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Cash dividends and investor protection in Asia☆

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ABSTRACT

We study the importance of investor rights in payout policy determination in Asia, using a sample of up to 52,778 firm years. The listed Asian firms located in relatively high investor protection, common law countries, have a greater tendency to payout and, if they do so, they tend to pay out more. We also examine the importance of distinctive creditor and minority shareholder rights in respect to payout policy determination. In our study of a variety of payout events (decisions to pay out, to initiate or omit payout and to markedly increase or decrease payout), we show that this set of payout events is principally determined by competing creditor and minority shareholder rights, rather than managerial sought reputation related effects, to diminish the cost of capital. Our findings indicate that creditors exert significant and far reaching influence over corporate payout policy decision-making, however, the importance of the agency costs of equity predominates.

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1. Introduction

In this article, we study the principal-agent relation and associated agency conflicts in respect to corporate payout determination in Asia. In particular, we examine the importance of distinctive creditor and minority shareholder rights in respect to payout policy determination across a wide variety of investor protection environments present in the region.

In a seminal contribution to the literature on international corporate governance, La Porta, Lopez-de Silanes, Shleifer, and Vishny (2000) find that higher dividends internationally are an 'outcome' of better minority shareholder protection regulation, at the country level, which enables these stakeholders to negotiate effectively with management and controlling shareholders. Over the last decade, several researchers have found corroborative evidence in favor of managers distributing more cash as dividends in countries with better minority shareholder protection regulation. For example, Dittmar, Mahrt-Smith, and Servaes (2003) find evidence that firms incorporated in stronger shareholder protection countries hold less cash. Further, Pinkowitz, Stulz, and Williamson (2006) find that cash is worth less to the minority shareholders invested in the firms in low-protection countries as a result of legal frameworks which facilitate the expropriation of this cash by the management and controlling shareholders.

Kalcheva and Lins (2007) and Jiraporn, Kim, and Kim (2011) find that individual firm-level corporate governance quality also has a significant impact on its dividend policy. Kalcheva and Lins (2007) simultaneously control for minority shareholder protection both at the firm- and the country-level, and find that firms with weak minority shareholder protection, which are incorporated in countries that permit weak minority shareholder rights, hold more cash. Jiraporn et al. (2011) show that stronger governance at firm-level not only leads to a higher propensity to pay but also to higher payout amounts. In addition, Brockman and Unlu (2011), indicate that the firm's disclosure environment plays a significant role in dividend payout policy determination through its effect on agency costs. Although it is therefore evident that both firm- and country-level measures of potential agency conflicts have been found to determine corporate payouts, Harford, Mansi, and Maxwell (2008) show that a firm's cash holding is principally influenced by the country-level minority shareholder protection rather than firm-level protection. Taken together, these international studies establish a pronounced linkage between minority shareholder rights at the firm- and country-level and cash holding as well as the disbursement of dividends at the firm-level. These studies suggest that in low-protection countries, management can stockpile cash while in high-protection countries legal frameworks enable minority shareholders to obligate the management to distribute cash and this manifests itself in the form of higher payout ratios in these countries.

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In a complementary strand of the literature, researchers have turned to examining the importance of distinctive creditor and minority shareholder rights in respect to payout policy determination.[1] Brockman and Unlu (2009) use country-level creditor rights indices to document that creditors can strongly influence the management to adopt a more restrictive payout policy as a 'substitute' mechanism for weak creditor rights to minimize the firm's agency cost of debt. In fact, they report that the agency costs of debt play a more influential role in dividend policies internationally than the agency costs of equity. In a similar vein, Chae, Kim, and Lee (2009) find international evidence that firms with higher external financing costs undertake a more restrictive payout policy in order to maximize the value of the firm.

In this article, we adopt logit and Tobit regression model specifications, together with the Fama and MacBeth (1973) hypothesis testing methodology, to build on the findings presented in Brockman and Unlu (2009), in respect to the impact of creditor and minority shareholder protection regulation on firm dividend policies. Unlike in the extant literature, which generally has a dominance of civil law countries in its sample (Brockman & Unlu, 2009, 2011; La Porta et al., 2000; von Eije & Megginson, 2008), our Asian sample of ten developing countries includes an approximately balanced dataset of five common law and five civil law countries. This allows a potentially insightful investigation of the impact of common and civil law regulatory frameworks on dividend policies in respect to emerging economies exclusively. In addition, our measurements of country level creditor and minority shareholder rights are preferred to those which are adopted in Brockman and Unlu (2009). Specifically, while we adopt a dynamic measurement, 2005 through to 2009, of creditor and minority shareholder rights indices, Brockman and Unlu (2009) avail of a static measurement of these rights.[2] In our investigation of the impact of investor rights on firms' dividend policies we follow Brockman and Unlu (2009) in controlling for firm maturity, leverage, profitability, growth opportunities, size and cash holdings. In addition, we extend this set of control variables to include the ownership concentration (Chemmanur, He, Hu, & Liu, 2010; Faccio, Lang, & Young, 2001), earnings reporting frequency (von Eije & Megginson, 2008), stock market liquidity and market capitalization (Pinkowitz et al., 2006) as well as income risk (von Eije & Megginson, 2008) and privatization (Megginson, Nash, & Randenborgh, 1994; von Eije & Megginson, 2008) variables. Finally, following Brockman and Unlu (2009), in respect to the determination of dividend policies, we consider the determination of dividend omissions but we also consider the determination of dividend initiations, large dividend increases and large dividend reductions.

Our main findings can be summarized as follows. First, using a sample of up to 52,778 firm years and allowing for traditional payout determination variables, the Asian firms located in relatively high investor protection, common law countries, have a greater tendency to pay out and, if they do so, they tend to pay out more. Second, we also examine the importance of distinctive creditor and minority shareholder rights in respect to payout policy determination. The amount of payout, and the decisions to initiate dividends and distribute a large increase in the dividends, are determined by the balance of these 'stakeholders' rights' and the corresponding capacities of these stakeholders to influence insiders to retain or disgorge cash, respectively. Albeit, the decision to pay out (excluding the decision to *initiate* the payout of dividends), is conducted to promote, from the perspectives of creditors and minority shareholders, the reputation of the firm. Finally, our findings indicate that creditors exert significant and far reaching influence over corporate payout policy decision-making, however, in Asia the importance of the agency costs of equity predominates. These findings are robust to an extensive set of control variables and model specifications.

The remainder of this article is organized as follows. In Section 2, our dataset is outlined and the constructed proxy explanatory variables are described with a particular focus on creditor and minority shareholder investor protection regulation variables. In Section 3, we present summary statistics at the firm-, country- and industry-levels. In Section 4, we present our empirical findings. Finally, a summary and concluding remarks are presented in the last section.

2. Data

In this section, we describe the sample of firms and both the dependent and independent variables adopted in this study. The dataset of independent variables, for our study, comprises an extensive set of country-specific investor protection variables and a well informed set of firm-specific characteristics, as detailed in Table 1. We obtain our firm-level data from Worldscope *via* Thomson One Banker Analytics. We obtain our country level investor protection data from the World Bank's Doing Business database. With regard to both our dependent and our independent variables, we adopt a real US$ numeraire currency, with a base year for real value calculations set at 1990. To convert our nominal values into real values, we use country specific consumer price indices sourced at the World Bank in its World Development Indicators database.

Our dataset extends from 1990 to 2009 as a result of the limited availability of Asian related data at Worldscope prior to this period. We end the sample of data in our study in 2009 to minimize the effect of the sub-prime crisis on our firm specific control variables, which are included, as lagged variables (up to 2008), in our model specifications. Our dataset is also constrained to include the listed firms headquartered in the ten Asian countries examined in this study. In order to avoid the problem of survivorship bias we search for both active and inactive, *i.e.*, either dead or suspended listings in Worldscope. In addition, we eliminate firms with duplicate International Security Identifying Numbers (ISIN) and foreign firms. Following Fama and French (2001), we exclude utilities (SIC Code 4900–4949) and financial firms (SIC Code 6000–6999).[3] Finally, firms with dividends which are greater than their total sales and firms with negative dividends, sales or market-to-book ratios are excluded from our analyses.

Our set of constraints yields 5840 industrial listed firms across the ten Asian countries examined in this study. Our sample is proportionately divided between civil law (41%) and common law countries (59%). In particular, the civil law countries in the sample include China (686 firms), Indonesia (276 firms), Philippines (121 firms), South Korea (620 firms) and Taiwan (657 firms) and the common law countries observed include Hong Kong (655 firms), India (1369 firms), Malaysia (696 firms), Singapore (363 firms) and Thailand (397 firms).

2.1. Dividend payout

We study the impact of investor protection, while controlling for an extensive set of firm-specific characteristics, on the firm's likelihood to pay and the payout amount by conducting logistic and Tobit regression analyses. To examine the likelihood to pay, we use a dividend payout dummy (RDIV) which is equal to one if the firm initiates a common cash dividend, otherwise it is equal to zero. In our Tobit regressions, following von Eije and Megginson (2008), we scale the real amount paid as common cash dividend by calculating its natural logarithm. In this way, we purposefully avoid the inclusion of firm-specific accounting data as a component of our dependent variable, *e.g.* by scaling cash

[1] There are also several studies which examine the impact of the agency costs of debt on dividend policies at the individual country level, hence holding constant the creditor rights environment (Easterbrook, 1984; Kalay, 1982; Smith & Warner, 1979).

[2] The dynamic measurements of creditor and minority shareholder investor rights, which are sourced at the World Bank, are not available prior to 2005.

[3] The payout policy and external financing of utilities are highly regulated. The financial reporting systems of financial firms differ from the wider sample of firms in our sample.

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