of earnings (Chen & Dhiensiri, 2009; Booth and Chang, 2011). For this theory to hold, firm managers should firstly possess private information about a firm's prospects and need to have the incentives to convey this information to the market and secondly, if this signal is true, firms with poor performance should not be able to send any false signals to the market such as increasing the dividend payments.

Changes in the share price is not caused by the dividend pay-out itself but it reflects the future prospects of the firm. A reduction in dividend is viewed as poor management of the firm and it reflects firms having less cash than it had in the past. Fairchild (2010) found that dividends will increase the value of the firm by sending out positive signals on the firm's earnings. Hence, firms generally do not increase their dividend or prefer not to give out dividends so as not to give a false signal to the investors or shareholders when the firm reduce the dividends for the following year.

In order not to give out any false signals, Lintner (1956) found that firms will follow a fixed dividend policy and gradually increase the dividend pay-out to achieve the target pay-out ratio. Glen et al. (1995) find a substantial difference in dividend policies of companies in developed and emerging markets like Malaysia. Their study shows that companies in emerging markets follow a less stable or in other words constant changing dividend policies although these firms do have a target pay-out ratios. On the other hand, Isa (1992) find that firms in Malaysia follow a stable and non-changing of dividend policies. Hence, firms which are in favour of no dividend or tend to give out lower dividend pay-out are actually trying to avoid a negative perception on the company management or financial condition according to the signalling theory.

2.2.2.2 Agency Theory

A well-known argument in favor of substantial dividend payments is based on the agency theory of dividend. Jensen and Meckling (1976) states that agency conflicts occur when there is a separation of ownership and control or a divergence of interests between the firm's managers and the external shareholders. The underlying assumption is that managers, who is controlling the firm, may not necessarily always act in line with maximizing the shareholders' wealth. When the retained earnings are high, managers may channel the extra funds into projects that do not increase the shareholders wealth.

Easterbrook (1984), Jensen (1986), Myers (1998), Fluck (1999) and Gomes (2000) in their studies state that dividend policies are able to address the agency problems between corporate insiders and outside shareholders who are the investors and shareholders of the firm. The firms' profit can be diverted by the insiders who are the firm managers for personal use or being invested in unprofitable projects that provide private benefits for the insiders.

As a consequence, outside shareholders normally very inclined to choose dividends rather than retained earnings. They tend to view the failure to disgorge the free cash will lead to its diversion by certain insiders of the firm especially firm managers. The managers are also seen to advance their own interests by investing in projects that are linked to the managers. With this mindset, most shareholders would agree on a generous dividend policy as this can reduce the amount of free cash flows in the firm.

By paying dividends, the managers will return the corporate earnings to the investors and are not able to use these earnings for their own benefits.

Unfortunately, there is not a fully satisfactory theoretical agency models of dividends that can explain the dividend policies. Different models such as Gomes (2000) explain different aspects of the dividend policies. Rozeff (1982) suggests that firms tend to adopt an optimal monitoring system which acts to reduce the agency costs. Jensen (1986) argues that a firm is more likely to share the profits with the shareholders when the firm has a lower monitoring costs. As such, this study can say that the dividend policy is a measure of the extent to which agency conflicts between existing shareholders, managers, new investors and lenders that exist within the firm (Easterbrook, 1984).

Bohren et al. (2012) in their study found a strong evidence that dividend payments are able to reduce the agency conflicts in the firm especially among the stakeholders. Farre Mensa et al. (2014) also found the same result and concluded that among all the reasons like taxes and asymmetric information, the dividend pay-out was found to be mostly affected by the agency conflict. On the other hand, Baker et al. (2011) found mixed results when they studied the firms listed in the US and non-US market.

2.3 Determinants of Dividend Policy

There are two basic views that deal with dividend policy in the presence of market imperfections which are “for” and “against”. Based on previous studies done, dividend policy is not shaped just by considering the firm’s internal environment like the firms' target dividend pay-out ratio, earnings, debt level and cash flows but also external factors like the country's governance rating, tax and legal system.

Other studies have been carried out to examine the relationship between dividends and concentrated ownership as subject of corporate governance (Mitton; 2004, Truong & Heaney 2007; Harada and Nguyen 2011). Mitton (2004) found that firms with both country-level investor protection and strong corporate governance have higher dividend pay-outs which is consistent with agency models of dividends. Fodil and Walid (2010) in their study found that the shareholder rights policy to be the most important determinant of dividend policy. Their results is in accordance with the outcome model of dividends (La Porta et al., 2000) who suggest that when the investors or shareholders' rights are well protected, they can use their voting power to pressure managers to pay higher dividends instead of spending the excess cash.

Corporate governance has become a major consideration for a lot of investors especially after the Asian Economic Crisis that happened back in 1997 partly due to the lack of governance mechanism. Both the government and the industry players had since make changes to deal with the weakness to regain the investors' confidence in the Malaysian capital market starting with the appointment of independent directors in a firm. Nonetheless, Sing and Ling (2008) found that appointment of independent directors in Malaysian firms is merely to fulfil the firm's listing requirement rather than as a measure to improve the transparency and efficiency of the corporate governance. Besides having an independent director, Malaysia government has established The Minority Shareholder Watchdog Group (MSWG) back in year 2000 as part of a broader capital market framework to protect the interests of minority shareholders. Its main role is to increase the market discipline by encouraging good governance amongst public listed firms and raising the shareholder value over time.

Bancel et al. (2009) in their study found that the major factor influencing dividend policy are similar across the countries studied and some country specific differences exist due to the difference in the country's legal structure. Da Silva et al. (2004) found that the Anglo-American system tend to provide a higher investor protection while the German or Continental European system allows firms to have a higher flexibility in terms of their dividend policy. La Porta et al. (2000) in their study found that firms operating or established in common law countries will pay higher dividends than firms established in code law countries. Common law countries typically offer superior protection on the minority shareholders.

Lintner (1956) in his research discovered that firms maintain a target dividend pay-out ratio and these firms will adjust their dividend policy to meet this target. Firms pursue a steady dividend policy initially and then gradually increase their dividends to achieve the desired target pay-out ratio. Lintner's study also stressed that investors prefer to invest in firms with a steady dividend policy. Bulan and Hull (2013) study strengthened the model further when the managers were reluctant to reduce the dividend pay-out and prefer an uninterrupted dividend payments. An increase in dividend pay-out will only be materialized when the stability of firm's earnings has been achieved.

A number of studies have since been conducted around the world mostly on a specific country using this Lintner's framework. It has been tested by Chateau (1979) in Canada, Shevin (1982) in Australia, Leithner and Zimmermann (1993) in West Germany, UK, France and Switzerland using this model and different results were obtained.

In the 1990s and 2000s, Lintner’s dividend model performance degraded and no longer can be used to study the dividend policy. It appears that dividends have become less responsive to changes in the firms’ earnings due to the shift of pay-out from cash dividends to share repurchases. Baker and Powell (2000) found that determinants of dividends differ among industries based on their survey on New York Stock Exchange listed firms and conclude that the expected future earnings are the main determinant of dividend policy.

As for Malaysia, Pandey (2003) in his study of corporate dividend policy and behaviour in Malaysia found that pay-out ratios varied from one industry to another. His results of multi-nominal logit analysis proved that the dividends of companies listed in KLSE are related to the changes in earnings which is in support of Lintner’s model. Osobov and Denis (2007) found that the dividends pay-outs among the largest and most profitable firms is primarily determined by the distribution of free cash flow in the firm consistent with the lifecycle theory. Ajmi and Hussain (2011) also found that life cycles theory is positively related to the firms’ dividend decisions in Saudi Arabia.

Nonetheless, this research is aimed to investigate and find out how a firm's largest shareholder (LO) will influence the payment of dividends to the shareholders in Malaysia by taking into consideration of the firms' financial background like the level of leverage, the level of profitability of the firm, the future investment opportunities available to the firm, the firm's cash level, the firm's size, the firm's age as well as the type and the concentration of ownership.

2.4 Type of Firm Ownership and Dividend Policy

The identity of the large shareholder may be important (Gugler & Yurtoglu, 2003). The large shareholder may be an insider if the firm or a financial institution or a state. Some shareholders are able to influence the firm's policy and performance better than other large shareholders. For this study, the types of large shareholders can be divided into two groups mainly the manager owned (MO) large shareholders and corporation owned (CO) large shareholders. Previous research on the relationship between ownership structure and dividend policy has largely focused on companies in the US and the UK as the markets are well regulated and the ownership is widely distributed instead of in the hands of few large shareholders. Tirole (2006) state that US firms are generally diffusely owned and US firms are more diffusely owned than comparable firms elsewhere.

2.4.1 Corporation Owned (CO) Firms

Allen et al. (2000) found that financial institutions will find cash dividends attractive for taxation reasons. Thus, firms will have higher tendency to pay dividends and will actually pay more dividends when the large shareholder is a financial institution or also known as corporation owned (CO). A study on corporation owned firms done by Barclay et al. (2009) found out that large shareholders who are financial firms tend to give out higher dividend compared to non-financial firms. Short et al. (2002) found that large shareholders like institutions have a preference for cash dividends over retained earnings.

2.4.2 Manager Owned (MO) Firms

There are two different views on how the ownership concentration may affect the dividend pay-out for manager owned (MO) large shareholders. Firstly, manager owned (MO) large shareholders may increase the dividends to constrain or limit the managerial opportunism. The dividends given out can be a sign of the severity of the conflict between the large shareholder which is the controlling owner and the minority outside shareholders. Manager owned (MO) firms may also increase the dividend pay-out as a consequence of good corporate governance. Secondly, firms' managers are able to influence a firm's policy easily compared to other shareholders. For example, when the largest shareholder (LO) is an insider of the firm, the firm will have a higher preference for retained earnings over giving out dividends due to expropriation. The firm managers, being the largest shareholders may choose to pursue their own interests at the expense of other small shareholders. Hence, large shareholders tend to decrease the dividend pay-out.