ICME 2022 "Re-envisioning the Business Management Landscape for VUCA World"
Proceedings of the 11th International Conference on Management and Economics

Does Corporate Governance Affect Dividend? Evidence from Firms Listed in the Colombo Stock Exchange under Consumer Staples and Industrial Sectors

Dilhara W. M. A.[a*] , Wanniarachchige M. K.[b]

[a*,b] *Faculty of Management and Finance, University of Ruhuna, Sri Lanka*

A B S T R A C T

Corporate governance literature provides contradictory findings on how corporate governance affects dividend payments. Therefore, this study investigates the effect of corporate governance on dividends using annual data from 2016 to 2020 from 51 firms listed under the consumer staples sector and 35 firms listed under the industrial sector on the Colombo Stock Exchange. The corporate governance index comprising of 18 corporate governance best practices categorized under four main governance dimensions was used to measure the level of compliance with corporate governance. The dividend was measured using the dividend yield ratio. The pooled OLS regression analysis was used to assess the effect of corporate governance on dividends while controlling the effects of firm size, profitability, and industry. The findings suggest that corporate governance has no significant effect on dividend payments despite the fact that compliance with corporate governance best practices has been improved from 2016 to 2020.

Keywords: Corporate governance, Colombo Stock Exchange, Dividend, Sri Lanka

[*] Corresponding author: ayushaweeratunga2015@gmail.com

11th ICME at University of Ruhuna, Sri Lanka.
ISBN: 978-624-5553-28-0

1. Introduction

Despite several studies on dividend payments, the determinants of dividend are still unclear (Rajput & Jhunjhunwala, 2019). Even though the role of institutions in determining dividend payments has been identified in the literature, the association between corporate governance and dividend policy has received limited attention in empirical studies (Yarram, 2015).

The board of directors monitor and control the firms on behalf of owners since there is a separation of ownership and control (Mehdi et al., 2017). Therefore, there should be an effective monitoring system to have a board of directors independent from the management (Sener & Selcuk, 2019). Here, the board of directors acts as the agents of the owners in overseeing the management actions. This mechanism is widely known as corporate governance. Corporate governance holds management accountable for their decisions and actions. As a result, corporate governance acts as a source of investor confidence as well (Asadullah et al., 2021).

Some studies have claimed that higher corporate governance compliance leads to higher dividend payments (Shamsabadi et al., 2016; Yarram, 2015). According to La-Porta, Lopez-De-Silanes, & Vishny (2000), the outcome model emphasizes the positive association between corporate governance and dividend. Whereas Benjamin & Zain (2015) claim that firms with higher compliance pay fewer dividends. More precisely, the substitution model emphasizes the negative association between corporate governance and dividend (La-Porta et al., 2000). In contrast, Elmagrhi et al., (2017) state that there is no association between corporate governance and dividend payments.

According to Mitton (2004) and Sawicki (2009), many studies have investigated the association between corporate governance and dividend payments using cross-country data. Those studies claim that dividend payments can be influenced by the institutional environment of a country, particularly the substance and execution of legal restrictions for outside investors (Ye et al., 2019). However, these studies do not consider certain features that are unique to each country. Therefore, Setiawan & Phua (2013) show the necessity of analyzing a specific country because the contextual factors might have a substantial influence on this relationship.

Further, the majority of studies regarding the effect of corporate governance on dividends have been conducted in developed countries. Therefore, the findings of those studies cannot be applied to the Sri Lankan context due to social, cultural and economic disparities in Sri Lanka compared to such developed countries. Moreover, only a limited number of studies have been conducted in Sri Lanka regarding the effect of corporate governance on dividend payments (Baker et al., 2020). However, the approaches used in each study to measure corporate governance vary heavily. Therefore, this study investigates the effect of corporate governance on dividends using data on 86 firms listed under the consumer staples sector and the industrial sector on the Colombo Stock Exchange

2. Literature review

Different board characteristics have varying effects on dividend decisions. For example, the effect of board size on dividend payment is twofold. First, according to some literature, larger boards pay lower dividends since larger boards are ineffective when compared with smaller boards (Mehdi et al., 2017). Second, some literature argues that larger boards pay higher dividends than smaller boards (Jensen, 1993) because smaller boards are incapable of performing the required governance functions (Nazar, 2021). According to Ntim, Opong, & Danbolt (2015), larger boards are better capable of mitigating the management's opportunistic

actions due to more experience and skills. Therefore, larger boards are better able to reduce agency issues and improve dividends. Bokpin (2011) argued that the shareholders receive higher dividends from the firms with a higher number of directors because in such boards, the CEO's decisions are monitored by a considerable number of individuals.

Board effectiveness depends on the existence of external directors on the board. Therefore, having one-third of independent directors on the board reflects better governance (Oba et al., 2010). These outside directors have considerable power to influence dividend decisions (Al-Najjar & Hussainey, 2009). Shareholders use dividend policy to evaluate the management when managerial controlling systems are ineffective (Rozeff, 1982). Therefore, encouragement of independent directors leads to larger dividend payments since they are independent of managers and shareholders (Yarram & Dollery, 2015). Thereby, firms pay higher dividends for protecting minority shareholders when the board independence acts as an effective controlling mechanism. Otherwise, firms pay lower dividends. However, Borokhovich, Bruanarski, Harman, and Kehr (2005) stated that board independence strengthens shareholder control by limiting dividend payments. Therefore, dividend payments decrease as a result of increased external directors on the board (Elmagrhi et al., 2017). As a result, board independence can act negatively on dividend payments.

According to Gill & Obradovich (2012), when both positions of chairperson and CEO are held by a single person, he or she has the authority to determine how much benefit should be provided to stockholders and how much to save for potential investments. Therefore, the CEO has additional authority to influence dividend decisions when there is CEO duality (Ntim et al., 2015). Thereby, the probability of dividend payment is high when CEO heads the board due to a low level of conflicts of interest (Uwalomwa et al., 2015). Further, CEOs who have worked for a relatively long time pay higher dividends (Ghosh & Sirmans, 2006). This is an attempt by managers rooted in pleasing shareholders. Conversely, Fama and Jensen (1983) show that the division of dual roles in a company results in lower agency conflicts and higher dividend payments. However, Elmagrhi et al. (2017) indicate that the CEO duality does not affect dividend payments.

A higher number of board meetings leads to higher dividend payments due to fewer agency conflicts (Ntim, 2013) since frequent board meetings help to increase working efficiency by allowing managers and shareholders to get information transparently (Greco, 2011). Further, paying higher dividends helps to reduce poor governance connected with board meetings. Therefore, firms pay higher dividends to inform the market that the interest of stockholders is being secured (Sawicki, 2009). Conversely, Benjamin & Zain (2015) stated that well-performing boards meet infrequently and generate fewer conflicts. Therefore, board meeting frequency affects adversely dividend payments when reducing agency costs. However, Pangestu & Megawati (2021) state that board meeting frequency does not affect dividend payments.

By reducing the information asymmetry between shareholders and managers, the audit committee ensures better communication between the firm and the outsiders and reduces the principle-agency problem (Pahi & Yadav, 2019). Therefore, the presence of external and independent auditors on audit committees is likely to decrease the desire of management to distribute personal benefits to shareholders (Baker et al., 2020). Thereby, firms pay higher dividends to shareholders. The nomination committee affects the board's

performance by nominating the appropriate individual and including diversity in the board (Zahra & Pearce, 1989).

The profitability of a firm appears to be a considerable determinant of dividends (Al-Najjar & Hussainey, 2009) since profitable firms are more likely to pay greater dividends. Setiawan and Phua (2013) stated that the higher-earning companies pay higher dividends to their investors. Thereby, profitability is positively related to the dividends. Coulton and Ruddock (2011) state that firms can pay higher dividends to shareholders to address the issue of information asymmetry. Further, larger firms pay higher dividends due to the stability of cash flows. Thereby, firm size may act either positively or negatively with dividends.

This literature review indicates that there is inconsistency in the findings. Some studies have claimed that corporate governance positively affects dividend payments (Shamsabadi et al., 2016; Yarram, 2015). Conversely, some studies indicated a negative effect of corporate governance on dividend payments (Benjamin & Zain, 2015; Setiawan & Phua, 2013). In contrast, Elmagrhi et al., (2017), argue that there is no association between corporate governance and dividend payments. Therefore, investigating how corporate governance affects dividend payment is necessary.

3. Methodology

This study assesses the effect of corporate governance on dividends using annual data from 2016 to 2020 on 86 firms. The data was collected from the published annual reports. Initially, all 91 firms listed in the CSE under the consumer staples and the industrial sectors as of 30th April 2021 were selected for the sample based on the cluster sampling technique. However, five firms were removed from the sample during data collection because data was not available on a continuous basis. Therefore, the final sample consists of 86 firms. Nevertheless, when cases with missing data were removed the final sample consisted of 384 firm-year observations.

The corporate Governance Index (CGI) was used to measure corporate governance. As illustrated in Table 1, this index is constructed based on selected 18 best practices which are then classified into four main dimensions: board function, audit committee, remuneration committee and nomination committee. This approach is similar to Shamsabadi et al. (2016), Baker et al. (2020), Sawicki (2009) and Gompers et al., (2003). Jiraporn, Kim, & Kim (2011) have calculated CGI on a scale of zero to one. In this study, one point is added to the governance index for each element that meets the relevant condition. Otherwise, add zero. Therefore, the CGI in this study ranges from zero to 18. Thereby, the higher CGI value reflects better corporate governance. The dividend yield was used to measure the dividend and it was measured by dividing the dividend per share by the opening share price of the year (Al-Kayed, 2017).

Table 1: Best Practices of Corporate Governance Index

Dimension	Indicators
Board Function	Board Size: Measured by the number of directors on each firm in a year (Higher than the average board size in the relevant year)
	Board Independence: Measured by the percentage of non-executive directors of the board (Higher than the 50% of directors)
	CEO Duality: Chairperson and CEO is the same individual

	Board Meeting Frequency: Measured by the number of board meetings held in each firm (Higher than the average board meetings in the relevant year)
	Directors' Shareholding: Measured by the percentage of shares hosted by directors (Higher than the 5% of total shares)
	CEO's Shareholding: Measured by the percentage of shares hosted by the CEO (Higher than the 5% of total shares)
Audit Committee	Existence: Presence of an audit committee Chairman: Independent non-executive director Non-executive Directors: Minimum three Meetings: At least once a year
Remuneration Committee	Existence: Presence of a remuneration committee Chairman: Independent non-executive director Non-executive Directors: Minimum three Meetings: At least once a year
Nomination Committee	Existence: Presence of a nomination committee Chairman: Independent non-executive director Non-executive Directors: Minimum three Meetings: At least once a year

To control for other firm-specific factors, firm size, profitability and industry were used as control variables. Firm size and profitability were assessed through the natural logarithm of total assets (LTA) and Return on Assets (ROA) (Al-Najjar & Hussainey, 2009; Nguyen, Dang, & Dau, 2021; Rajput & Jhunjhunwala, 2019). Since there were firms from two sectors, namely the consumer staples sector and the industrial sector, an industry dummy was used to capture the industry effect. The dummy variable indicates value of zero for the industrial sector and one for the consumer staples sector.

Model A: $\text{Div} = \alpha + \beta_1 \text{CG} + \beta_2 \text{FSIZE} + \beta_3 \text{PB} + \beta_4 \text{IND} + \varepsilon$ *(1)*

Model B: $\text{Div} = \alpha + \beta_1 \text{CG} + \beta_2 \text{FSIZE} + \beta_3 \text{PB} + \varepsilon$ *(2)*

The data were analyzed under two models using pooled OLS regression analysis. Model A was used to analyze the data by including the industry dummy while Model B was used to analyze the data by excluding the industry dummy. Div denotes the dividend. Corporate governance is indicated by CG. FSIZE and PB respectively stand for the firm size and profitability. IND denotes the industry. Intercept, coefficient and random error are indicated by α, β and ε respectively.

4. Findings and discussion

As illustrated in Table 2, compliance with corporate governance varies greatly among firms (*SD* = 2.48, *CV* = 0.24). Moreover, the level of compliance with corporate governance is low (*M* = 10.31). Dividend yield ratio also shows a considerable variation (*SD* = 2.48, *CV* = 1.19). Therefore, the dividends of the firms are quite diversified. LTA and ROA account for lower dispersion. This implies that the firm sizes in the sample are not drastically different. The low standard deviation of ROA indicates a lower level of dispersion of profitability.

Table 2: Descriptive Statistics

Variable	Symbol	Min	Max	Mean	SD
Corporate Governance Index	CGI	5	16	10.31	2.48
Log of Total Assets	LTA	7.87	11.13	9.66	0.61
Return on Assets	ROA	-0.19	0.34	0.04	0.08
Dividend Yield Ratio	DYR	0.00	11.15	2.09	2.48
Industry	IND	0	1	0.58	0.49

Notes: N = 384

The overall OLS regression model was statistically significant in predicting dividend in model A, (R^2 = .325, $F(4,379)$ = 45.534, p < .001). Therefore, around 32.5 percent of the variation in dividends is explained by the explanatory variables. Table 3 shows that the CGI has no significant effect on dividend (β = .004, p = .930). This indicates that regardless of corporate governance compliance, firms have paid similar amounts as dividends. This finding is in line with some of the previous studies on corporate governance such as Elmagrhi et al. (2017) who also have found no effect of corporate governance on the dividend. However, the LTA indicates a significant positive effect on dividend (β = .536, p = .004). This indicates that larger firms pay more dividends. Sulong and Ahmed (2011) have found similar results in their study. The ROA also indicates a significant positive effect on dividend (β = 15.635, p < .001). This suggests that profitable firms pay higher dividends. This finding is consistent with the results of Yarram and Dollery (2015) and Shamsabadi et al. (2016). The industry dummy indicates a significant negative effect on dividends (β = -.669, p = .002). This indicates that the industrial sector pays more dividends than the consumer staples sector.

Table 3: Regression Results - Model A

Dependent Variable: Dividend
R^2 = .325, $F(4,379)$ = 45.534, p < .001

Variable	Symbol	β	*t*	VIF
Corporate Governance Index	CGI	0.004	0.087	1.163
Log of Total Assets	LTA	0.536**	2.903	1.134
Return on Assets	ROA	15.635**	12.067	1.041
Industry	IND	-0.669**	-3.122	1.022

Notes: ** indicates statistical significance at 5% level.

Moreover, the overall regression model was statistically significant in predicting dividend in model B as well, (R^2 = .273, $F(3,388)$ = 48.567, p < .001). Therefore, around 27.3 percent of the variation in dividends can be explained using explanatory variables. Similar to Model A, Table 4 shows that the CGI has no significant effect on dividend (β = -.018, p = .722). This implies that the level of compliance with corporate governance in Sri Lanka is limited due to the lack of execution and awareness of corporate governance practices by the firms. Therefore, a corporate governance system is not simply sufficient to alter management behavior regarding dividend payments. This result is in line with some of the previous studies on corporate governance such as Shahid, Gul, Rizwan, and Bucha (2016) who also have found

no effect of corporate governance on the dividend. When the industry dummy was removed, LTA also does not show a significant effect on dividend payments (β = .378, p = .071). Setiawan and Phua (2013) have found similar results in their study. However, the ROA indicates a significant positive effect on dividend (β = 16.925, p < .001) similar to Model A. This finding is consistent with the results of Pahi and Yadav (2019) and Al-Najjar and Kilincarslan (2016).

Table 4: Regression Results - Model B

Dependent Variable: Dividend
R^2 = .273, F(3,388) = 48.567, p < .001

Variable	Symbol	β	*t*	VIF
Corporate Governance Index	CGI	-0.018	-0.357	1.135
Log of Total Assets	LTA	0.378	1.809	1.129
Return on Assets	ROA	16.925**	11.529	1.034

Notes: ** indicates statistical significance at 5% level.

The absence of an effect of corporate governance on dividends indicates that this study supports neither the outcome model nor the substitution model. This disassociation could be due to the lack of awareness about the benefits of implementing corporate governance practices among the investors. In this manner, corporate governance cannot act as a mechanism to pay dividends in firms, particularly in consumer staples and industrial sectors.

5. Conclusions and implications

This study investigates the effect of corporate governance on dividends using annual data from 2016 to 2020 from 51 firms listed under the consumer staples sector and 35 firms listed under the industrial sector in the Colombo Stock Exchange. Despite the numerous findings in the literature, the findings of this study suggest that corporate governance does not have any significant effect on dividend payments. Accordingly, this finding supports neither the outcome model nor the substitution model proposed by La-Porta et al. (2000). This indicates that regardless of corporate governance compliance, firms have paid similar amounts as dividends. Further, the ROA indicates a significant positive effect on dividend payments. This suggests that the profitable firms enhance the level of dividend payments. Moreover, firm size has a significant positive effect on dividend in model A. Therefore, the evidence supports the agency cost approach of dividend strategy. The findings of this study have implications for government and financial policymakers. This study focused only on the consumer staples sector and the industrial sector in Sri Lanka. Therefore, future studies may consider the other sectors in the Colombo Stock Exchange. Further, future studies may consider the interactions between various governance frameworks and other financial policies.

References

Al-Kayed, L. T. (2017). Dividend payout policy of islamic vs conventional banks: Case of Saudi Arabia. *International Journal of Islamic and Middle Eastern Finance and Management, 10*(1), 117-128.

Al-Najjar, B., & Hussainey, K. (2009). The association between dividend payout and outside directorships. *Journal of Applied Accounting Research, 10*(1), 4-19.

Al-Najjar, B., & Kilincarslan, E. (2016). The effect of ownership structure on dividend policy: Evidence from Turkey. *Corporate Governance, 16*(1), 135-161.

Asadullah, M., Waris, M., Kamran, M., & Nadeem, M. M. (2021). Corporate governance and dividend payout policy: Mediating role of leverage. Evidence from emerging economy. *Annals of Social Sciences and Perspective, 2*(1), 113-133.

Baker, H. K., Dewasiri, N. J., Premaratne, S. P., & Koralalage, W. Y. (2020). Corporate governance and dividend policy in Sri Lankan firms: A data triangulation approach. *Qualitative Research in Financial Markets, 12*(4), 543-560.

Benjamin, S. J., & Zain, M. M. (2015). Corporate governance and dividends payout: Are they substitutes or complementary? *Journal of Asia Business Studies, 9*(2), 177-194.

Bokpin, G. A. (2011). Ownership structure, corporate governance and dividend performance on the Ghana stock exchange. *Journal of Applied Accounting Research, 12*(1), 61-73.

Borokhovich, K. A., Bruanarski, K. R., Harman, Y., & Kehr, J. B. (2005). Dividends, corporate monitors and agency costs. *The Financial Review, 40*(1), 37-65.

Coulton, J. J., & Ruddock, C. (2011). Corporate payout policy in Australia and a test of the life-cycle theory. *Accounting & Finance, 51*(2), 381-407.

Elmagrhi, M. H., Ntim, C. G., Crossley, R. M., Malagila, J. K., Fosu, S., & Vu, T. V. (2017). Corporate governance and dividend payout policy in UK listed SMEs. *International Journal of Accounting and Information Management, 25*(4), 459-483.

Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. *Journal of Law Economics, 26*(2), 301-325.

Ghosh, C., & Sirmans, C. F. (2006). Do managerial motives impact dividend decisions in REITs? *J Real Estate Finance Econ, 32*, 327-355.

Gill, A., & Obradovich, J. D. (2012). The impact of corporate governance and financial leverage on the value of American firms. *International Research Journal of Finance and Economics, 12*(4), 899-917.

Gompers, P. A., Ishii, J. l., & Metrick, A. (2003). Corporate governance and equity prices. *The Quarterly Journal of Economics, 118*(1), 107-155.

Greco, G. (2011). Determinants of board and audit committee meeting frequency: Evidence from Italian companies. *Managerial Auditing Journal, 26*(3), 208-229.

Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *The Journal of Finance, 48*(3), 831-880.

Jiraporn, P., Kim, J.-C., & Kim, Y. S. (2011). Dividend payout and corporate governance quality: An empirical investigation. *The Financial Review, 46*, 251-279.

La-Porta, R., Lopez-De-Silanes, F., & Vishny, R. W. (2000). Agency problems and dividend policies around the world. *The Journal of Finance, 55*(1), 1-33.

Mehdi, M., Sahut, J.-M., & Teulon, F. (2017). Do corporate governance and ownership structure impact dividend policy in emerging market during financial crisis? *Journal of Applied Accounting Research, 18*(3), 274-297.

Mitton, T. (2004). Corporate governance and dividend policy in emerging markets. *Emerging Markets Review, 5*, 409-426.

Nazar, M. C. A. (2021). The influence of corporate governance on dividend decisions of listed firms: Evidence from Sri Lanka. *Journal of Asian Finance, Economics and Business, 8*(2), 289-295.

Nguyen, H. V., Dang, H. N., & Dau, H. H. (2021). Influence of corporate covernance on dividend policy in Vietnam. *Journal of Asian Finance, Economics and Business, 8*(2), 893-902.

Ntim, C. G. (2013). Monitoring board committee structure and market valuation in large publicly listed South African corporations. *International Journal of Managerial and Finance Accounting, 5*(3), 310-325.

Ntim, C. G., Opong, K. K., & Danbolt, J. (2015). Board size, corporate regulations and firm valuation in an emerging market: A simultaneous equation approach. *International Review of Applied Economics, 29*(2), 194-220.

Oba, B., Ozsoy, Z., & Atakan, S. (2010). Power in the boardroom: A study on Turkish family-owned and listed companies. *Corporate Governance, 10*(5), 603-616.

Pahi, D., & Yadav, I. S. (2019). Does corporate governance affect dividend policy in India? Firm level evidence from new indices. *Managerial Finance, 45*(9), 1219-1238.

Pangestu, A., & Megawati. (2021). The effect of corporate social responsibility (CSR), board of directors meeting frequency and foreign ownership on dividend policy. *Financial Management Studies, 1*(2), 29-37.

Rajput, M., & Jhunjhunwala, S. (2019). Corporate governance and payout policy: Evidence from India. *Corporate Governance, 19*(5), 1117-1132.

Rozeff, M. S. (1982). Growth, beta and agency costs as determinants of dividend payout ratios. *The Journal of Financial Research, 5*(3), 249-259.

Sawicki, J. (2009). Corporate governance and dividend policy in Southeast Asia pre- and post-crisis. *The European Journal of Finance, 15*(2), 211-230.

Sener, P., & Selcuk, E. A. (2019). Family involvement, corporate governance and dividends in Turkey. *Managerial Finance, 45*(5), 602-621.

Setiawan, D., & Phua, L. K. (2013). Corporate governance and dividend policy in Indonesia. *Business Strategy Series, 14*(5/6), 135-143.

Shahid, M. S., Gul, F., Rizwan, M., & Bucha, M. H. (2016). Ownership structure, board size, board composition and dividend policy: New evidence from two emerging markets. *Journal of Business Studies 12*(2), 25-36.

Shamsabadi, H. A., Min, B.-S., & Chung, R. (2016). Corporate governance and dividend strategy: Lessons from Australia. *International Journal of Managerial Finance, 12*(5), 583-610.

Sulong, Z., & Ahmed, P. K. (2011). Ownership structure, board governance, dividends and firm value: An empirical examination of Malaysian listed firms. *International Journal of Business Governance and Ethics, 6*(2), 135-161.

Uwalomwa, U., Olamide, O., & Francis, I. (2015). The effect of corporate governance mechanisms on firms dividend payout policy in Nigeria. *Journal of Accounting and Auditing, 1*, 2200-2211.

Yarram, S. R. (2015). Corporate governance ratings and the dividend payout decisions of Australian corporate firms. *International Journal of Managerial Finance, 11*(2), 162-178.

Yarram, S. R., & Dollery, B. (2015). Corporate governance and financial policies: Influence of board characteristics on the dividend policy of Australian firms. *Managerial Finance, 41*(3), 267-285.

Ye, D., Deng, J., Liu, Y., Szewczyk, S. H., & Chen, X. (2019). Does board gender diversity increase dividend payouts? Analysis of global evidence. *Journal of Corporate Finance, 58*, 1-26.

Zahra, S. A., & Pearce, J. A. (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management, 15*(2), 291-334.