

The Impact of Corporate Governance on Dividend Policy: A Case from Pharmaceuticals Companies in Pakistan

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Abstract— This study observed empirically the impact of corporate governance on dividend policy by using the data of six pharmaceuticals firms listed in Pakistan Stock Exchange (PSX). The data covered five years period from 2014 to 2018. The data were gathered from annual reports of all the sample firms. Multiple regression models were used to check the impact of corporate governance on dividend policy. Results showed the effect of corporate governance on firm dividend policy of pharmaceuticals firms. Board size, board independence, board meetings and gender diversity had significant positive impact on firm's dividend policy. It means shareholders must look into the following variables before investing in these firms. There is no impact of a firm audit committee on dividend policy. This study helps researchers, academic personnel, shareholders and board of directors.

Keywords— Corporate Governance, Dividend Policy, Signaling Theory, Agency Theory, Board Size.

Introduction

Corporate Governance is a concept to improve management performance in supervising or monitoring the management performance while guaranteeing the management accountability for the shareholders based on regulatory framework (Dalimunthe et al., 2016; Lubis et al., 2016; Muda et al., 2016). The concept of Corporate Governance is proposed for achieving more transparent company management for all financial statements users. If the concept is used properly, then the economic growth is expected to move forward in line with better transparent company management, which eventually gives benefits to many parties. (Nasution & Setiawan,

2007). The level Good Corporate Governance users can be measured, & it can be compared with each other. A number of methodologies for measuring Good Corporate Governance have been developed & can be used by users.

Corporate governance is the center of attention in today's business world. This is greatly due to the large number of shareholders whose wealth and interests are at stake in the business. What has further highlighted corporate governance today has been the increasing influence and awareness of these stake holders. Without sound corporate governance a business cannot survive (Amad, 2015).

Corporate governance is also used as a mechanism for mitigating agency cost, though it can also influence the firms' dividend payout. Corporate governance is also regarded as the pool of processes, guidelines and regulations; it directs and controls both individuals and organizations to achieve the ultimate goal of improving organizational performance. Besides, it strives to minimize the agency cost of protecting the right of shareholders and those that are affected by the firms' dividend ratio (Afzal & Sehrish, 2011; Li-Hui & Ching-Chun, 2017).

The other control variables like GDP, trade openness, inflation rate, telephone mainlines, literacy rate and agglomeration are also making an optimistic and significant impact on the flow of FDI in developing countries like Pakistan. (mubasher et.al, 2020)

Dividend policy can be defined as the policy a firm uses to decide how much it will pay to shareholders in dividends (Ranti, 2013). Dividends are considered an information signal of firm performance to financial markets where regular dividends is an indicator the firm is doing well (Al Amarneh & Yaseen, 2014). Similarly, (Naser et al., 2013; Abu Manneh, 2014) suggested that dividend policy is considered important signal of company's prospect of stability and growth, and eliminating dividends is a signal of poor firm performance. Particularly, the dividend principle assumes that the firms have to return the generated cash to the shareholders as dividends when there are no investments opportunities (Almeida et al., 2015).

Dividend policy represents established guidelines which regulate management decision in sharing Profit after Tax (PAT) to ordinary shareholders. According to Pandey (1999) cited in Ashamu, et al (2012), dividend policy is a decision by the financial manager on whether the firm should distribute all profit or retain them or to distribute a portion and retain the balance.

Dividend policy has always been one of the most controversial and frequently researched areas in the field of finance and dividend payout decision is an important part of corporate policy. The question of why firms pay dividends regularly becomes one of the main topics of financial studies for researchers. Shareholders generally believe that dividends provide important signals about the firm's ability to generate sufficient profits. The relationship between corporate governance and dividend policy in the emerging markets is an important research topic as part of the newly developing literature in corporate finance (Tahir et al., 2020).

I. Problem Statement

The scope of governance is not limited up to the corporate level but actually it starts from a personal level whose basis is the ethical background. As a single drop collectively makes a river, same is the case with corporate governance mechanism, all the members from the ownership level to a gate keeper level, are a part of a corporation and all these entities directly or indirectly influence or influenced by the actions of the company. So to control, monitor the working, there should be a need to introduce, implement and enforce the codes of corporate governance in a true sense (Shabbir et al., 2013). Pakistan economy depends 80% on corporations they contribute significantly in GDP, GNP, BOP and ultimately on the financial health of the country. But unfortunately, Pakistan is a highly family concentrated ownership country, the system of corporations is in the hands of the unqualified, non-professional persons who have not concerned with the interest of others, they try to safeguard their own benefits either by hook or by crook. These practices exert a harmful impact on the performance of company, and ultimately harm the name of country (Shabbir et al., 2013).

From the review of several studies the present study intend to check the influence Corporate governance (CG) on dividend policy by considering sub dimensions of corporate governance and dividend policy in pharmaceutical companies for the time span of 2014 to 2018 because pharmaceutical companies play a vital role in our economy of Pakistan but it is not considered yet in order to answer the following questions that how corporate governance will affect the dividend policy in pharmaceutical firms? When a company made policies about dividend the question arise how corporate governance do effect on making the decision of dividend policy?

Corporate governance has an important impact on cash dividend policy, where cash dividends may be the result of improved corporate governance or an alternative to corporate governance (La Porta et al., 2000). Based on this, La Porta et al., proposed two competitive cash-dividing agent models in 2000: the result model and the substitution model. Among them, the result model believes that managers with better governance rarely abuse free cash flow, which increases the possibility of companies paying dividends and raises the level of dividend payment. Therefore, the results model predicts that the cash dividend payment level is positively correlated with the corporate governance effect. The surrogate model argues that when external investors observe that less-governed companies are more likely to generate agency problems stemming from insider control and free cash flow, companies with poorer governance pay less for companies with better governance. Cash dividends are even more necessary. Therefore, it is predicted that the company's dividend payment level is negatively correlated with the quality of corporate governance. From this point of view, these contradictory hypotheses have yet to be further tested.

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Objective of the Study

- To find out if board size has an effect on dividend policy.
- To find out if board independence has an effect on dividend policy.
- To find out if board meetings has an effect on dividend policy.
- To find out if gender diversity has an effect on dividend policy.
- To find out if audit committee has an effect on dividend policy.

Research Questions

- How does board size affect dividend policy?
- How does board independence affect dividend policy?
- How does board meetings affect dividend policy?

- How does gender diversity affect dividend policy?
- How does audit committee affect dividend policy?
- Significance of the Study

This study will provide more awareness and detailed reflection on significance of various factors effecting corporate governance. Corporate governance is playing a vital role in the financial and overall performance of a company and firms are getting more yield with it. The study will be helpful for the policy makers and top management while making corporate policies so they must consider the elements which used in this study.

II. Research Methodology

Population in this research was 12 pharmaceuticals companies listed on Pakistan Stock Exchange (PSX) as a target population. The sample was 6 pharmaceuticals firms and purposive sampling technique was used to select the sample because firms selected for the sample are chosen by the judgment of the researcher and also by the availability of data.

Data was collected from the annual reports of pharmaceuticals companies listed on the Pakistan Stock Exchange (PSX) by using secondary source, which covers a period of five years between 2014 and 2018. And different other sources are books, journals, research papers, thesis, articles and market analysis of PSX etc.

Statistical package for social science (SPSS) used to get the results of this study by applying regression model. Regression model has been used to check the effect of dependent (Dividend Policy) and independent variable (Corporate governance) by selecting multiple regress model because in corporate governance more than one dimension was used to check the influence on dividend policy. Also applied different other tests e.g. ANOVA, Descriptive statistics, coefficient of determination etc.

III. Results and Discussion

A. Model Summary

Model	R	R square	Adjusted R square
1	.676a	.458	.345

The model summary table actually shows the combined relationship of the independent variable on the dependent variable. The model summary table shows $R = 0.676$ which indicates that 67% of variation occurs in the dependent variable (dividend policy) due to independent variable (corporate governance). The R Square of our data is 0.458 which shows that 45% changes happens in dependent variable (dividend policy) due to independent variable (corporate governance)

B. Anova

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	1.728	5	.346	4.049	.008b
1 Residual	2.048	24	.085		
1 Total	3.776	29			

When the P value is less than .05 and the value of F is greater than 4 and less than 16 then the model will be significant. The table shows that the P value is .008 which is less than .05 and the value of F is 4.049 which is greater than 4 and less than 16 which confirms that the model is significant. Its degree of freedom is 5 and regression square is 1.728.

IV. Discussion And conclusion

This research contributes on the ongoing debate about the role corporate governance with dividend policy. It examined the role corporate governance with dividend policy in Pakistani context. Pharmaceuticals companies listed on Pakistan Stock Exchange (PSX) is used in the sample of this research paper. To shed the light of Pakistan context of emerging markets to find the association of dividend policy and corporate governance, this study has examined 6

pharmaceuticals firms based on the availability of data in Pakistan. The panel data for time period was 2014 to 2018 to examine the impact of corporate governance with dividend policy. The results demonstrated that corporate governance has positive impact on dividend policy which means that firms having well corporate governance will pay more dividends. The value of R^2 shows that 45% changes happens in dividend policy due to corporate governance supported by findings of (Gunawan et al., 2019), (Sumail, 2018), (Elmaghrha et al., 2016), (Pahi & Yadav, 2019), (Aydin1 & Cavdar1, 2015).

Several studies have shown some form of linkage between corporate governance and dividend policy; whether corporate governance impact dividend policy or not. However, not all studies have arrived at the same results; in fact, some have concluded to the contrary. Therefore, the current study has attempted to analyze impact of corporate governance on dividend policy in pharmaceuticals companies in Pakistan from 2014 to 2018.

The descriptive statistics were used to describe the data and then correlation analysis was conducted to show the direction and strength between corporate governance and dividend policy. Afterwards, regression analysis was carried out using multiple regression.

From the results of model summary it can be concluded that 45% dividend policy is effected by corporate governance. Similarly from table of coefficients it can be concluded that board independence, board size, gender diversity and board meetings are in significant relationship with dividend policy, whereas audit committee are in insignificant relationship with dividend policy, which illustrates that increasing or decreasing number of audit committee members has no concern with dividend policy. And by increasing number of board members, non executive directors, number of meetings and motivating gender diversity, dividend paid to the shareholders will increase and vice versa.

So in order to conclude we could say that pharmaceuticals firm can apply the outcome since corporate governance variables influence the decision of the amount of dividends paid to the shareholders.

Limitations and Future Direction

Future studies could cover more time period by using panel data analysis and can increase or decrease the number of firms to take into consideration the impact of corporate governance on dividend policy. The future studies could also take into consideration of more variables from corporate governance and dividend policy and can also take control variables as well as can select any other sector.

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