

The Effect of Board Independence on Dividend Policy among Manufacturing Listed Companies in Malaysia

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Abstract

The aim of this study is to explore the effect of independent directors on dividend policy among manufacturing listed companies in Malaysia. The panel data of this study was obtained from Datastream of manufacturing listed companies within the FTSE Bursa Malaysia Top 100 index over the period of 2012-2021. For this purpose, a sample of 29 companies was selected using the census method. The firm's panel was analyzed using descriptive statistics and Pooled Ordinary Least Square (OLS). Fixed effects technique was chosen to investigate the influence of board independence on dividend policy, proxied with dividend yield and dividend per share (Market-Based Measure). Descriptive analysis presented that on average, companies' independent directors were 48% of the board size which does not meet the 50% requirement number of independent directors as stated in the Malaysian Code on Corporate Governance 2021. In addition, the finding also shows that board independence and dividend policy is significantly and negatively related. Therefore, manufacturing companies can advocate for higher dividends by limiting a number of board independence.

Keywords: Independent Directors, Dividend Policy, Manufacturing Companies, Bursa Malaysia, Fixed Effect.

Introduction

Corporate governance plays a vital role, and one significant aspect is board independence, which has been found to influence dividend policy. Research indicates that non-financial companies with independent directors tend to have a more positive approach towards dividend policies. Moreover, board independence moderates the relationship between dividend policy and agency costs. The presence of independent directors ensures that the

board can make unbiased decisions in the best interests of the company and its shareholders, avoiding conflicts of interest (Nurdin & Kasim, 2017).

The board of directors consists of individuals with different skills and expertise. An effective board is a combination of directors with professional experience and skills together, hence it could bring constructive discussions on shareholder and corporate wealth. In Malaysia, there is no specific standard to evaluate the professional experience and skills of directors, which can lead to variations in the selection process. Additionally, some directors may be chosen based on family connections, while others remain on the board for a very long and continuous periods.

This situation comes to the challenge of determining the appropriate board size in Malaysia, as there is a need for talented directors, but no clear guideline on how large the board should be.

The significance of having independent directors on a board is underscored by regulatory rules in Malaysia. In adherence to these regulations, a minimum of two directors or 33% of the overall board size must be independent directors (Commission, 2012). These independent directors play a crucial role in monitoring the decisions made by the CEO, providing impartial opinions to the board and shareholders, and safeguarding shareholder interests in determining dividend policies. Independent directors are expected to contribute to effective corporate governance and enhance company performance. However, there is criticism that independent directors who previously was not a member of the company may have a lack in understanding and insights to make fair decisions or provide opinions on dividend policies. This raises the question of whether independent directors are indeed valuable contributors in dividend decision-making. Therefore, the objective of this study is to examine how board independence influences dividend policies within companies.

Dividend policy is a crucial aspect of corporate decision-making, which involves determining whether and how much to distribute dividends to shareholders over time. A survey in the field of corporate finance reveals that firms can distribute cash to shareholders through various means such as cash dividends, share repurchases, and special dividends (Shafana & Safeena, 2019).

Studies on dividend policy have been extensively researched in developed countries over the years. Researchers in countries like the United States, United Kingdom, and Australia have explored the relationship between board independence and dividend policy in the context of corporate governance practices. These studies often focus on how the presence of independent directors on the board influences the dividend decisions of companies. For instance, (Thompson & Manu, 2021) conducted a study examining the impact of board characteristics on dividend policy in US firms the findings revealed that board characteristics such as average age, female presence, and size had a strong positive significant effect on the likelihood of dividend declaration.

In recent years, there has been a growing interest in studying dividend policy in emerging and developing nations. Researchers have explored how unique institutional, legal, and cultural factors in these countries may shape dividend decisions. For instance, a study in Sri Lanka investigated the impact of independent directors on dividend policies of non-financial

companies (Shafana & Safeena, 2019). This research contributes to the understanding of how board independence affects dividend policy in emerging economies.

In Malaysia, dividend policy research has gained significant attention due to the country's dynamic and growing economy. Studies have explored the determinants and outcomes of dividend decisions in the context of Malaysian listed companies. Researchers in Malaysia have shown interest in the role of board independence in shaping dividend policies as a means to enhance corporate governance practices and protect minority shareholders' interests. One study investigated the link between corporate board attributes, board behavior, and financial leverage using dividend payout records at Bursa Malaysia (Tahir et al., 2023). Another study explored the influence of government shareholding on dividend policy in Malaysia (Sinnadurai et al., 2021).

Prior studies in developed countries, emerging economies, and Malaysia have collectively contributed to the understanding of dividend policy and its relationship with board independence. These studies have provided valuable insights into the corporate governance mechanisms that influence dividend decisions among public listed companies. Earlier study by (Borokhovich et al., 2005), investigated the connection between board independence and dividend payments by analyzing a dataset of 192 U.S. firms spanning the period from 1992 to 1999. The results demonstrated a significant negative association between board independence and dividend payments. These findings also supported with (Iqbal, 2013) stated that independent directors have a negative influence on the dividend policy.

Literature Review

In corporate governance, the boards are the most important component. It is due to separation of ownership and control that is prevalent in modern business. Corporate governance includes relationship between a company's management, board, shareholders, and other interested parties which will determine the course of actions the company will make for their development. The existence of an independent board with professional competence within the organization is very important (Mansourinia et al., 2013).

According to Bursa Malaysia, independent director is very important in the company as they will protect the interests of minority shareholders and can contribute to a company's decision-making process by providing an impartial perspective. They are particularly valuable in situations where the interests of management, the company, shareholders, and other stakeholders may conflict, such as executive compensation, related party transactions, environmental concerns, and auditing. It is important for independent directors to approach board discussions and approval processes. One aspect of independent directors that is receiving growing attention is their length of services. The argument for implementing term limits for independent directors is because the longer independent director serves in the company, the familiarity may increase while objectivity will decrease over the time.

Board independence are directors who have no connection to the company but their directorship Clifford & Evans (1997) as cited in (Shehu, 2015). In corporate governance, when the board is more independent, they are more capable of carrying out its role of oversight management, and that is seen as the primary role of the board of directors (Berle & Means,

193, as cited in (Abdullah, 2016)). Independent directors are responsible to oversee chief executive officer's decisions and providing the board of directors or shareholders with unbiased advice to guarantee that the wealth of shareholders is not being abused while determining dividend policy. Independent directors are expected to bring more commitment towards company's performance and excellent corporate governance (Chuah et al., 2015).

The Malaysian Code on Corporate Governance (MCCG) has a connection to a company's dividend policy since the principles it has, for instance board independence, board duality, and board size, within others, which are part of corporate governance, can significantly impact the decision-making process regarding dividend payments to shareholders. Independent directors are required but are currently restricted from serving on boards due to regulations. In Malaysia, independent directors must make up at least two board members, or 33% of the entire board size (Commission, 2012). Malaysian Code of Corporate Governance 2021 updated that, at least half of the board comprises independent directors.

According to Malaysian Code of Corporate Governance 2021, Malaysia (2021) the regulation sets a rule that restricts the independent directors' term to a maximum of nine years, with no further extension. Once they have served for nine years, the independent director can remain on the board but will be considered as a dependent director. If the board wishes to keep an independent director for more than nine years, they must provide a valid justification and obtain annual approval from the shareholders through a two-tier voting process.

Methodology and Data

This study uses qualitative research to examine the link between the dependent variable, independent factors, and control variables. In order to quantify the data and statistical analysis, many scholars have employed this approach extensively (Baalbaki et al., 2013). There was total 29 manufacturing companies listed under Bursa Malaysia among top 100 listed companies, which being observed by the researcher. This study employs a 10-year timeframe, spanning from 2012 to 2021, to investigate the correlation between variables. Utilizing panel data, the analysis encompasses a total of 290 observations drawn from 29 companies over the specified decade. Secondary data, sourced from the annual reports of these companies listed on Bursa Malaysia, forms the basis of the research dataset. The research design incorporates panel data analysis techniques, specifically the Pooled Ordinary Least Squares (OLS) model, the Hausman test, and the Fixed Effect Model (FEM).

The data used in this study are secondary data, with the data source coming from the financial statements from the annual reports of manufacturing companies listed on the Bursa Malaysia. This study is cross-sectional and panel data with a type of time series. Researchers collected in order to gather the information. The three variables being studied in this study are board independence, dividend policy, and firm size. Dividend policy is proxied by dividend yield and dividend per share respectively.

Variables specification and measurements

This study employs two primary variables: board independence, serving as the independent variable, and dividend policy, serving as the dependent variable.

Dependent Variables

The dependent variables used in this study is the dividend policy which the researcher proxied by; Dividend Per Share (DPS) and Dividend Yield (DY) which is measured by dividend per share announced and given by the company's and Dividend Yield is measured by dividend per share divided by market share price have been used to measure the dividend policy. This method of measurement is in line with the work of (Zhao & Ng, 2021).

Independent Variable

The independent variable employed in this study is the board independence which the researcher used for corporate governance. In this study board independence is measured by the ratio of non-executive directors on the board divided by all of the directors employed in the company's board.

Control Variable

Firm size (FS) serves as the control variable in this study, and it is assessed through the total value of assets held by each company. Given that the total asset values were excessively large for regression analysis, a natural logarithm transformation was applied to scale down these values. The introduction of this control variable is motivated by the idea that performance might be influenced by additional factors beyond those addressed by the independent variables, with firm size being one such factor, as exemplified by (Olabode et al., 2022).

Model Specification

This study embraces and adapts the econometric model originally employed by (Adeusi et al., 2013) which is presented as follows:

$$DPS_{it} = \alpha + \beta_1 BI_{it} + \beta_2 SIZE_{it} + \mu_{it} + \epsilon_{it}$$

$$DY_{it} = \alpha + \beta_1 BI_{it} + \beta_2 SIZE_{it} + \mu_{it} + \epsilon_{it}$$

DY stands for Dividend Yield, DPS represents dividend per share, BI represents board independence, and SIZE refers to the natural logarithm of total assets.

Data Analysis and Discussion

The data sets are summarized in Table 1 below, which provides the summary of descriptive statistics. The correlation matrix between the variables is also provided in Tables 2.

Table 1

Descriptive Statistics

Variables	Mean	Median	Maximum	Minimum	St.Dev.
Board Independence	49.059	50	75	22.22	11.506
Dividend Yield	3.057	2.516	18.75	0.429	2.393
Dividend Per Share	20.073	10.429	98	0.583	21.942
Firm Size	9.644	9.618	10.668	8.49	0.526

The data runs for ten years period, from year 2012 to 2021. N = 29 companies. Number of panel data observations for ten years = 290; 2. DY = Dividend yield, DPS = Dividend Per Share, BI = Board independence, SIZE = Log company size.

The dividend yield has an average (median) of 3.057 (2.516) for a group of 29 manufacturing companies in Malaysia. This indicates that the dividend yield amounts to approximately 3.05%

of the share price. Nevertheless, the mean value obtained in this study is less than the average value is 3.81% documented by Hashemijoo et al (2012), who examined 84 consumer product publicly traded companies in Malaysia across a six-year span since 2005 to 2010. Within the subset of 29 companies operating in the trading/services sector, certain entities exhibited a maximum dividend yield of 25.91%, while others recorded a minimally dividend yield of 0.429%. It suggests that certain companies chose not to declare dividends to their shareholders in specific accounting years, based on their dividend policy as determined by the board.

The average (median) board independence stands at 48.059 (50) within a cohort of Malaysian companies. As per the Securities Commission Malaysia (2012), regulatory guidelines stipulate that a minimum of 2 or else 33% of the overall board size need comprise of independent directors. The be an average of board independence of 48.05% in the sample meets the requirement of having at least 33% independent directors. This average is slightly lower than the average board independence of 49% reported by Khan et al (2014), who studied 178 Malaysian industrial public listed companies from 2002 to 2011. Nevertheless, the current figure surpasses the findings of a study undertaken by Subramaniam et al (2011), wherein commonly board independence of 41.2% was reported across 300 Malaysian publicly traded companies spanning the duration from 2004 to 2006. In this study, the maximum board independence observed was 75%, indicating that some manufacturing companies in Malaysia had boards where 75% of the directors were independent. In contrast, the minimum of 22.22% suggests that there were companies that did not meet the required standard of having 33% independent directors on their board.

In this study, the range of company size measured from a maximum of 10.668 to a minimum of 8.49. The computed average (median) for company size is 9.64. Notably, this average is higher in comparison to the company size average of 8.46 documented by (Ramasamy et al., 2005), Their study focused on a sample of 30 Malaysian plantation-based publicly traded companies during the period from 2001 to 2003. Furthermore, the maximum, minimum, and average company size in this study are lower than the results reported by (Borhanuddin & Pok, 2011), who studied 276 Malaysian publicly traded companies across 6 core sectors from 2002 to 2005, with figures of 16.690, 8.216, and 12.510, respectively. Additionally, (Yoong et al., 2015) reported even higher company size in their study, which examining 379 Malaysian public-listed family owned companies between 2007 to 2009, the study reported a maximum value of 24.496, a minimum of 16.947, and a mean value of 19.635 reported.

Table 2

Correlation matrix for the Variables

Variables	Dividend Yield	Dividend Per Share	Board Independence	Firm Size
Dividend Yield	1			
Dividend Per Share	0.1677	1		
Board Independence	-0.1060	0.0677	1	
Firm Size	-0.1467	0.1702	0.0082	1

Notes: 1. $0.00 \leq r \leq 0.19$ = very weak, $0.20 \leq r \leq 0.39$ = weak, $0.40 \leq r \leq 0.59$ = moderate, $0.60 \leq r \leq 0.79$ = strong, $0.80 \leq r \leq 1.00$ = very strong

Based on table 2 the result shows that the independent variable which is Board Independence has a very weak negative relationship with dividend yield as result fall within $0.00 \leq r \leq 0.19$ range among manufacturing listed companies in Malaysia. For the control variables, firm size (SIZE) has a very weak relationship with dividend yield which is $0.00 \leq r \leq 0.19$. Furthermore, firm size (SIZE) has a very weak negative relationship with dividend yield as result fall within $0.00 \leq r \leq 0.19$.

For the analysis with Dividend Per Share (DPS), Board Independence has a very weak relationship with dividend per share as result fall within $0.00 \leq r \leq 0.19$ range among manufacturing listed companies in Malaysia. For the control variables, firm size (SIZE) has a very weak relationship with dividend per share which is $0.00 \leq r \leq 0.19$. Furthermore, firm size (SIZE) has a very weak relationship with dividend per share as result fall within $0.00 \leq r \leq 0.19$.

Table 3

Test of Multicollinearity

Variables	VIF	1/VIF
Board Independence	1.00	0.99
Firm Size	1.00	0.99
Mean VIF	1.00	

For the result where dependent variable is dividend yield, both board independence and firm size have VIF values of 1.00, which indicates that there is no significant multicollinearity issue between these variables. In the Table 3, VIF of 1.00 suggests that the variance of the coefficient estimates is not inflated due to collinearity, meaning that these variables do not strongly correlate with each other. Therefore, the regression model appears to be free from multicollinearity concerns, which is essential for obtaining reliable and accurate coefficient estimates.

For the result where dividend per share is the dependent variable, both board independence and firm size also exhibit VIF values of 1.00, indicating that there is no substantial multicollinearity between these variables. A VIF of 1.00 suggests that the variance of the coefficient estimates is not inflated due to collinearity, signifying that these variables do not strongly correlate with each other. As a result, the regression model appears to be free from multicollinearity concerns, which is crucial for obtaining reliable and accurate coefficient estimates.

Table 4

Regression Results of Dividend Per Share

Variables DPS	Coefficient	Standard Error	P-values
Board Independence	-0.269	0.133	0.053*
Firm Size	5.819	1.576	0.001*
Sigma_ u	0.225		
R square	0.075		
Observations	212		
Fraction of variance due to u i	0.744		

The findings from Table 4 present the results of the fixed effect analysis on the correlation between board independence and dividend per share. The analysis reveals a significant relationship between board independence and dividend per share, with a significant value of 5.3%. The coefficient for board independence in this model is -0.269, indicating a negative relationship. Thus, it can be concluded that board independence and dividend per share are significantly and negatively associated. As a result, dividend policy has significant negative relationship with board independence.

Table 5

Regression Results of Dividend Yield

Variables DY	Coefficient	Standard Error	P-values
Board Independence	-0.374	0.017	0.038**
Firm Size	0.755	0.492	0.136
Sigma_ u	0.025		
R square	0.064		
Observations	234		
Fraction of variance due to u i	0.634		

The findings presented in Table 5 outline the outcomes of the fixed effect analysis regarding the correlation between board independence and dividend yield. The analysis indicates a significant relationship between board independence and dividend yield, with a significance value of 0.038, which is lower than the threshold of 5%. Hence, it can be inferred that there is a statistically significant relationship between board independence and dividend yield. In addition, the coefficient for Board Independence in this model is -0.374 which indicates that the relationship is negative. Therefore, Board Independence (BI) and Dividend Yield (DY) is significantly and negatively related. Which conclude that, dividend policy has significant negative association ship with board independence.

According to Fama and Jensen (1983), the board of directors plays a crucial role in managing agency costs. One way to enhance the effectiveness of the board is by appointing independent directors who can oversee the actions of managers and exercise control.

According to the findings of Al Shabibi & Ramesh (2011), various factors impact corporate governance, with board independence being a significant determinant that drives companies to distribute dividends. The research underscores the significance of specific company attributes, including profitability, company size, growth, ownership structure, liquidity and financial leverage, influencing the dividend policies of non-financial companies in the United Kingdom.

Sharma (2011) discovered a weak positive correlation between board independence and dividend policy. Similarly, Kilincarslan (2021) conducted a study that yielded statistically significant results, supporting the notion of a positive relationship between board independence and dividend policy. Tahir et al (2020) consistently reported a positive association between dividend yield and board independence. These findings collectively

indicate that a higher level of board independence can contribute to reducing agency costs and allowing shareholders to receive higher dividend payouts.

Huu Nguyen et al. (2020) suggest that when a company's board includes outside directors, it aims to reduce agency costs. These outside directors effectively represent and protect the interests of shareholders, ensuring that their rights within the company are safeguarded. The researchers conclude that as the number of outside directors increases, the company is more likely to pay higher dividends. This indicates a positive relationship between board independence and dividend payout. These findings are consistent with the study conducted by Duygun et al (2018), which observed that shareholders are inclined to seek increased dividends when the board comprises inside directors. This inclination may stem from concerns about the board's decision-making regarding earnings. Obtaining the extant literature on board independence, the current study also anticipates a positive correlation between board independence and the dividend payout policy.

Conclusion and Recommendations

The relationship between board independence and dividend policy of manufacturing listed companies in Malaysia from 2012 to 2021 has been investigated employing data gathered from the financial statements and DataStream Eikon of all the 29 companies. The outcome indicates that board independence exerts a significantly negative impact on the dividend policy. This study aims to benefit and contribute to a variety of parties, including policymakers, regulators, investors, corporations, forthcoming researchers, and academics. Nevertheless, this study has certain limitations, and recommendations are proposed.

There are some recommendations for future studies. Researchers may include various sectors such as technology, consumer products, manufacturing, and real estate. To enable cross-sector comparisons, it is recommended that the researcher examines and contrasts companies in the trading/services sector with those in various other sectors. This comparative analysis would reveal on the distinct factors and outcomes that influence different industries. This approach would provide a competitive advantage over other studies by offering a broader perspective.

Furthermore, by including a wider range of sectors, the sample size would increase, leading to improved data collection accuracy. Additionally, for future studies, it is suggested to incorporate additional aspects of corporate governance, such as board size, CEO duality, and gender board diversity. The inclusion of these factors would enhance the accuracy and effectiveness of the study's findings, making them more valuable for consideration by other researchers in the field. This would allow for comparisons to be made across different sectors. Researchers should also investigate and compare companies in the trading and services sector with those in alternative sectors to understand the factors and outcomes which influence different industries.

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