

INSTITUTIONAL SHAREHOLDERS AND DIVIDEND PAYOUT IN MALAYSIA

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Abstract

This study seeks to furnish insights on institutional shareholders by assessing whether higher presence of institutional shareholders leads to higher dividend payout or vice versa in line with a particular version of the agency theory. The panel data consists of 100 Malaysian firms from the trading and services sector of Bursa Malaysia from the years 2005 to 2008. In line with the 'efficient monitoring hypothesis' theory of institutional shareholders and in conjunction with the outcome model of dividends, we find the presence of institutional shareholders results in higher dividends payout in Malaysia. In spite of the lower fraction of shareholding by institutional shareholders in Malaysia as compared to developed markets, it is clear from the results that they in fact bring about a positive impact to the firms they invest in by resulting in higher dividends payments. We have provided a framework linking the two theories of dividends (outcome and substitute) and the three theories of institutional shareholders (efficient monitoring hypothesis, conflict of interest hypothesis and strategic alignment hypothesis) to better analyze the two broad ranging theories into greater depth.

Keywords: Dividend, Institutional Shareholders, Corporate Governance, Agency Theory

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1 Introduction

This paper investigates the relationship between institutional ownership and dividend policy in Malaysia. Under the agency setting, large block holding is considered a mechanism to controlling the agency problems which arise whenever managers have incentives to pursue their own interests at the expense of those of shareholders (Faccio and Lasfer, 2000). In the Malaysian financial market, institutional investors have become increasingly important (Wahab et al, 2008). It is also generally assumed that larger dividends payouts help reduce agency conflicts (Easterbrook, 1984, Jensen, 1986, La Porta et al, 2000). However the interaction institutional shareholding share with dividend payout remains largely mixed. One popular argument stems from the notion that institutional shareholders are professional in their decision making capabilities and more vigilant in controlling agency costs (Afza and Mirza, 2011). Hence firms with higher degree of institutional shareholders may have relatively less concerns with regards to agency conflict and thus pay lower

dividends. Although this idea sounds convincing and confirmed by a number of studies (see, e.g.; Rennebog and Trojanowski, 2004; Khan, 2006) others report results completely in the opposite direction (see, e.g. Ramli, 2010; Afza and Mirza, 2011; Han et al, 1999).

The possible explanations for the mixed evidence on this subject could be attributed to the *efficient-monitoring hypothesis* of institutional shareholders' (Pound, 1988). Grounded in agency-theory-based explanations that the interests of managers and shareholders in large public corporations often diverge and that shareholders do not have effective control over managers because of information asymmetry and problems related to moral hazard (Milgrom & Roberts, 1992) the *efficient-monitoring hypothesis* offers useful insights on institutional shareholders' affect on firms. Although this hypothesis largely explains institutional shareholders' affect on firm performance, it could arguably explain the impact of institutional shareholders on dividends as well as the latter is in fact an outcome of firm performance.

A prominent theory on dividends is the dividend outcome and dividend substitution model by La Porta

et al (2000). It turns out, in line with La Porta et al (2000) revelations, the outcome and substitute theory of dividends could interact in a particular fashion with the *efficient-monitoring hypothesis* outlined above. This study has produced a number of contributions. Foremost, we provide a framework which elucidates the relationship between institutional shareholders and dividends, i.e. where the dividends outcome and substitute model of La Porta et al (2000) and the three institutional shareholders hypotheses (Pound, 1988) is pieced together to better analyze the two broad ranging theories into greater depth. Although agency theory argues that increased institutional shareholders presence could alleviate concerns of agency conflict and hence reduce the need to pay more dividends, another explanation is the increased pressure institutional shareholders exert on management results in payments of excess cash as dividends. In fact it turns out that in Malaysia the latter argument is true where increased presence of institutional shareholders results in increased pressure on managers to pay out higher dividends. Our study looks at the question of dividends and institutional shareholders in a particular industry (observed from the view point of the framework presented in this study) and find that firms within the Trading and Services sector reflect a particular fashion as to how institutional shareholders' presence affect dividends. Next, the definition of institutional shareholders used in this study is broader than the definition used by other studies. The final contribution emerges from the fact that most prior studies on this area have been carried out in developed countries. This study is done in Malaysia, where the corporate governance practices of the stock market not comparable in maturity compared to developed markets.

2 Background literature and hypotheses

Corporate managers are agents of shareholders. Owing to the agency theory, managers are expected to run firms in line with the interests of shareholders. However in the pursuit of managing firms, managers could pursue their own interests at the expense of shareholders. This conflict of interest carries with it several imperatives including agency costs and creates the need for shareholders to control the vocation of managers (called the monitoring of expenditure) (Nivoix, 2005). Institutional ownership is defined as the equity holdings of institutional investors which consist of banks, insurance companies, investment advisers, pension funds and endowments organizations (Bushee 1998). The presence of institutional shareholders in this aspect is seen as a positive pressure on management to ensure they strive towards improved performance of the firm and release any excess cash in the form of dividends. The availability of these free cash flows is an inducement for managers to indulge in activities does not yield benefits to shareholders (Afza and Mirza, 2010). In this regard institutional shareholders could use the powers bestowed upon them through their

shareholding to exert their influence on management (Chaowarat and Jumreorvong, 2010).

The many benefits that institutional investors could bring to a company include diligent monitoring (Wan Hussin and Ibrahim, 2003), prevent managerial opportunistic reporting behavior (Mitra and Cready, 2005) and enhanced corporate performance (McConnell and Servaes, 1990). During the 1930s, most organizations' equities were owned by their founders or family. Hence, the agency theory problems occurred since managers may not perform in the best interest of the shareholders (Berle and Means, 1932; Jensen & Meckling, 1976). However, since the twentieth century, the pattern of the ownership changed where individual share ownership has reduced but institutional share ownership has gone up. As a result, institutional investors play an important role in reducing agency conflict and efficiency of the corporate governance practices by firms (Claessen and Fan, 2002; McConnell and Servaes, 1990; Nahar et al., 1998).

Corporate dividend policy should be designed to minimize the sum of capital, agency, and taxation costs (Easterbrook, 1984). Dividends can be used to mitigate agency problems in a company (Easterbrook 1984; Jensen 1986; Rozeff 1982). The payment of dividends may act to help reduce agency costs which arise between managers and external shareholders. Dividends can also minimize agency conflicts by subjecting companies to the scrutiny of capital market monitoring (Easterbrook 1984). Thus firms with increased presence of institutional shareholders could also be expected to pay higher dividends.

However the argument above which leads one to theorize that increased institutional shareholders presence could result in higher dividends payments is not as straightforward as it seems. As discussed earlier in Section 1 the possible explanations for the mixed evidence on this subject could be attributed to the three hypotheses relating to institutional shareholders (Pound, 1988), i.e. *efficient-monitoring hypothesis*, *conflict-of-interest hypothesis*, and *strategic-alignment hypothesis*. Before delving into the three hypotheses above, it is imperative at this juncture to apprehend the dividend outcome/substitute theory of La Porta et al (2000). La Porta et al. (2000) discusses the two models of dividend policy, the "outcome model" and "substitute model" in relation to CG. The outcome model claims that the payment of dividend is the result of effective governance where well governed firms pay dividend because such payments reduces the opportunity for expropriation from shareholders. Shareholders thus successfully pressure managers to disgorge excess cash or free cash flow. On the other hand, the substitute model claims payment of dividend substitute other governance mechanism where poorly governed firms need an alternative means of establishing a reputation for acting in the interests of shareholders if they intend to raise capital from public funds in the future. In their paper, La Porta et al., (2000) found that because legal protection of minority shareholders differs across countries, dividends

policies also varies across countries in ways consistent with a particular version of the agency theory of dividends. Common law countries like the US, UK and Malaysia have stronger laws that protect shareholders and better governance and exhibit characteristics of the outcome model while civil law countries have weaker protection of shareholders and weaker governance and hence exhibit the characteristics of the substitute model²⁹. This idea has in fact been tested in studies on dividend and institutional shareholders³⁰.

While the outcome and substitute model of La Porta et al (2000) provides two possible models which explains dividend policy, Pound (1988) offers three possible explanations of institutional shareholders' characteristics in investee firms. The *efficient-monitoring hypothesis* posits that institutional shareholders possess greater expertise and can monitor management at a lower cost than compared to small shareholders. The *conflict-of-interest* proposition suggests that in view of other profitable business relationships with the firm, institutional shareholders are coerced into voting their shares with management. For instance, an insurance company may hold a significant portion of a firm's stock and concurrently act as its primary insurer or a bank may invest in a firm in which it's a significant financier too. Voting against management may significantly affect the firm's business relationship with the incumbent management whereas voting with the management results in no obvious penalty (Bhattacharya and Graham, 2007). In other words the power gained from institutional shareholders' ownership stake may be tampered somewhat by their reliance on the firm for business activity (Heard and Sherman, 1987). The *strategic-alignment* hypothesis posits that institutional shareholders and managers find it mutually advantageous to cooperate. Generally, cooperation reduces the beneficial effects on the firm value that could result from monitoring by large shareholders. Some authors argue that this 'cooperation' could potentially cripple the management-monitoring function of large shareholders, and result in the expropriation of minority shareholders (Bushman and Smith, 2001).

²⁹ However the orientation towards the outcome or substitute model according the common law or civil jurisdictions have produced conflicting results where firms in common law countries have also exhibited characteristics of the substitute model while firm in civil law countries have exhibited characteristics of the outcome model when different aspects of governance are tested in relation to dividends (see e.g. Hwang et al. ,2004; Leng, 2008; Al-Najjar and Hussainey, 2009; Khan 2006; Sawicki, 2009). The general dimensions of corporate governance studied in relation to agency costs have been widely categorized into six areas; board membership; ownership concentration; audit committee, internal control and internal audit; take-over defenses; regulation and enforcement; external auditors; monitoring from block holders; see. Brown et al, 2011 for more details).

³⁰ Khan (2006) reports that dividends and institutional shareholders presence are substitute monitoring devices, on a study of UK firms.

In examining the relationship between institutional shareholders and dividends, the dividends outcome and substitute model of La Porta et al (2000) and the institutional shareholders hypotheses could be pieced together to better analyze the two broad ranging theories into greater depth. A diagram on the possible link the dividend outcome/substitute theory share with the institutional shareholders is presented in Table 1 below.

The *efficient-monitoring hypothesis* posits those institutional shareholders are competent observers of management. If the outcome based dividend model characteristic is prevalent, heightened monitoring by higher institutional shareholders presence would result in effective pressure on management to payout higher dividends and hence a positive relationship. Jensen's (1986) free cash flow theory suggests that managers are reluctant to pay out dividends, preferring instead to retain resources under their control. Eckbo and Verma (1994) argue that institutional shareholders will prefer free cash flow to be distributed in the form of dividends in order to reduce the agency costs of free cash flows. From this perspective, it may be argued that institutional shareholders may counter a tendency for managers to prefer the excessive retention of cash flow and, by virtue of their voting power, force managers to pay out dividends.

The prevalence of the substitute model of dividends would could cause higher institutional shareholders presence to be negatively associated with dividends as the latter would not be necessary to mitigate agency conflict due to the heightened monitoring by institutional shareholders and hence a negative relationship. Zeckhauser and Pound (1990) suggested that institutional shareholders may act as a substituting monitoring device, hence, reducing the need for external monitoring by the capital markets.

The *conflict of interest* hypothesis assumes that management and institutional shareholders are connected through business vocations and hence would be unable to effectively discharge their monitoring roles effectively. The subsistence of the outcome model of dividends would result in a negative relation between institutional shareholding and dividends as firms with higher institutional shareholders could experience lower monitoring functions and shareholder power and hence lower dividends and vice versa. On the other hand the prevalence of the substitute model of dividends could witness higher dividends being paid with increased level of shareholders presence in order to compensate the weaker monitoring of the latter and hence a positive relationship³¹.

³¹ Consistent with Wahab et al (2008), we could not determine the exact nature of the business relationship between the firm and institutional investors. Our method is consistent with those of Brickley, Lease and Clifford (1988), Chaganti and Damanpour (1991) and Cornett et al. (2007), which only assume that such a relationship exists between the institutional investors and the firms.

Table 1. Linkage between Dividend Outcome and Substitute theory with Institutional Shareholder hypotheses

Dividend outcome/ Substitute model	Institutional Shareholders hypotheses	
Dividend theory Relationship	Efficient monitoring hypothesis	
	Outcome	Substitute
Relationship	Positive	Negative
	Conflict of interest hypothesis	
Dividend theory Relationship	Outcome	Substitute
	Negative	Positive
Dividend theory Relationship	Strategic alignment hypotheses	
	Outcome	Substitute
Relationship	Negative	Positive

The *strategic-alignment-hypothesis* holds that institutional shareholders and managers could realize the benefits of mutual cooperation, which could be detrimental to the expected monitoring functions of the former (Bhattacharya and Graham, 2007). In such scenarios, the prevalence of the outcome model of dividend could see higher institutional shareholders presence (who are strategically aligned with managers) to be associated with lower dividend payment as the force of the former on management diminishes and thus being less forceful to compel management to disgorge dividends. In the advent of the substitute model of dividends, higher institutional shareholders presence would be seen as a sign of weaker monitoring (in light of the *strategic-alignment-hypothesis*) and create the need for higher dividend payments to alleviate agency conflict concerns. The orientation of the *strategic-alignment-hypothesis* and *conflict of interest* hypothesis towards toward lower monitoring effectiveness is also termed by some authors as the ‘passive monitoring’ hypothesis (Kochhar and David, 1996; Pound, 1988). Some researchers have collectively grouped the three theories above as ‘active monitoring’ theory and passive monitoring theory (for *conflict of interest* hypothesis and *strategic-alignment-hypothesis* (Harasheh, 2011).

In a nutshell it can be observed that each of the hypotheses relating to institutional shareholders can be analyzed within a particular version of the dividend outcome and substitute model. In this study we examine the assumption relating to the *efficient-monitoring hypothesis* and the dividend outcome/substitute model directly. The assumptions relating to the second and third hypotheses are beyond the scope of this study. Specific information on the existence and nature of business relationship between institutional shareholders and management is needed to test the second hypothesis and information on the extent to which certain institutional shareholders could be strategically aligned with managers is needed to test the third hypothesis on institutional shareholders. Hence this study specifically examines the efficient monitoring hypothesis and posits there is a relationship between the former with the dividend outcome or substitute model.

2.1 Tax-based argument of dividend

Studies on dividends and institutional shareholders have often made sure it mentions the tax-based hypothesis of dividend clienteles and institutional shareholders’ preference for dividends. The tax-based hypothesis is not considered in our study and secondly, even if there is any affect of this hypothesis on our model, it is assumed to be constant for a number of reasons. The tax-based dividend hypothesis in general predicts that dividend payout is positively related to institutional ownership because institutions prefer dividends over capital gains under the differential tax treatment (Han et al., 1999). Most studies examining the impact of institutional shareholder level (independent variable) on dividends (dependent variable) have made inferences on the tax-based hypothesis without operationalizing the ‘taxation’ variable in their models (see e.g. Han et al., 1999; Ramli, 2008; Ramli, 2011; Khan, 2006; Afza and Mirza, 2011). Only one recent influential study (which lamented the fact that in spite of the special tax status of corporate shareholders, it is surprising that no one has investigated the relation between corporate stock ownership and dividend policy) examined institutional shareholders and individual shareholders and their preference for dividends in line with the tax-hypotheses and found no support for both groups on their preferences for dividends (Barclay et al, 2008). Ultimately the ground-breaking study on agency theory and dividend policies around the world by La Porta et al (2000) examined shareholders protection laws (independent variable) and tax advantage (independent variable) on dividends (dependent variable) and found no conclusive evidence on the effect of taxes on dividend policies³². In contrast to the Barclay et al (2008) study which examined both individual shareholders and institutional shareholders, our study only examined the latter and it is thus assumed that even if any tax-based hypotheses’ affect could be present, it should be fixed on a group of homogeneous shareholders and secondly largely fixed

³² The La Porta et al (2000) study comprised 33 countries and divided them into common law countries and civil law countries. Malaysia (a common law country) was one of the countries included in that study.

within a particular industry (Trading and Services sector, where the sample for this study is drawn upon).

Studies built-upon the ‘prudent-man hypotheses or rule’ of institutional shareholders essentially examined dividends (independent variable) in relation to the impact on institutional shareholders level (reverse in direction as compared to our study)³³ and a few of them have considered and operationalized the tax-based hypothesis in their models (see e.g. Allen et al., 2000; Jun et al., 2011). Excerpts from Allen et al, 2000, Vol LX, No 6, pp.3 which reads “firms can attract more institutions as shareholders by paying dividends” and “in our agency model, taxable dividends exists to attract informed institutions” point out the direction of testing the tax-based hypotheses’ in relation to the dividends and institutional shareholders where it is clear that for studies which intends to specifically examine the tax-based hypothesis should examine it in relation to the impact of dividends on institutional shareholders level. The supports for the tax-based hypotheses have since emerged from these two studies where both Allen et al., (2000) and Jun et al (2011) find evidence of tax clientele affect of dividends on institutional shareholders. The weight of one study of institutional shareholders on dividends which finds no support for the tax-based hypotheses (Barclay et al, 2008) against two studies of dividends on institutional shareholders with both reporting results in support of the tax-based hypotheses is enticing us to conclude at this juncture that the tax-based hypotheses is more appropriate to tested in studies of dividends on institutional shareholders and not vice versa. However in view of the sparse evidence on this highly specialized area, we are of the opinion that the evidence on the right direction for testing the tax-based hypothesis is still mixed at this moment and more studies are needed before more concrete conclusion could be made. Nevertheless our effort in putting in clearer perspective the current state of knowledge on the tax-based hypotheses is an added contribution of this study.

Based on the arguments above our study assumes the tax-based influences to remain constant for a group of institutional shareholders in a specific industry. In addition we assume homogeneity with regards to institutional shareholders in relation their tax clientele. Majority of the institutional shareholders of Malaysian public listed firms are locally based where they collectively represent about 70 percent of total institutional shareholding in public listed companies on Bursa Malaysia (Wahab et al, 2008) and are assumed to be similar in their preferences for dividends from the tax-based hypotheses.

2.2 Institutional shareholders in the context of Corporate Governance

The role institutional shareholders play in corporate governance is obvious. In recent years institutions have become increasingly involved in corporate governance (Allen et al, 2000). Given the weight of their votes, the way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance (MCCG, 2001). In this respect, institutional shareholders should take a positive interest in the composition of boards, with checks and balances, and to the appointment of a core of non-executives of necessary caliber, experience and independence. Institutional investors are playing an increasingly important role in the stock market (Gompers and Metrick, 2001). Institutional ownership also serve as an alternative monitoring mechanism to dividend because institutional investors’ stake and voting power in the firm gives them the incentive and the ability to influence managerial behavior (Shleifer and Vishny 1986). Thus the idea of considering institutional shareholders as credible force of corporate governance in empirical research is a well founded one.

2.3 Recent Trends in Institutional Shareholding

Institutional shareholders have been steadily increasing their percentage of holdings in equity markets worldwide. In the US for example, institutional investors have increased their percentage holdings of US equities and the figure stood at 70 percent in 2006 (Blume and Keim, 2008). Institutional ownership of U.S. firms has gone up remarkably in the last fifty years and they currently jointly have the majority of U.S. shares (Gompers and Metrick 2001).

The institutional shareholding landscape in Malaysia is quite unique to its country and region. In Malaysia, the corporate environment is parallel to many other Asian markets where big conglomerates are family or government owned (Claessens and Fan, 2002; Thillainathan, 1999; Cutler, 1994; Lang et al, 1999). Zhuang et al. (2000) further found that the largest shareholder still possesses an average of 30.3 percent of the total shares among all listed organizations in Malaysia in 1998. He also found that the top five shareholdings averagely exceed 58.8 percent. Additionally, Claessens et al. (200a) collected a sample data of 238 firms in Malaysia, and found 40.4 percent of these firms are closely owned by a single large shareholder. Individual or family shareholders are chief as the large shareholders in Malaysia (Zhuang et al., 2001). The presence of institutional shareholders is still relatively low in Malaysia as compared to developed countries, although this trend is growing. As of 2002 and 2003, the total institutional shareholding in Malaysia only stood at 13%, Wahab et al (2008). The low but

³³ See Section 4 below on Endogeneity for details on the assumptions of the ‘prudent-man hypotheses of institutional shareholders.

growing presence of institutional shareholders in Malaysia therefore provides a unique environment and dataset to test the importance of institutional in the context of dividends payments.

The five largest public institutional investors in Malaysia are Employees Provident Fund (EPF), Lembaga Tabung Angkatan Tentera (LTAT), Permodalan Nasional Berhad (PNB), Lembaga Tabung Haji, and National Social Security Organization of Malaysia (PERKESO). EPF is the primary pension fund organization in Malaysia which enjoys exclusivity in collecting pension deduction from employees of private sector. LTAT is the endowment and pension fund for members of the armed forces of Malaysia. PNB is one of the major investment arm of the government. PERKESO is the fund established for workplace hazards and accidents compensation. Collectively, the ownership of institutional shareholders identified above represents about 70 percent of total institutional shareholding in public listed companies on Bursa Malaysia (Wahab et al, 2008).

2.4 Prior studies on institutional shareholding and dividends

Previous research evidence on the relationship between dividends and institutional shareholders is mixed. In view of the sticky nature of this topic where both dividends and institutional shareholders have examined been as the antecedent of each other (reverse causality), this section is limited to the discussion of studies which examined the affect on institutional shareholders on dividends³⁴. Han, Lee and Suk (1999) find institutional shareholders are inversely related to dividends in the US³⁵ and make no mention of the outcome/substitute model of dividends. Although the authors attribute these findings to the tax based hypotheses of dividends, taxation was not measured in any way in the study. The attribution of the results of their study makes more clear sense when viewed from the framework presented in this study in Table 1. As emphasized earlier the findings of La Porta et al (2000) was found to yield conflicting results in subsequent research carried out where each CG variable or each broad areas or categories CG could possess its own unique relationship with dividends. Thus board, audit committee, institutional shareholders, auditors, regulations and insider ownership in one country itself does not yield similar results when viewed from La Porta et al (2000) inclination of the dividend outcome and substitution model based on the common law or civil orientation of

countries respectively³⁶. Thus inference of the results of the study above would render the results to be in line with the substitution model of dividends and the efficient monitoring hypothesis of institutional shareholders. In Pakistan (a common law country) Afza and Mirza (2011) find dividends to be positively related to dividends. Again when viewed from the framework presented in Table 1, the results render the results to be in line with the outcome model of dividends and the efficient monitoring hypothesis of institutional shareholders. In the UK dividends and institutional shareholders are positively related in line with the outcome model of dividends and the efficient monitoring hypothesis of institutional shareholders (Khan, 2005). Ferreira, Massa and Matos (2010) who examined institutional shareholders in relation to dividend studied 37 countries over the period of 2000 – 2007. The authors conclude that institutional shareholders are inversely related to dividends in their joint analysis of all 37 countries. Countries included in their study covered both common law and civil law countries. Although the contributions of La Porta et al (2000) is briefly mentioned in their study, the conclusion achieved did not relate the dividend substitute and outcome theory as well the three institutional shareholders hypotheses mentioned earlier in a concrete manner, where the application of the framework presented in our study would result in clearer and more in-depth justifications for their findings.

In some countries the dividends and institutional shareholders are positively associated in line with agency costs explanation but in rather countries the opposite is true in. In Malaysia, dividends and institutional shareholders are also positively associated (Ramli, 2010). Similarly Leng (2008) observed a positive relationship between dividends institutional shareholders presence in Malaysia. The available evidence on this topic in Malaysia is thus rather sparse. Thus we contribute towards the dearth of literature in Malaysia on this topic.

2.5 Hypothesis

The sole and ultimate aim of this study is examine if institutional shareholders are associated with dividends in a particular fashion when observed from the dividend outcome/substitute model and the efficient monitoring hypothesis framework. In line with the lengthy discussion above on dividends and institutional shareholders, it shows that the outcome model version of agency theory suggests that dividend policy can be used as corporate governance mechanisms to mitigate agency concerns. On the other hand larger institutional shareholders presence could be associated with more power to pressure directors to

34 The issue of reverse causality (endogeneity) of the estimates has been dealt with in Section 3 and 4 below with the use of robust techniques.

35 US is a common law country and hence expected to exhibit features of the outcome model of dividends (which would have resulted in a positive relationship between institutional shareholders and dividends).

36 See for e.g. Al-Najjar and Hussainey (2009) in the UK; Leng (2008) in Malaysia; Sawicki (2009) in South East Asia; Jiraporn and Ning (2006) in US; Jiraporn, Kim and Kim (2011) in the US; Hwang, Park, Park (2004) in South Korea.

managers and hence serve as alternative mechanisms to mitigate agency concerns (Ramli, 2010). The ‘efficient monitoring hypotheses’ argues institutional shareholders play a significant role in monitoring management (Pound, 1988). Thus the presence of increased large institutional shareholders presence could act as a strong pressure on management to pay out excess cash in the form of dividends which otherwise see the opposite in firms with lower institutional shareholders experiencing lower shareholder power in pressuring management directors to pay dividends. On the other hand the substitute model version of agency theory suggests that dividend policy can be used as alternate mechanisms to mitigate agency concerns when corporate governance is weak. Thus the presence of large institutional shareholders could result in lower dividends payments as dividends are not needed to function as an alternative control device. As previous studies on dividends tend to produce a positive association between institutional shareholders, we posit the following hypothesis (in its alternate form):

Institutional shareholders presence positively affects dividend payout in Malaysia.

3 Research methods and data description

The data used for this study was hand collected from annual reports retrieved from the official website of Bursa Malaysia (the Malaysian Stock Exchange) from 2005 to 2008. Our study is conducted on firms listed under the ‘Trading and Services’ category of Bursa Malaysia firms. Driven by motivation of previous studies on institutional shareholders and firm performance which examined specific industries (Hallowell, 2006), we choose the trading services sector which is comparatively a key growth sector in

the Malaysian economy. Malaysia is moving towards a service based economy where this sector has been growing steadily (<http://etp.pemandu.gov.my>). The Malaysian government intends to transform the economy into a serviced based one and thus ample investment opportunities, growth potential and incentives is made available for the private sector in this industry. The trading and services sector is the second largest sector in the Bursa Malaysia with a total of 182 firms. Out of 182 firms in the trading and services sector, a total of 100 firms are randomly selected. The trading and services sector is almost similar the ‘retail sector’ study done in US by Hallowell (2006) and would thus be useful to determine if Malaysian firms in the similar sector exhibit similar characteristics on the topic of this study. Also, due to the exploratory nature of this study, we chose to test the hypotheses on a particular industry first, with the possible extension to all industries in the near future.

This study uses panel regression technique to analyze the model estimates. This study uses the panel data regression to estimate the outcomes of this research. By combining time series of cross section observations, panel data is argued to be more advantageous (Hsiao, 1989), informative and robust due to a greater degrees of freedom and variation in data (Gujarati, 2003). The commonly used Newey-West standardized error panel regression is employed to control for possible heteroskedastic and multicollinearity in the model. In addition, the dynamic two-step Generalized Method of Moments (GMM) panel estimation is employed to remedy possibly endogenous concerns in the model. We thus posit the following model:

$$\text{LNDPS}_{it} = a_0 \text{INTERCEPT}_{it} + a_1 \text{IS}_{it} + a_2 \text{LNDPS}_{(-1)it} + a_3 \text{ROE}_{it} + a_4 \text{GEARING}_{it} + a_5 \text{SALES_GR}_{it} + a_6 \text{LNTA}_{it} + a_7 \text{CFO}_{it} + e_{it} \quad (1)$$

Where i : represents company
 t : time period

The experimental variable is in bold where:

Dependent variable

LNDPS Natural logarithm of dividends per share

Experimental variable

IS - Institutional Shareholders’ is the fraction of total institutional Shareholders’ ownership to total shareholding.

Control variables

LNDPS (-1) Lagged one year of the natural logarithm of dividends per share

CFO - Cash flow from Operating Activities

ROE - Return on equity (Earnings divided by equity)

SALES_GR - Sales growth from year t to $t+1$

GEARING - Gearing – (Non-current Liabilities/Equity)

LNTA - Natural logarithm of total assets

3.1 Dependent variable

This study examines the impact of institutional shareholders' presence on dividends payments, specifically in relation to how the two interacts under the broad realm of agency theory. The dependent variable is measured as dividend per share (DPS). Dividends per share (DPS) is consistent with the same proxies used in other dividends studies (see for instance Khan, 2005). Following test of normality, logarithmic transformation is applied to DPS, thus LNDPS.

3.2 Experimental variable

Institutional shareholders (IS) is measured as the proportion of institutional shareholders to total shareholding (similar to Wahab et al, 2009; Ming and and Gee, 2008; Wahab et al, 2008). However our study captures a larger proportion of institutions shareholding as we measure it as the total percentage of IS from the Top 30 Shareholders List, as disclosed in the annual report of sample firms. The Top 30 Shareholders List disclosed in the annual report accounts for 70 – 90 percent of the total ownership of firms listed in Malaysia. This measurement is more wide ranging than many previous studies (see e.g. Wahab et al, 2008; Hartzell and Starks, 2002; Cornett et al., 2007) who measure IS as the percentage of the top 5 institutional investors' shareholding.

3.3 Control variables

Given that dividends payments are firm-specific, this study includes control variables to control firm specific effects. The natural logarithm of total assets (LNASSETS) is a proxy for firm size and is used as a control variable because it has been reported to be positively related to dividends (Sulong & Mat Nor,

2008). Return on equity (ROE) is expected to show positive relationship with dividends and measured as earnings divided by total equity, consistent with (Abjaoud and Ben-Amar, 2010). GEARING is negatively related to dividends (Collins et al., 1996) because both dividends and debt are alternate mechanisms to reduce the agency costs of free cash flows. Cash flow from operating activities (CFO) is essentially the measure of free cash flows (Abjaoud and Ben-Amar, 2010). In this regard, firms would pay dividends to reduce their free cash flow and hence a positive association. Firm growth (GROWTH) has been established in past studies to be associated with dividends (Rozeff, 1982) and is measured as sales growth from year t to $t+1$. Shares buy-back is not considered for inclusion as control variable because they are not a common practice in Malaysia (Ramli, 2010). Only allowed since 1997, share buy-back transactions volume are still low in Malaysia with only 32, 62, 70, 127, 145 and 154 firms engaging in share buy-back for the years 2002, 2003, 2004, 2005, 2006 and 2007 respectively (Nadarajan et al., 2009). Although the trend of share-buy-back is increasing, the figures for the year 2007 for example only represented 15.6 percent of total firms listed in Bursa Malaysia (Oh, 2010). The global financial crisis of 2007/2008 could also bring about possible noise in the control variables, and therefore, we have included year dummies as part of the estimate. The year dummy variable is a vector of dummy variables denoting the different years to which firms sample belong to, namely dummy year 2005, dummy year 2006, dummy year 2007 and dummy year 2008 (with dummy year 2007 being the omitted year).

4 Results

4.1 Descriptive statistics

Table 2. Descriptive Statistics (2005-2008, n=100)

	DPS	IS	CFO	GEARING	ROE	REVENUE	TA
Mean	0.061	0.184	137,000,000	0.534	0.086	1,190,000,000	2,750,000,000
Median	0.020	0.170	22,563,841	0.287	0.099	331,000,000	632,000,000
Maximum	0.565	0.660	284,000,000	12.994	10.716	22,300,000,000	83,200,000,000
Minimum	0.00	0.000	(151,000,000)	-6.384	(31.137)	8,179,000	5,575,784
Std. Dev.	0.095	0.157	42,100,000	1.153	2.047	2,900,000,000	9,540,000,000

Note: *DPS* is the dependent variable and is the dividends per share. *IS* is the fraction of institutional shareholders: *ROE* is return on equity: *CFO* is cash flow from operating activities: *Revenue* is total revenue in a financial year. *TA* is the total assets of firms.

Table 2 above presents the descriptive statistics. The dependent variable is *DPS* (dividends per share) and the mean is RM 0.061 or 6.1 cents. The inclusion of non-dividends paying firms improves the results of this study and reduces the biasness attached to including only dividends paying firms. The data for

dividends show that on average firms in the Trading and Services sector pay a modest dividend 6.1 cents. Ramli (2010) in her study of Malaysia from 2002 to 2006 reports that dividend payout in Malaysia has been on the rise. Thus dividend is still an important mechanism that reduces agency costs from the

institutional shareholders' perspective. The experimental variable (IS) has a mean of 0.184 which means 18 percent of shareholders of firms in this sector are institutional shareholders. This figure is higher than the 12 percent of institutional shareholders in Malaysia in 2002 reported by Wahab et al (2008) because our study used a broader definition of institutional shareholders. The mean for IS confirms the phenomena of low presence of institutional shareholders in firms listed in Bursa Malaysia. Results

for developed markets like US and UK reported earlier shows that the presence of institutional shareholders in Malaysia is comparatively lower. The low IS presence in Malaysia compared to the developed markets provides a unique opportunity to test the notion if they still efficiently play their monitoring role.

4.2 Correlations matrix for sample firms (2005-2008)

Table 3. Correlation matrix (2005 – 2008, n=100)

	LNDPS	IS	LNTA	ROE	GEARING	CFO	SALES_GR
LNDPS	1.000						
IS	0.449	1.000					
LNTA	0.504	0.458	1.000				
ROE	0.095	0.062	(0.002)	1.000			
GEARING	(0.092)	0.091	0.092	0.340	1.000		
CFO	0.348	0.222	0.483	0.050	0.019	1.000	
GROWTH	(0.119)	0.047	0.141	(0.029)	(0.007)	0.144	1.000

Note: *LNDPS* is the dependent variable and is the natural logarithm of dividends per share; *IS* is the fraction of institutional shareholders' ownership to total shareholding. *ROE* is return on equity; *CFO* is cash flow from operating activities divided by total assets; *GROWTH* is sales growth from year *t* to year *t+1*. *LNTA* is the natural logarithm of total assets.

Table 3 shows the correlation or pair-wise Pearson correlation coefficients between the variables in this study. *LNDPS* has positive relationship with *IS*, *CFO*, *SALES_GR* and *LNTA* but has negative relationship with *GEARING*. All the directions of the relationship (positive or negative) between the dependent variable and the experimental variables and control variables are in the direction of prediction. The Pearson correlation test is also carried out to understand the underlying direction of relations between variables (positive or negative relationship) and identify the presence of multicollinearity among variables. Table 3 above indicates that multicollinearity is not a problem as the correlations are relatively low. According to Gujarati (2003), multicollinearity could be a problem when the correlation between variables exceeded 0.80 thus causing biased results in estimated models. None of the variables above show a correlation coefficient of above 0.80.

4.3 Multivariate Results

We first regress the control variables against *LNDPS*. The R^2 of the model is strong at around 78 percent and is evident of the appropriateness of the model and is higher than previous Malaysian studies on this topic (see Leng, 2008). It is clearly seen that *LNDPS* is positively and significantly affected by *LNDPS*(-1) or lagged one year of dividends at the 1 percent level. The results confirm the dividend smoothing behavior of sample firms in line with Lintner (1956) theory and consistent with Adjaoud and Ben-Amar (2010). *CFO* which is a measure of free cash flows shows that it affects *LNDPS* negatively but not significantly. As expected *GEARING* is negatively and but

significantly related to *LNDPS* at the 1 percent level. *GEARING* is expected to have a negative relationship with *LNDPS* because the higher the gearing the lower the equity of firm and hence dividends that needs to be paid. The second reason for this relationship is due to the fact that liability is also an element that disciplines managers and hence reduces the need to pay higher dividends. *ROE* is a measure of firm performance and in line with the expectation is positively related to *LNDPS* at the 1 percent level. The results shows that firm with better financial performance pay more dividends. *SALES_GR* as expected shows negative relationship with *LNDPS*. However the results are not statistically significant. Nonetheless the results still confirms to Rozeff (1982) idea that firm growth requires more funds and thus impedes the ability to pay higher dividends, hence the negative relationship. The results are also consistent with the findings of La Porta et al (2000) which showed high growth firms pay lower dividends where shareholders are willing to wait when the investment opportunity is good in countries with better investor protection laws like Malaysia. The final control variable is *LNTA* which is a measure of firm size. The results in Table 4 above shows that larger firms pay higher dividend and the observations are significant at the 5 percent level. The results confirms the prediction where larger firms are in a better position to raise external finance and hence able to pay out more as dividends. Furthermore larger firms are more at stake in terms of reputation for not paying dividend than their smaller counterparts. The results for all the control variables are consistent across Models 1 to 4 except *SALES_GR* which experiences a significant relationship with dividends when the Newey-West panel regression is employed.

Table 4. Impact of Institutional shareholders on dividends

	(1)	(2)	(3)	(4)
Constant	-2.586484 <i>2.386794***</i>	-2.374271 <i>-.184242***</i>	-2.582057 <i>-2.54***</i>	-2.775593 <i>-2.68***</i>
LNDPS(-1)	0.822818 <i>20.85455***</i>	0.805279 <i>19.76822***</i>	0.8289161 <i>17.44***</i>	0.8332233 <i>17.85***</i>
IS		0.739081 <i>1.631535**</i>	0.6521903 <i>1.4**</i>	0.6085957 <i>1.29**</i>
CFO	0.00763 <i>0.382942</i>	0.00678 <i>0.387708</i>	0.00007 <i>0.771</i>	0.00013 <i>0.970</i>
GEARING	-0.193058 <i>3.744404***</i>	-0.200034 <i>3.882353***</i>	-0.1995213 <i>-3.55***</i>	-0.1856134 <i>-3.26***</i>
ROE	0.062863 <i>2.137178***</i>	0.061471 <i>2.097639***</i>	0.0592439 <i>3.59***</i>	0.0566625 <i>3.46***</i>
GROWTH	-0.00833 <i>-0.966495</i>	-0.0787 <i>-0.862852</i>	-0.00126 <i>-2.06***</i>	-0.00014 <i>-2.18***</i>
LNTA	0.097366 <i>1.91848**</i>	0.07682 <i>1.474838</i>	0.0921326 <i>1.91**</i>	0.09413 <i>1.95**</i>
YEAR_DUM06				0.3177666 <i>2.00**</i>
YEAR_DUM05				0.2081243 <i>1.42*</i>
YEAR_DUM08				0.23342 <i>1.93*</i>
R-squared	0.781109	0.784	0.784	0.784
Adjusted R-squared	0.774542	0.7764	0.7764	0.7764
F-statistic	118.9491***	103.1839***	119.32***	119.38***

Notes: t-statistics are italicized; Significance at the 1%, 5% and 10% is denoted by ***, ** and * respectively. Model 1 examines the affect of the control variables; Model 2 is the full model; Model 3 is the full model using the panel Newey-West regression; Model 4 is the full model using the panel Newey-West regression with year dummies. *LNDPS* is the dependent variable and is the natural logarithm of dividends per share. *IS* is the fraction of institutional shareholders to total shareholding; *ROE* is return on equity; *CFO* is cash flow from operating activities divided by total assets; *GROWTH* is sales growth from year *t* to year *t+1*. *LNTA* is the natural logarithm of total assets. Year effects – year dummy (*YEAR_DUM05*, *YEAR_DUM06*, *YEAR_DUM07*, *YEAR_DUM08*); with *YEAR_DUM07* being the omitted year.

The results for *IS* confirm the idea that the ‘efficient monitoring hypothesis’ is true in Malaysia for the Trading and Services sector, consistent with Ramli (2010) and Leng (2008). Higher institutional shareholders level results in higher dividends payout and is consistent with the agency theory arguments which claim that due to strong influence and expert knowledge of the equity market, the presence of institutional shareholders act as an efficient monitoring force which successfully exerts pressure for directors to divulge cash in the form of dividends which could otherwise be abused the latter.

The commonly used Newey-West standardized error panel regression to control for heteroskedastic and contemporaneous errors is employed alongside the pooled panel regression as additional robustness procedures. Year dummies 1,2,3, and 4 are essentially represented by the time period of this study i.e. 2005 to 2008 respectively. The results above show that year dummies 3 and 4 are omitted due to collinearity. However year dummies 1 and 2 has significant affect on dividends at the 10 percent and 5 percent level respectively. The reason why years 2007 and 2008

could have significant affect on dividends could be attributed to the global financial crisis which started showing signs of economic distress worldwide in 2007 and ballooned in 2008.

4.3.1 Endogeneity

Generally endogeneity has been highlighted as an important concern in any corporate governance related study (Brown et al, 2011). The topic of institutional shareholders and dividends could possibly suffer from problems of endogeneity as studies have not only been conducted on the impact of institutional shareholders on dividends but also the latter on the former (see e.g. Jain, 2007). Thus modeling the relation between institutional shareholding presence and dividends could be sticky if there is an endogenous feedback from dividends to institutional shareholders presence. The apparent problem of endogeneity or reverse causality on studies involving institutional shareholders need not be elaborated any further when observing one recent study which states “In studies of institutional dividend preferences there is often an issue of causality as it is not certain whether the

institutions buy the stocks because they pay dividends or whether the firms pay dividends because they observe institutions on their share register”, Jun et al, 2011, Vol 38, No 1, pp. 222. However the authors of this study make no effort to control the issue of endogeneity apart from spelling out the problem in a fashionable statement.

The reverse causality of dividends on institutional shareholders’ presence in fact originated from the ‘prudent-man-hypothesis’ of the school of thought which examines the effect of dividends and other firm performance measures on institutional shareholders presence. A the prudent man’ law-based investment strategy states that institutional shareholders might be attracted to firms with higher

performance and better dividend payout (Del Guercio, 1996). In other words, dividends payouts could determine the quantum of shareholding by institutional shareholders in a firm (Allen et al. 2000). Hence dividends could affect the presence of institutional shareholders and a reverse causality or endogeneity is possible (as compared to the framework of our study which argues institutional shareholders presence affect dividends. In order to alleviate the concerns over possible biasness to the results a diagnostics test have been performed dividends against the experimental variables and all the control variables. In order to detect the presence of endogeneity the Granger causality test is performed. The results are presented in Table 5 below.

Table 5. Granger Causality Test of Dividends versus the Independent variables

Hypothesis	F-statistics	P-value	Endogeneity
1a) IS does not Granger Cause LNDPS	1.70628	0.1855	No
1b) LNDPS does not Granger Cause IS	2.37797	0.1967	
2a) CFO does not Granger Cause LNDPS	0.18309	0.8329	No
2b) LNDPS does not Granger Cause CFO	0.07921	0.9239	
3a) GEARING does not Granger Cause LNDPS	2.99552	0.0534	No
3b) LNDPS does not Granger Cause GEARING	0.20705	0.8132	
4a) ROE does not Granger Cause LNDPS	0.00202	0.998	No
4b) LNDPS does not Granger Cause ROE	1.98464	0.1415	
5a) SALES_GR does not Granger Cause LNDPS	0.37261	0.6897	No
5b) LNDPS does not Granger Cause SALES_GR	0.16058	0.8518	
6a) LNTA does not Granger Cause LNDPS	1.91639	0.1512	No
6b) LNDPS does not Granger Cause LNTA	2.93225	0.1567	

Note: Significance at the 1%, 5% and 10% is denoted by ***, ** and * respectively. LNDPS is the dependent variable and is the natural logarithm of dividends per share. IS is the fraction of institutional shareholders to total shareholding: ROE is return on equity: CFO is cash flow from operating activities divided by total assets: SALES_GR is sales growth from year t to year t+1. LNTA is the natural logarithm of total assets.

The results (as shown above) rule out the presence of endogeneity between dividends and institutional shareholders presence along with other control variables. Subsequently even though the presence of endogeneity is refuted, the highly robust Generalized Method of Moments (GMM) regression is applied to improve the rigor of the results. In order to mitigate the possible problems of endogeneity, we perform the first difference GMM estimations, following Khan (2006) who applied in this technique on studies on cash holding and corporate governance while applied a study on dividends and institutional shareholders.

3.4.2 Results of first-difference GMM estimations

The p-value of first-order of serial correlation tests is not significant at any level which leads to the acceptance of the null hypothesis which asserts that there is no first order serial correlation among variables. Furthermore, the p-value of Hansen test of over-identification and Diff-in-Hansen tests of exogeneity are not significant at any level which means that the variables and instruments used for this equation are valid (Hansen test of over-identification)

and exogenous (Diff-in-Hansen tests). All the results are consistent with the results of Table 3 above.

Table 5 above shows the first difference GMM estimation outputs. It can be seen from Table 5 that IS is still positively associated with LNDPS at the 5 percent level. The result above show that year dummies 07 is omitted due to collinearity. However year dummies 05 and 08 has significant affect on dividends at the 10 level respectively and year dummy 06 at the 1 percent level. The reason why the year 2008 could have significant affect on dividends could due to the global financial crisis which started showing signs of economic distress worldwide in 2007 and ballooned in 2008.

The results of the GMM estimation in Table 5 above provide further strength to the acceptability of the hypothesis of our study. The results clearly indicate higher institutional shareholders presence results in higher dividends payout in sample firms. In the other words, firm which have higher percentage of institutional ownership tend to disgorge more cash in the forms dividends which could otherwise be used for non-profit maximizing ventures of self benefit of directors (conforming the to the outcome model of dividend and efficient monitoring hypothesis of institutional shareholders).

Table 6. Impact of Institutional shareholders on dividends with GMM

	(5)	(6)	(7)
Constant	-19.568 <i>-4.6***</i>	-19.427 <i>-4.65***</i>	-15.627 <i>-5.16***</i>
LNDPS(-1)	0.031 <i>0.36*</i>	0.025 <i>0.24*</i>	0.0880 <i>0.95*</i>
IS	2.676 <i>1.47**</i>	2.734 <i>1.61**</i>	17.666 <i>2.34***</i>
CFO	0.074 <i>2.2***</i>	0.087 <i>2.71***</i>	0.222 <i>2.56***</i>
GEARING	-0.276 <i>-4.75***</i>	-0.251 <i>-4.42***</i>	-0.229 <i>-4.55***</i>
ROE	0.034 <i>4.52***</i>	0.027 <i>3.06***</i>	0.028 <i>3.1***</i>
GROWTH	-0.078 <i>-1.05</i>	-0.0645 <i>-0.09</i>	-0.094 <i>-0.33</i>
LNTA	0.7531 <i>3.73***</i>	0.756 <i>3.89***</i>	0.357 <i>1.9**</i>
IS*GEARING			-1.430 <i>-6.02***</i>
IS*LNTA			0.980 <i>2.34***</i>
IS*ROE			4.188 <i>3.44***</i>
IS*GROWTH			-0.015 <i>-0.24</i>
YEAR_DUM06		0.251 <i>3.04***</i>	0.174 <i>2.09***</i>
YEAR_DUM05		0.128 <i>1.74*</i>	0.274 <i>3.34***</i>
YEAR_DUM08		0.234 <i>1.43*</i>	0.236 <i>3.62***</i>
Sargan tests :	319.55 <i>0.192</i>	326.16 <i>0.189</i>	292.66 <i>0.231</i>
Arellano-Bond test for AR(1) in first differences:	1.52 <i>0.158</i>	1.92 <i>0.255</i>	2.37 <i>0.182</i>
Hansen test of over-identification: Chi square	30.66 <i>0.23</i>	30.88 <i>0.231</i>	29.51 <i>0.288</i>
Diff-in-Hansen tests of exogeneity : Chi square	5.85 <i>0.781</i>	6.44 <i>0.598</i>	6.65 <i>0.374</i>

Note: z-statistics are italicized; Significance at the 1%, 5% and 10% is denoted by ***, ** and * respectively. This table shows the impact of institutional shareholders' presence on dividends in the first-difference GMM estimations. Model 5 is the full model; Model 6 is the full model with year dummies. Model 7 presents the interaction between IS and firm-specific control variables. LNDPS is the dependent variable and is the natural logarithm of dividends per share. IS is the fraction of institutional shareholders to total shareholding; ROE is return on equity; CFO is cash flow from operating activities divided by total assets; GROWTH is sales growth from year t to year t+1. LNTA is the natural logarithm of total assets. Year effects – year dummy (YEAR_DUM05, YEAR_DUM06, YEAR_DUM07, YEAR_DUM08); with YEAR_DUM07 being the omitted year. AR(1) is the test for first-order-serial correlation in the first-differenced residuals, which asserts under the null hypothesis that there is no serial correlation. Hansen test of over-identification asserts under the null hypothesis that all instruments are valid. Diff-in-Hansen tests of exogeneity is asserts under the null hypothesis that the instruments used for the equations in levels are exogenous. The p-value of first-order of serial correlation tests is not significant at any level which leads to the acceptance of the null hypothesis which asserts that there is no first order serial correlation among variables. Furthermore, the p-value of Hansen test of over-identification and Diff-in-Hansen tests of exogeneity are not significant at any level which means that the variables and instruments used for this equation are valid (Hansen test of over-identification) and exogenous (Diff-in-Hansen tests).

5 Conclusion

5.1 Overall conclusion

In this study, institutional shareholders examined as to their impact on firms' dividend policy. In particular this examined study whether the presence of institutional shareholders results in higher dividends payout other vice versa. Data is collected from 100 firms listed in the Bursa Malaysia for a four year period of 2005 – 2008 from the trading and services sector. In line with the 'efficient monitoring hypothesis' theory of institutional shareholders and in conjunction with the outcome model of dividends, we find the presence of institutional shareholders results in higher dividends payout in Malaysia. In spite of the lower fraction of shareholding by institutional shareholders in Malaysia as compared to developed markets, it is clear from the results that they in fact bring about a positive impact to the firms they invest in by resulting in higher dividends payments.

5.2 Contributions, limitations and direction for future research

This paper offers a novel explanation for the puzzle why institutional shareholders' presence results in higher dividends payout or vice versa. The fundamental contribution of this study stems from the conceptualization and testing of two contrasting ideas within the agency theory dimension of firm dividend policy with institutional shareholders' presence. We have provided a framework linking the two theories of dividends (outcome and substitute) and the three theories of institutional shareholders (efficient monitoring hypothesis, conflict of interest hypothesis and strategic alignment hypothesis) which has not been previously conceptualized in any study before. In this study the efficient monitoring hypothesis has been tested in relation to firms' dividend payout alongside the outcome and substitute models. The value of this new approach at examining dividend policy and institutional shareholder hypotheses lies in building on the novel framework presented in this study to take a closer look at alternate association that results in payout decisions by firms as a result of their institutional shareholders' presence, especially in light of the inconclusive evidence by the immense volume of empirical research around this topic. Future studies should explore the two other institutional shareholders hypotheses in relation to dividend payout in relation to this framework to obtain a clearer understanding of this topic.

This study is carried out on specific industry, i.e. the trading and services sector firms of Bursa Malaysia. Future studies should explore if institutional shareholders have a positive impact on dividend payout of other sectors in Bursa Malaysia, namely the plantation sector, property sector, consumer products sector, industrial products sector, construction sector,

technology sector, financial sector and mining sector or the whole Bursa Malaysia. We have measured institutional shareholders on a general definition, i.e. the fraction of all types of institutional shareholders. Future studies on Malaysia could partition institutional shareholders into various groups like local institutional shareholders, foreign institutional shareholders or banks based institutional shareholders, insurance firms based institutional shareholders and etc as studied in other markets to understand further if different groups of institutional shareholders have similar or dissimilar effects on firms' dividend policy.

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