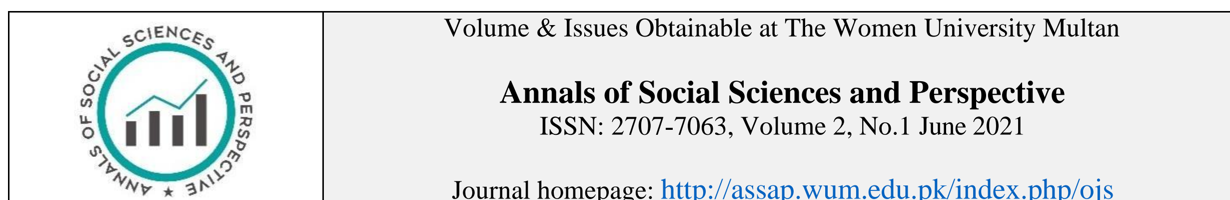
Volume & Issues Obtainable at The Women University Multan

Annals of Social Sciences and Perspective
ISSN: 2707-7063, Volume 2, No.1 June 2021

Journal homepage: http://assap.wum.edu.pk/index.php/ojs

Corporate Governance and Dividend Payout Policy: Mediating Role of Leverage. Evidence from Emerging Economy

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ARTICLE DETAILS

History:
Received: *May 09, 2021*
Review: *June 25, 2021*
Accepted: *June 28, 2021*
Available Online: *June 30, 2021*

Keywords:
Corporate governance, dividend payout, leverage, mediator.

ABSTRACT

The purpose of this study is to examine the relationship between corporate governance and dividend payout policies. The role of leverage as a mediating factor between corporate governance and dividend distribution in nonfinancial firms in the PSE 100 index is also examined. In spite of the fact that the relationship between corporate governance and dividend payout has been proven, the role of leverage as a mediator is being investigated for the first time. Code of Corporate governance indicators include CEO duality, the audit committee, the number of meetings, independent directors, and board size. In circumstances when the CEO is not also the chairman of the board of directors and an audit committee exists, leverage appears to play a key mediating function in the link between corporate governance and dividend payout policies. Board size and leverage have a strong and positive relationship, while leverage and dividend payout ratio have a considerable and negative relationship. Result reveal that if a company has audit committee and CEO is separate from chairman board of directors and want to increase the dividend payout then the company will have to decrease its leverage. Empirical results show that board size is significantly and positively related to leverage and leverage is significantly and negatively related to dividend payout. So the company will have to keep its board size minimum to minimize the leverage and maximize dividend payout if it is willing to pay higher dividends. On the other hand, it is found that the investors who opt to purchase shares with the intent to receive higher dividend they will have to select a company with minimum board size. It is revealed from the empirical results that smaller board size keeps the leverage minimum and consequently dividend will be maximum.

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1. Introduction

Various studies have been conducted to understand and explain the policy of dividend. However, most of the studies covered dividend policies of developed countries like United Kingdom and USA. In developing countries like Pakistan and India very few studies have been conducted. Even if the studies are conducted but the question of accurate dividend policy is yet unanswered. According to Naser et al, 2013 Dividend policy is used to signal the growth and profitability prospect of a company therefore it is very important for any company. Policy of dividend is a major indicator for potential investors and shareholders to check the performance of managers and decided about their investment portfolio. Additionally, dividend policy has an impact on a company's capital structure and investment decisions As a result, both management and shareholders can reduce agency costs. Dividends are an essential source of income for shareholders, as well as cash**.** The issue is very important for the company managers, to signal good financial performance in the market. However, the company's dividend policy must be analyzed in order to determine its key reasons for doing so. As part of the study's examination of the relationship between corporate governance and dividend policy in companies listed on the Pakistan Stock Exchange, leverage's mediating influence is also considered. They define corporate governance as: "the framework of connections and responsibilities that exist inside a broad group, including investors, board members and the chief executive officer in order to achieve optimal performance." Corporate governance is influenced by a number of factors, including the frequency of board meetings, the presence of an audit committee, the CEO's dual position, the size of the board, and the number of independent directors. Therefore, it can be claimed that these factors potentially influence the activities and policies carried out by managers. Existence of a vigilant corporate governance policy enhances independence of auditor and provides transparent information atmosphere within which managers of financial sector take more knowledgeable decisions (Bolo, 2006).

A company's dividend payment policy is a major consideration for investors. Investors lose trust in a company if it fails to pay dividends for an extended period of time, resulting in a decline in the share price. This study focuses on how Corporate governance plays role in better management of leverage and hence providing an enhanced dividend payout policy.

Objectives of the study are as under

- To explore relationship between corporate governance and dividend payout policies.
- To find out relationship between corporate governance and leverage.
- To explore the relationship between leverage and dividend payout policies.
- To find out mediating role of leverage.

Numerous studies have been conducted on corporate governance and leverage, corporate governance and dividend payout policies, and leverage as a determinant in dividend payout policy. To my knowledge, no research has been done on leverage as a mediator between corporate governance and dividend distribution policy.

The shareholders who are interested in dividend, this study will help them to invest in a company which is expected to pay higher amount of dividend.

A lot of work has been done on relationship of corporate governance and leverage, corporate governance and dividend payout policies and leverage and dividend payout policies. But in

my knowledge leverage is not used as mediating variable between corporate governance and dividend payout policies.

In circumstances when the CEO is not also the chairman of the board of directors and an audit committee exists, leverage appears to play a key mediating function in the link between corporate governance and dividend distribution policies. Leverage has a large and positive link with board size while dividend payout ratio has a large and negative association with leverage. To raise dividend payouts, companies that have audit committees and CEOs distinct from board chairmanships must reduce their leverage, according to this study's findings. Board size is considerably and positively correlated with leverage, while leverage is significantly and adversely correlated with dividend payout according to empirical findings. If the company is willing to pay bigger dividends, it will have to restrict its board size to a minimum to minimize leverage and maximize dividend distribution. . On the other hand, it is found that the investors who opt to purchase shares with the intent to receive higher dividend they will have to select a company with minimum board size. It is revealed from the empirical results that smaller board size keeps the leverage minimum and consequently dividend will be maximum.

The remainder of the paper organized in the following way. Section 2 about current literature and theoretical premises to explain the linkage between variables and developed several testable hypotheses. Part 3 represents the conceptual framework, research design, methodology. Section 4 includes the findings and section 5 related to the conclusion, recommendations, limitations, implementations, and future research suggestions.

2. Literature Review and Hypothesis Development

Corporate governance structure guides the designing and implementing the company's policies. Corporate governance makes the managers responsible for their actions. Professional practices of corporate governance are a cause of investor's confidence. Gompers et al. (2003) explored that efficient corporate governance enhances company's value. It was explored by Claessens et al. (2002) that advance frameworks of corporate governance provide better access to financial institutions, cheaper loans, improved performance and extra care for the interest of all stakeholders. According to Cuong and Canh (2012), the optimal debt ratio is less than 59.27 percent, which increases the firm's worth. A study conducted by Ron Jana (2010) examined the association between business capital structure and board characteristics in Nepal. Therefore, corporate governance reduces financial leverage and disagreements in the agency, according to the study's results. The association between board size and board skill is statistically significant only when board size and tenure are combined, but not when board size and tenure are considered. Another study has found that executive directors on the board and debt levels have a positive correlation. They also found that larger debt levels are used to expropriate a few stockholders, rather than as a punitive and disciplinarian tool by the management of construction enterprises.

Management must select whether or not to reinvest profits or distribute them among shareholders when deciding on a corporate dividend policy. Decisions about the timing and ratio of profits to be distributed as dividends are part of the dividend policy. A company's dividend distribution policy is affected by a variety of factors such as retained earnings, investment opportunities, liquidity and share prices in the market, as well as the company's dividend policy and the lender's constraints. Generally, two schools of thought exist for the dividend policy:

1. Relevance Theory explains association between dividend policy value of firm and share price.
2. Irrelevance theory claims that there is no association between above mentioned variables.

2.1 Dividend Relevance Theory

Financing decisions and investment decisions are two main categories of decisions that are made by finance managers (Baker and Powel 2005). Financing decisions guide the suitable and cost effective sources of funds whether it is internal and external and decisions of investment means the level of assets that is necessary to run the business smoothly. Assets of firms are financed either through debt or equity. Decision about dividend payment belongs to the category of financing decisions because the management has to decide either to pay the dividend or reinvest the profits for future growth prospects. This management of earnings is known as corporate dividend policy. Dividends policy guides whether the firm should maintain constant dividend growth rate or the average fraction of earnings to be paid out over time. Briefly we can say that dividend payout policy means deciding about the ratio and timing of dividend payment. As dividend policy effects shareholders' wealth and the firm's ability to retain earnings to invest in profitable opportunities therefore determining dividend pay-out is a sensitive matter. Study of Pruitt and Gitman in 1991 strongly recommends that we cannot separate financing decisions from dividend decisions because they are interrelated. If a company decides to pay dividends, it will use a part of retained earnings and subsequently less earnings will be available to reinvest. This decision may force the firm to seek for funds from external sources. Therefore, dividend policy is considered among major factors that influence corporate value and wealth of shareholders. (Baker et al, 1985). So the policy of dividend payment is relevant to the company value.

2.2 Dividend Irrelevance Theory

The dividend policy is irrelevant to the firm's value, according to the dividend policy irrelevance theory. According to a group of financial scholars, dividend irrelevance is a valid notion (Miller and Modigliani, 1961) and assumptions of study are as following:

- When taxes and transaction costs are eliminated, single buyers or sellers cannot affect the market price, and information is freely available, there is a perfect capital market.
- In the market, participants behave rationally, valuing their securities by discounting future cash flows. The investor is certain about the firm's investment policy and has complete knowledge of cash flows; and
- There is no agency problem.

2.3 Dividend Policy in Practice

Allocation of profit between retained earnings and payments to shareholders is determined by dividend policy. Responsibility of management is to find balance between dividend distribution to shareholders and growth. Therefore, dividend policy is important factor in the value of the firm. Firms may opt either stable or residual dividend policies according to their given conditions.

2.3.1 Residual Dividend Policy

Therefore, it has chosen a residual dividend strategy to finance its new projects and investments with domestically generated revenues (Aduda and Kimathi, 2011). As part of a residual dividend policy, dividends are given only after all current and anticipated liquidity requirements have been satisfied. It is possible to determine whether or not the company has enough money to invest once all expenses have been satisfied because of this dividend policy. Generally following steps are taken for residual dividend policy:

1. Preparation of capital budget that determines the requirement of funds for operations and investment during the year.
2. Estimated requirement of liquid assets to finance the investment and expansion.
3. Whether retained earnings are to be used partially or fully for capital expenditure.
4. Remaining portion of earnings can be distributed as dividend.

2.3.2 Stable Dividend Policy

Consistency in the payment of dividend is known as stable dividend policy. It means payment of a fixed amount as dividend every year without considering the fluctuation in the profits of the company (Ap Gwilym et al., 2000). The approach fulfills the interest of some individual and institutional speculators in securing consistent cash inflows just like salary. Under a steady profit pay-out approach, profits can be reasonably anticipated. It can be seen as an indication of the company’s monetary strength and reestablishes trust in the company. Major difference between stable and residual dividend approach is that while the former is practically sure and stable the latter is unverifiable and fluctuating. Despite fact that a consistent profit approach can positively affect the company, the strategy could turn out to be unsafe. Once a firm chooses a steady profit strategy, any alterations to that strategy may be seen negatively by the business community in general. Most business regulations regulate dividend programmed to safeguard stakeholder rights. Company law requires that dividends be paid solely from retained earnings or current year profits, whichever is greater. Dividend from capital is never allowed. Govt. monetary and fiscal policies and changes in taxation rules and regulations also have major impact on the dividend policy.

2.4 Factors Influencing Dividend Policy

2.4.1 Profitability

For many years, profitability has been a famous factor for determining ability of a firm to pay dividend. Lintner (1956) and H. Kent and Gary E. Powell (2000) explored the relationship between profits, dividend distribution, and taxes collected. As a result, a sequence of dividend payment affected by current income and past dividends was found. In a study of 318 New York stock exchange firms Farrelly, Baker and Edelman in year 1986 concluded that the main factor is the level of dividend income and dividend pattern projected for future. Function of the profitability was studied by Ling et al. (2008) who investigated on a sample of 100 companies listed on Bursa Malaysia; he used return on equity and the return on assets as proxies. ROA and ROE show a significant association with dividend payout ratio.

Kowalewski et al. (2007) and Guizani and Mondher (2012) looked at the relationship between dividend payout ratio and assets turnover and found it to be significant. An association between return on assets and dividend payments was shown to be considerable, and organizations that make larger returns on their assets and have good cash flow are more

likely to pay bigger dividends. Also, according to Al-Kuwari (2010), government ownership and profitability of enterprises are positively associated with dividend payment ratio.

As a result, dividend policy is heavily influenced by profitability. The authors of a 2004 study by DeAngelo and Skinner, as well as Amidu and Abor, state that (2006). Profitability and dividend payout were found to be positively correlated, according to the study. Some profitable corporations elect to pay shareholders less dividends and reinvest the earnings in operations (Maldajian and El Khoury, 2014). According to Al-Malkawi (2008), a 15-year research of Jordanian public listed companies revealed that companies with increasing profitability pay higher quarterly dividends than those with declining profitability. As a result of his findings, the signalling hypothesis of dividend policy is supported; companies with larger profits prefer to pay out more dividends to their shareholders in order to send a message about their financial performance.

Gupta and Banga (2010) investigated 150 companies of India for the period of seven years that were listed on Bombay Stock Exchange. Significantly negative relationship between dividend payout and company performance was found, which is also consistent with other studies (Aurangzeb & Dilawer, 2012; Kania & Bacon, 2005). Growth firms, on the other hand, seek to pay smaller dividends to shareholders. Highly profitable corporations are more likely to invest in future projects to develop their business, as indicated by Rozeff (1982). A favorable relationship between profitability of the company and dividend distribution policy is also expected as a result of this study.

2.4.2 Free Cash Flow

According to Jensen (1989), in the context of free cash flow, this refers to the amount of cash that is available in excess of what is needed to finance all positive NPV projects. There is evidence to suggest that excess cash flow is a contributing factor to agency costs. Conflicts of interest between internal and external stakeholders result from excess cash flow. Management wants to defend its own interests, while shareholders seek to maximize the value of their stock. Dividend payout is heavily influenced by the company's cash flow status.

It is not possible to pay out large dividends because of the shortage of funds. Due to the fact that dividend payments are based on cash flow. Because accounting methods can affect current revenues, cash flow position represents a company's ability to pay dividends. (Ali and Ramirez G, 1993). Dividend payout ratio and cash flow are positively related according to (Abor, 2006). They claim that a firm's ability to pay dividends is not only determined by its profitability. Kopor (2008) finds that dividend payout ratio is influenced by cash flow.

Jensen (1986) argues that manager can invest cash in projects that can have negative NPV, therefore the firm should opt to pay a dividend to the shareholders to avoid misuse of excessive cash flow. Dividend payment is a useful mechanism to control the agency problems. A study was conducted by Ali and Ramirez (1993) to explore determinants of corporate dividend policy on a sample of 105 nonfinancial listed companies of New York Stock Exchange. Using factor analysis, low systematic risk was found in high cash flow firms and it is considered as a reliable signal for the payment of higher dividends.

During the period 2000-2006, Anil and Kapoor (2008) examined the factors that affected the dividend payout ratio in the Indian IT sector. Cash flow and dividend payout ratio showed a significant positive relationship. According to a study conducted by Kania and Bacon(2005), cash flow and dividend payout ratio have a negative relationship.

2.4.3 Corporate Size

Generally, financers prefer mature and big companies because mature firms are considered as more reliable than small and new firms. And opposite to this scenario either financer don't borrow to small and new firms or their rate of interest is very high therefore small firms have to rely on their own sources. Baskin (1989) found that leverage, growth, company size, dividend payout ratio and operating income have impact on price of share.

In a research of nonfinancial firms of UK by Al Shabibi et al. (2011) firm size, board's independence, risk and profitability proved to be significantly correlated with dividend policy.

In Saudi Arabia it was found by Osman et al. (2010) that profitability, company size and business risks have significant impact on decision of dividend payout. However, Leverage, Government ownership, and age also correlated with dividend payout decisions of nonfinancial firms.

As independent variables, Fama and French (2001) looked at size, growth potential, and profitability when examining dividend payment policy. As a result of the study, the size of the company had a favourable and significant impact on dividend payment decisions. The size of the corporation was determined by the natural logarithm of the average of the total assets over the year.

Al-Kuwari (2009) studied dividend payout for companies of Gulf Cooperation Council (GCC) countries for the period 1999-03. The results of study prove that size has significant impact on dividend payout policies. Al-Shubiri (2011) found that large companies in Jordan pay more dividend than small companies. As the size of firm increases it has better ability to pay higher ratio of dividends. As the higher dividend ratio is paid to shareholders it consequently reduces the agency cost. Because this way the managers don't have excessive amount of cashAs a proxy for business size, the natural logarithm of sales was used in this study. Other studies have utilised the natural logarithm of sales to reduce the impacts of scale in the final regression and to eliminate any remnants of the size of other variables used in the positive association model. We've known for a while that business size and dividend payout ratio are positively correlated (Musiega, Alala, Douglas, Christopher, and Robert, 2013). Anupam Mehta (2012) points out that large companies have access to capital market and can arrange cheap finance therefore they prefer to pay dividend however on the contrary small companies have difficulties in borrowing therefore they have to rely on internal sources of funding. This phenomenon encourages large firms to pay dividend at higher ratio of earning than that of small firms. Kangarlouei, Motavassel, Azizi, and Farahani (2012) pointed out that size and market of the firm have negative correlation with dividend policy. It proves that firms prefer to reinvest in the assets instead of paying dividend to shareholders. Negative correlation between size and dividend was found by Wang, Ke, Liu, and Huang (2011). Hashemijoo, Mahdavi Ardekani and Younesi (2012) study the impact of dividend policy on share price volatility in the Malaysia stock market also found negative relationship with firm size and dividend payment.

2.4.4 Growth

La Porta et al. (2000) found that a country where legal system is strong and the shareholder is protected with state's law, rapid growth firms pretend to pay less dividend and to tend to invest in growth opportunities and the shareholders allow the managers to do so because they

are protected. However, in the states where shareholders are less protected they don't allow managers to reduce the dividend. They prefer to receive the dividend instead of investing in growth opportunities. The firms also tend to pay higher dividends to sustain a strong reputation even if they have good opportunities of growth.

Dividend payout ratio is effected by sales growth. Dividend is decided along with investment and financing decisions. According to Partington (1983), dividend is determined independent of investment and financing decisions. Because dividend payment is important and management may have motive to sustain its repute in the market by paying higher dividends.

Higgins (1981) explored that there is direct correlation between financing needs of a firm and growth. Cash requirements increase in growing firms and sales revenue can't meet these requirements therefore the firms need financing from external sources. It has been shown by Higgins (1972) that the dividend payout ratio is inversely connected with a company's requirement for capital to finance expansion opportunities Rozeff (1982), Lloyd (1985) and Collins (1996) found that dividend payouts and sales growth had a strong negative relationship.

2.4.5 Board Size

Dividend distribution policy and board size are found to be highly correlated (Mansourinia et al. 2013). For the five-year period 2006-10, 140 companies listed on the Tehran Stock Exchange were studied. The researchers found a considerable positive correlation between board size and dividend policy, which was confirmed by statistical analysis. The regression analysis method was used by Uwuigbe (2013) to find a favorable link between board size and dividend policy.

A substantial positive link was also established by Subramaniam and Susela (2011) between the size of the board and dividend payout. Large boards and family-owned businesses pay bigger dividends, according to the statistics. Directors are forced to disperse income as dividends because they have a larger stake in the company. The size of the board and dividend payout were found to be positively correlated in a study of Nigerian companies by Uwalomwa, Olamide, and Francis (2015).

Large boards can monitor the operations of a company in a better way Kiel and Nicholsan (2003), and this phenomenon improves the quality of operations of a company. This is due to the variety of knowledge and back ground of the decision makers. It is easier to interact with and acquire the consent of board members when the board is smaller, which facilitates the making of decisions swiftly (Haniffa & Hudaib, 2006). A smaller board also makes it easier to make decisions about dividend policy. In both cases, advantages and disadvantages exist. When it comes to dividends, however, the size of the board does not matter.

2.4.6 CEO Duality

According to Krenn (2014), CEO duality means Chairman of the board and CEO are the same thing. 140 companies were selected for the study by Mansourinia et al. (2014) to examine the impact of CEO duality on dividend distribution policy from 2006 to 2010. The study found a minimal connection between CEO dualities and dividend policy. There is little or no impact of the chairman of the board of directors on dividend policy.

When CEOs have a dual function in the company, Chen, Lin, and Kim (2011) discovered that they are less likely to pay dividends. A negative association between CEO duality and dividend payouts is revealed by the outcomes of this research study. This concentration of power prevents other directors from staying on their opinions or voicing their opinions if the CEO also holds the position of president of the board of directors. CEO can overturn other directors' decisions in this circumstance, which could lead to an agency problem.

Schen and Suffian (2014) examined the relationship between CEO duality and dividend policy in Malaysian oil and gas enterprises from 2009 to 2013, and found that the dual function of the CEO can help align managers' and shareholders' interests, reducing agency costs. A CEO who is also the chairman of the board of directors can readily control managerial actions. Due to the fact that dividends cannot effectively regulate the agency problem, corporations with CEO duality prefer to distribute lesser dividends to their shareholders. However, Arshad, Akram, Amjad, and Usman (2013) reported a negative relationship between CEO duality and dividend policy in Pakistan.

2.4.7 No. of Meetings

The number of board meetings and corporate governance were shown to be significantly correlated in Vafeas's (1999) study of 307 enterprises throughout the period 1990-94. A substantial impact is also had on agency theory. With respect to the firm's value, the number of yearly board meetings is negatively connected. As the frequency of meetings increases, the share price declines, according to research. After several years of anomalous board activity, it was observed that the operating performance had improved. Companies with a bad performance history and companies not involved in corporate control transactions showed these gains. On the whole, board activity, as measured by meeting frequency, appears to be an important aspect of board operations. In 2005, Adams utilized the term of board meetings to include all board meetings and committee meetings. In order to assess the efficiency and efficacy of corporate governance, he relied on this proxy.

2.4.8 Independent Directors

Board of directors play an important role in reducing agency costs, according to Fama and Jensen (1983). This increases the board's ability to supervise and monitor management. A study by Mansourinia et al. (2013) of companies registered on the Tehran Stock Exchange concluded that board independence and dividend policy had a negligible association. During the study period, 140 firms were studied. Dividend payments to shareholders are not influenced by executive or unconstrained managers, according to the study's findings.

Al-Shabibi and Ramesh (2011) find that board independence is the most important indicator of corporate governance, and that it is what motivates a business to pay dividends. Research shows that certain company variables (such as size and profitability) have an impact on dividend policy for non-financial UK enterprises. They found that board independence had little effect on dividend policy (Batool and Javid, 2014). According to the study, Pakistani companies pay lower dividends than their counterparts in other emerging economies because they are dependent on external finance.

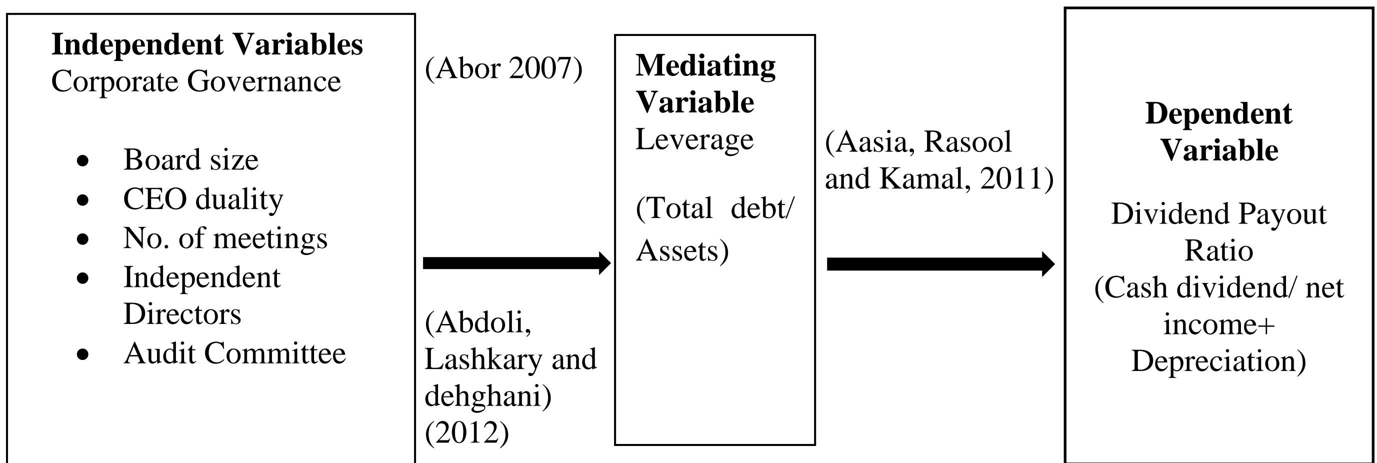
The natural logarithm of revenue was utilised in this study as a proxy for firm size. A natural logarithm of sales was employed in other studies to diminish the effects of scale in a final regression and to eliminate any vestiges of the magnitude of other variables utilised in the positive association model. This correlation between business size and dividend payment

ratio has been known for some time (Musiega, Alala, Douglas, Christopher, and Robert, 2013).

2.4.9 Audit Committee

Due to its ability to implement company laws and regulations, as well as ensure good corporate governance procedures, an audit committee can be a significant part of a firm's value. It is a requirement of corporate governance principles that the audit committee operate independently while adhering to high levels of professionalism. The audit committee is responsible for monitoring measures that ensure that shareholders and company managers have equal access to information about the company (Rouf, 2011, p.240). As a result of this monitoring and control, agency difficulties are minimised. Ho (2005) examined the positive association between audit committees and dividend payouts and found that they were positively correlated. Klein (2002) discovered that audit committee independence and earnings management had a negative connection. Unbiased audit committees are important for low cost debt financing (Anderson, Reeb, and Mansi, 2004).

2.5 Theoretical Framework



2.6 Hypothesis

H1: Corporate governance has significant impact on dividend payout policy.
H2: Corporate governance has significant impact on leverage.
H1: Corporate governance has significant impact on dividend payout policy.
H2: Corporate governance has significant impact on leverage.
H3: Leverage significantly mediates the relationship between corporate governance and dividend payout policy.

3. Data Collection, Variables and Measurement

3.1.Data Collection

Audited financial statements of KSE 100 index companies are used for the analysis. We studied nonfinancial firms of KSE 100 index. And these are 67 firms. Our period of study is financial year 2011 to financial year 2015. The reason of the selecting the period is that before that duration major changes in corporate governance is done. Financial sector is not including because financial sector has strong code of the corporate governance due to double

control of the two authority SECP (securities commission of Pakistan) and state bank of Pakistan.

3.2.Measurement of Variables

3.2.1.Dividend Payout Ratio

Many variables are used in the different studies to explain dividend policy. A significant portion of the studies used ratio of cash dividend to net income and depreciation.

3.2.2.Leverage

Leverage is a major factor to decide dividend policy (AL- Shubiri, 2011; Subramaniam et al., 2011). In Pakistan, while deciding about the dividend payout ratio the management has to consider the leverage. If the company has higher level of leverage the management will prefer to pay off debts before distribution of profits as a dividend. Because if the company is financially stable and has sufficient resources to avail growth opportunities only then it can stay for the longer period. But if despite of higher level of leverage the company decides to payout dividend then it will have to rely on external sources of funds and as the external financing increases, the cost of finance is also increased. Therefore, the management prefers to maintain balance between debt and the equity.

3.2.3.Corporate Governance

Agency cost is a result of separation between management and ownership of a company and dividend payout is used as a mechanism to minimize agency cost. In the current study 5 proxies of corporate governance are being used namely:

- Number of meetings
- Board Size
- Number of independent directors
- Audit committee and
- CEO duality

Table 1: Description of Dependent and Independent Variables

Variable	Nature of Variable	Definition
Dividend Payout (Div x)	Dependent	Cash dividend/Net income+ Depreciation
Leverage (Lev)	Mediating	Total debt/assets
Board Size	Independent	No. of members on Board
Independent directors	Independent	No. of external directors on Board
CEO Duality	Independent	CEO acting as chairman of Board
Audit Committee	Independent	Whether audit committee exists or not
No. of meetings	Independent	Number of Board meetings in a year

Table 2: Correlations

		BODSIZE	CEDU	Meetings	Idirectors	AC
BODSIZE	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	327				
CEDU	Pearson Correlation	-.141*	1			
	Sig. (2-tailed)	.011				

	N	327				
Meetings	Pearson Correlation	.246**	-.119*	1		
	Sig. (2-tailed)	.000	.032			
	N	327	327	327		
Idirectors	Pearson Correlation	.317**	.071	.177**	1	
	Sig. (2-tailed)	.000	.201	.001		
	N	327	327	327	327	
AC	Pearson Correlation	-.102	.029	-.106	.123*	1
	Sig. (2-tailed)	.067	.598	.055	.026	
	N	327	327	327	327	327

Correlation table shows that board size is negatively correlated with CEO duality, audit committee and dividend and positively correlated with number of meetings and independent directors. Moreover, board size is significantly related with CEO duality, independent directors, audit committee and number of meetings. CEO duality is negatively correlated with number of meetings and positively correlated with independent directors and audit committee. However, CEO duality has significant relationship with number of meetings but its relationship with independent directors and audit committee is insignificant. Number of meetings has negative relationship with audit committee and positive relationship with independent directors. Number of meetings has significant relationship with board size, CEO duality, audit committee and independent directors.

Independent directors have positive correlation with audit committee. Relationship of independent directors with audit committee is significant.

Table 3: Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Board Size	327	4.00	17.00	9.0000	2.19
Meetings	327	1.00	24.00	5.4740	2.36
Independent Directors	327	.00	13.00	1.7523	1.96
Leverage	327	4.80	165.64	49.0865	23.69
Dividend Payout	327	.00	158.93	26.7208	30.43

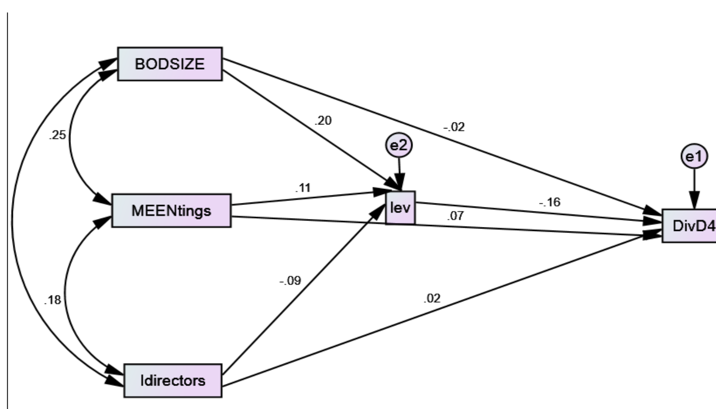
Descriptive statistics show that in our sample of 327 firms minimum board size is 4 and maximum board size is 17 with a standard deviation of 2.19. CEO Duality is measured through dummy variable. Minimum number of meetings is 1 and maximum number is 24 with a standard deviation of 2.36. Minimum number of independent directors is 0 and maximum number of independent directors is 13 with a standard deviation of 1.96. It means there are companies who don't have independent directors. Audit committee is measured through dummy variable. Presence of audit committee is measured as 1 absence is measured as 0. Leverage is calculated as ratio of total debt and total assets of the company. Minimum leverage is 4.80 and maximum is 165.64 with a standard deviation of 23.69. It means some companies use debt to finance their assets as well as their operations.

Dividend payout is calculated by dividing the dividend by net income and depreciation. Minimum payout ratio is 0 that means some companies are either in loss or not paying

dividends and maximum payout ratio is 158.93 it means these companies are paying dividend from their retained earnings. Mean value of payout ratio is 26.72. In the given table we have a sample of 327 companies, and we observe that there are 100 companies who have board size of 7 members. Only two companies have board of 17 members that is the maximum board size in our sample companies and only 3 companies have board size of 4 members that is the minimum board size in our sample. The results show that out of 327 companies there are 40 companies where CEO has dual role It means CEO is holding the office of chairman as well. In 287 companies' CEO role is not dual.

The results show that in one company only one board meeting is held that is the minimum number of meeting. In two companies 24 meetings are held that is the maximum number of meetings in a company. In 120 companies 5 meetings are held. This is the maximum frequency of meetings in our sample of 327 companies. Our results show that 9 companies don't have audit committee and 318 companies have audit committee. Our results show that 9 companies don't have audit committee and 318 companies have audit committee. There are 87 firms who do not have independent directors and there are 112 companies that have 1 independent director. This is the maximum frequency of the firms having independent directors. There is only one firm who has 13 independent directors.

Structural Equation Model



In our study audit committee, CEO duality, board size, number of meetings and independent directors are proxies of corporate governance. In the model we have board size, number of meetings and independent directors as independent variable, while CEO duality and audit committee are observed in group. Leverage is mediator and dividend payout is dependent variable.

Table 4: Regression Analysis: All

Relationship of variables			Estimate	P
Leverage	<---	Independent directors	-.092	.109
Leverage	<---	Meetings	.107	.056
Leverage	<---	Board size	.203	***
Dividend Payout	<---	Board size	-.016	.793
Dividend Payout	<---	Meetings	.073	.199

Relationship of variables			Estimate	P
Dividend Payout	<---	Independent directors	.024	.681
Dividend payout	<---	Leverage	-.161	.004

From the above mentioned table we observe that leverage is significantly related with independent directors, number of meetings and board size. At the same time leverage has significant impact on dividend. It proves that corporate governance has indirect relationship with the dividend payout. According to Preacher and Hayes (2009) a significant value of indirect effect shows an occurrence of mediation and according to above mentioned table leverage is displaying a significant mediation between corporate governance and dividend payout ratio.

Table 5: Regression Analysis (No CEO Duality)

Variables			Estimate	P
Leverage	<---	Independent directors	-.065	.295
Leverage	<---	Meetings	.100	.100
Leverage	<---	Board size	.184	.003
Dividend payout	<---	Board size	-.018	.777
Dividend payout	<---	Meetings	.073	.235
Dividend payout	<---	Independent directors	.033	.599
Dividend payout	<---	Leverage	-.164	.006
Dividend payout	<---	Size firm	-.017	.775

In the table we can observe that when there is no CEO duality leverage is significantly related with meetings and board size. All other variables have insignificant relationship. However, leverage is acting as mediator.

Table 6: Regression Analysis (CEO Acting as Chairman of BOD)

Variables			Estimate	P
Leverage	<---	Independent directors	-.215	.211
Leverage	<---	Meetings	-.004	.982
Leverage	<---	Board size	.211	.214
Dividend payout	<---	Board size	-.085	.621
Dividend payout	<---	Meetings	-.188	.248
Dividend payout	<---	Independent directors	-.140	.421
Dividend payout	<---	Leverage	-.140	.373
Dividend payout	<---	Size firm	.067	.663

The results show that all the variables have insignificant impact when CEO is holding the office of chairman of board of directors as well.

Table 7: Regression Weights (Audit Committee Does not Exist)

Variables			Estimate	P
Leverage	<---	Independent directors	-15.151	***
Leverage	<---	Meetings	3.707	.243
Leverage	<---	Board size	1.811	.442
Dividend payout	<---	Board size	-1.811	.942
Dividend payout	<---	Meetings	77.287	.027
Dividend payout	<---	Independent directors	93.018	.135
Dividend payout	<---	Leverage	4.757	.165
Dividend payout	<---	Size firm	-.005	.049

The results show that when audit committee does not exist the leverage has significant impact on independent director only. All other variables have insignificant relationships.

Table 8: Regression Weights: (Audit committee Exists)

Variables			Estimate	P
Leverage	<---	Independent directors	-.979	.161
Leverage	<---	Meetings	1.166	.038
Leverage	<---	Board size	2.266	***
Dividend payout	<---	Board size	-2.029	.596
Dividend payout	<---	Meetings	2.882	.391
Dividend payout	<---	Independent directors	1.721	.680
Dividend payout	<---	Leverage	-.781	.020
Dividend payout	<---	Size firm	.000	.765

The above table shows that in the presence of audit committee the leverage is significantly related to number of meetings, board size and dividend payout ratio. It means number of meetings and board size significantly influences the leverage and leverage significantly influence dividend payout ratio. Hence proved that the leverage is playing mediating role.

3.3.Mediation Analysis

3.3.1.Evaluation of Mediation

In the words of Hayes (2009), mediation occurs when one or more intervening variables have a positive impact on a result Y. It is possible to check the effectiveness of mediation using a number of different approaches. Nevertheless, in the current study, we employed AMOS v21.0 to test the mediation of the data. Several assumptions are made in order to evaluate the effectiveness of mediation. The mediator and independent variable must, for example, be associated. Independent and dependent variables in the presence of a mediator must show a significance relationship.

Table 9: The Mediation Results Overall

Structural Paths					Total Effect	P value	Direct Effect	P value	Indirect Effect	P value	Mediation Status
Independent Directors	→	Leverage	→	Dividend Payout Ratio	-.092	.130	.024	.531	.015	.135	No Mediation
Meetings	→	Leverage	→	Dividend Payout Ratio	.107	.168	.073	.080	-.017	.175	No Mediation
Board Size	→	Leverage	→	Dividend Payout Ratio	.203	.003	-.016	.878	-.033	.011	Full Mediation

There is full mediation when indirect effect value is significant, Preachser and Hayse (2009). In the above mentioned table, we are analyzing the overall results and we find that independent directors and number of meetings are insignificantly related with the leverage however board size is significantly associated with the leverage. So according to Preacher and Hayse (2009) mediation is accepted with the board size and mediation with independent directors and number of meetings is rejected.

Table 10: No CEO Duality

Structural Paths					Total Effect	P value	Direct Effect	P value	Indirect Effect	P value	Mediation Status
Independent Directors	→	Leverage	→	Dividend Payout Ratio	0.044	0.263.	0.033	.0.376	0.011	.308	No Mediation
Meetings	→	Leverage	→	Dividend Payout Ratio	0.057	.0.173	0.03	0.105	-0.016	.167	No Mediation
Board Size	→	Leverage	→	Dividend Payout Ratio	-0.047	.0.007	-0.017	.0.007	-0.030	.009	Partial Mediation

When there is no CEO duality we observe that according to Preacher and Hayse (2009) Partial mediation is accepted in board size only and in other 2 variables the mediation is rejected.

Table 11: CEO Duality Exists

Structural Paths					Total Effect	P value	Direct Effect	P value	Indirect Effect	P value	Mediation Status
Independent Directors	→	Leverage	→	Dividend Payout Ratio	-.111	0.541	-.141	0.440	.029	0.418	No Mediation
Meetings	→	Leverage	→	Dividend Payout Ratio	-.172	0.274	-.172	0.289	.000	0.930	No Mediation
B Size	→	Leverage	→	Dividend Payout Ratio	-.128	0.418	-.100	0.575	-.029	0.429	No Mediation

In the above mentioned table we observe that mediation is rejected in the light of Preacher and Hayse (2009)

Table 12: Audit Committee Exists

Structural Paths					Total Effect	P value	Direct Effect	P value	Indirect Effect	P value	Mediation Status
Independent Directors	→	Leverage	→	Dividend Payout Ratio	.034	0.443	-.022	0.606	.012	0.188	No Mediation
Meetings	→	Leverage	→	Dividend Payout Ratio	.036	0.387	.053	0.261	-.016	0.167	No Mediation
Board Size	→	Leverage	→	Dividend Payout Ratio	-.059	0.002	-.031	0.002	-.029	0.050	Partial Mediation

In the presence of audit committee partial mediation is accepted between with board size. Because according to Preacher and Hayse (2009) if independent and dependent variables have significant correlation indirect effect is also significant then it is partial mediation.

Table 13: Audit Committee Not Existing

Structural Paths					Total Effect	P value	Direct Effect	P value	Indirect Effect	P value	Mediation Status
Independent Directors	→	Leverage	→	Dividend Payout Ratio	.230	0.493	.777	0.348	-.543	0.568	No Mediation
Meetings	→	Leverage	→	Dividend Payout Ratio	.677	0.284	.535	0.350	.142	0.649	No Mediation
Board Size	→	Leverage	→	Dividend Payout Ratio	.357	0.038	.287	0.261	.071	0.769	No Mediation

The above-mentioned results show that mediation is rejected in the absence of audit committee.

4.Conclusion and Recommendations

Corporate governance and dividend policy were examined in this study, which found that leverage had a mediating function in nonfinancial firms in the PSE 100 index. Audit committee, CEO duality, number of meetings, board size and independent directors are some of the proxy measures of corporate governance utilized in this study. Depreciation and leverage are computed by dividing total debt by assets of the company to arrive at the dividend payout. There is a statistically significant association between independent variable corporate governance and mediator leverage, according to the regression analysis. Leverage, on the other hand, has a negative and significant relationship with dividend payout ratio. The dividend distribution lowers as leverage increases. There is a preference for debt repayment over dividend distribution among listed non-financial companies in Pakistan.

However, in the mediation path analysis we observe that among 5 indicators of corporate governance only board size is significantly related with leverage. Results show that when

CEO is not holding dual offices and audit committee exists at that time leverage plays mediating role between corporate governance and dividend payout ratio.

The leverage has implications on the dividend payout policies. The corporate governors cannot ignore leverage while making decision about dividend payout. Number of independent directors is negatively associated with leverage. As the number of independent directors increases they will force the board to pay off debt and reduce the leverage level. In our sample 112 firms have only one independent director that is 34.3% of the total population. Maximum number of independent directors is 13 that is found in only one firm out of 327 firms.

In the regression analysis number of meetings and board size are significantly and positively associated with leverage in our sample. Empirical results show that when CEO is holding the office of chairman of board of directors the association between corporate governance and leverage becomes insignificant and mediating role of leverage also becomes insignificant however when the CEO is separate from chairman then the board size and number of meetings have positive and significant association with leverage and independent directors have negative and insignificant association with leverage. However, leverage is negatively and significantly associated with the dividend payout ratio. In the path analysis mediation of only board size is accepted.

Leverage is positively and significantly associated with the number of meetings and board size in the presence of an audit committee, but independent directors are adversely and insignificantly associated with the level of leverage. In contrast, the dividend payout ratio has a negative and significant relationship with leverage. independent director are negatively and significantly associated with leverage in the absence of an audit committee, but the relationship between all other independent and dependent variables and mediating variables is insignificant on the other hand.

It is explored in our study that leverage is mediating between corporate governance and dividend payout. Result reveal that if a company has audit committee and CEO is separate from chairman board of directors and want to increase the dividend payout then the company will have to decrease its leverage. Empirical results show that board size is significantly and positively related to leverage and leverage is significantly and negatively related to dividend payout. So the company will have to keep its board size minimum to minimize the leverage and maximize dividend payout if it is willing to pay higher dividends. On the other hand, it is found that the investors who opt to purchase shares with the intent to receive higher dividend they will have to select a company with minimum board size. It is revealed from the empirical results that smaller board size keeps the leverage minimum and consequently dividend will be maximum.

Corporate governance theory states that a well-established system involves effective control and accounting systems, severe monitoring, an effective regulatory mechanism, and efficient use of firms' resources that contribute to better performance. Corporate governance mechanisms that have been in place for some time allow corporations to make decisions about dividend distribution policy and leverage level since they can pay back their debt on time. This means possibility of a firm to pay dividend and extent of payment depends upon level of leverage. Performance is improved if the cheaper loans are easily accessible to the company. However, much work is yet required on the subject of corporate governance and financing decisions to make the stakeholders more vigilant and more knowledge full.

4.1 Limitations of the Study

- Data of five years was taken in this study so the future studies can take data of longer period to examine the relationship.
- The results of present study cannot be generalized as data was only taken from nonfinancial companies of KSE-100 index.

4.2 Future Research Suggestion

Some research should be conducted on the following topics.

- Family involvement in between corporate governance and dividend policy and that literature should be the future topic.
- Dividend policy effected by many other aspects like political factors involvement and economic factors should be the next research phenomenon.
- A research should be conducted by the addition of the corporate governance many other variables like board expertise and knowledge and experience that directly influence the dividend policy making.

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