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Impact of corporate governance on financial decisions: a case of Pakistan

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Abstract: Financial decision of the corporate leads to strong profit as profit is the sole objective of the firms. The purpose of this research is to test the relationship between financial decision and corporate governance of the listed firm in Pakistan stock exchange. Financial decisions of a corporation stand at dividend and investment decisions, which mostly affect the objectives of the shareholders. Using anti-takeover safeguards based on governance indicators and internal ownership. Two main theories towards might affect how effective corporate governance is on financial decisions based on agency theory estimates. The outcome and substitution hypotheses are alternatives that describe the effect on company investment decisions. To test the study hypothesis, 300 listed non-financial companies were selected during the period 2015-2021 from Pakistan stock exchange PSX. Study uses panel least square techniques as data is panel. Findings concluded that strong corporate governance of the listed corporation leads to higher impact on decision of investment and policy of dividend in manufacturing companies of Pakistan. Results of the study affirms that as firms higher the profit earnings and revenue more they have opportunity to higher the payout of profit to shareholders. The study's findings also showed that listed Pakistani companies have been compelled to offer investors lesser or no dividends despite the country's weak economic situation. The study also discovered that organisations with less robust corporate governance systems have less cash on hand. The fact that there is a correlation between dividend yield and corporate governance elements including ownership structures, board composition, the volume of annual disclosures, shareholder rights, etc. suggests that companies that employ corporate governance techniques pay greater dividends. The findings imply that businesses are able to pay dividends if they continue to make money and expand. The substitute model hypothesis is supported by this study's use of several governance characteristics, but no effect on the outcome is found.

Key word: Investment decision, policy of dividend, Panel least square, Corporate Governance, PSX

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1. Introduction

In recent period, researcher more focus on the role of corporate governance in financial decisions such as dividend policy and investment decisions remains unresolved. Firms either distribute profits to

shareholders or invest profits in profitable opportunities. Dividend is a part of money from profit of an organization distributed to the shareholders. They have interest in the organization regarding dividend and they must focus on all about the organization effort to the best for them. Several research offer contradictory information concerning this relationship.
In Australia, for instance, Yarram (2015) reports a positive relationship between corporate governance a s well as policy of dividend decision, but study from Brazil shows an inverse relationship by Atanassova and Mandellb (2018). In Malaysia, there is inconsistent data about structure of board of companies' governance in
addition dividend policy, according to Benjamin and Zain (2015) and Shehu (2015). These contradictor y results, according to Baker et al. (2019), could be the result of various research settings and methodolo gy. Dewasiri and Weerakoon (2016) claim that many research with a quantitative foundation use proxy variables to clarify abstract ideas. To measure corporate governance, Mehdi et al. (2017) used corporate structure dimension as a proxy factors.
The propensity to pay dividends or dividend payout are common metrics used by researchers to evaluate dividend policies (Yusof & Ismail, 2016; AlKayed, 2017; Guizani, 2018).

Previous studies, like Baker et al. (2019) and Dewasiri et al. (2019), addresses the breadth of dividend policy, which includes both the inclination to pay dividends and the distribution of those dividends. These efforts includes project they invest, percentage of dividend, growth in sales, assets, and spend on new developments. So this is more focus on last decades work more on dividends such as Berle and Means (1932) highlighted the power of corporate governance, wherever structure of share is comprises into a small number of shareholder who held shares in organization, but managers hold overall control of the company. So dividend is depend on the will of manager but now environment is change. Miller and Modigliani (1961) known as (MM) theorem, explain dividend with some assumptions and concluded that dividend is not relevant to change in price of the stock.

Following MM, several researchers have concentrated more on the business value's relevance and irrelevance. Many researcher found other theories regarding dividend such as Agency cost theory by Easterbrook (1984), trade-off theory by (Easterbrook, 1984), signalling theory by (Jensen, 1986), life cycle theory by (Grullon et al., 2002; Deangelo and Deangelo, 2006), and catering theory by (Easterbrook, 1984) (Baker and Wurgler, 2004a, b). DeAngelo and DeAngelo (2006, 2007) claims that firm value is change due to dividend is also a first-order firm value determinant, on similarity by investment decisions. When market is not perfect and different news and laws happen, they explain that companies decide to pay dividend to enhance firm future earning to improve to overwhelmed asymmetric content of information. If the amount of dividend financed internally then this is as an expense for both current and future investment and it also determine the future growth in earning. Now a day's more recent focus on this topic is relationship of corporate governance with dividend policy. But most of the study is related to developed countries. Firms' dividend policies and corporate governance characteristics have a substantial impact. Corporate governance includes the number of directors on the board, family members on the board, independent members, non-executive members, dual membership, and several committees under this umbrella. The board of directors has greater decision-making authority over the company, and their choices can either help the company succeed or cause it to fail.

La Porta et al. (2000) study on two proposed model and explain the relation between corporate governance and dividend of firms. The outcome model explains that fewer share holders have pressure on management to take a decision to pay higher dividend and decrease cash expense on investment.

They all factors have positive effect on firm. Independent directors play an important role deciding a dividend for a minority shareholder in the firms.

Jiraporn et al. (2011) also support this evidence and show that higher the number of independent directors more to pay dividend in US firms. The other model substitution forecasts that managers pay more dividends to build a good relationship with minority shareholders. Cae et al. (2009) examined that dividend has a negative effect on firm value when managers improve firms decisions regarding dividend and investments. Jiraporn and Ning (2006) show that dividend is negative relation with firm decision to pay dividend. So, may be expected that more number of meeting and independent directors tend to be lower dividend and vice versa. Research proof on the connection among the board independence, board assembly frequency and dividend payout, however, those effects are blended now no longer in a right shape to explain in nicely manners. Studies such (Al-Najjar and Hussainey, 2009; Setia-Atmaja, 2009b) recognition on board and dividend and among board assembly frequency and dividends (John and Knyazeva, 2006).In this study we include emerging market such as Pakistan stock exchange to focus more on corporate governance, ownership structure with dividend and investment decisions of firms. Previous studies more focus on developed market. This study also answers the following questions:

1. Does higher dividends results in lower board independence, more meetings, information shares, size of board member and vice-versa?
2. Does higher investments by firms management results in lower board independence, more meetings, information shares, size of board member and vice-versa?

Study follow outlined such as in section 2 provides pertinent literature as well as hypothesis development. Section 3 describes the sample and the methodology of the variables used. Section 4 contains the study's findings and a discussion of the findings. Section 5 concludes the paper with some quick concluding notes.

2. Literature review

Several hypotheses have been advanced to explain corporate dividend behaviour. Early studies concentrated on trade-off theory, agency costs, and signalling theory. Firm dividends are affected by agency charges. (Farinha, 2003; Jensen, 1986). In order to address conflicts of interest between investors and management, companies facing higher agency expenses can offer higher dividends. Many studies utilise the size of the company as a proxy for agency expenses. Because of the greater separation of ownership and control, larger organisations often face higher agency fees than smaller companies.

Several studies have been conducted to study the relationship between corporate governance and dividend policy, with CEO duality and/or board traits used as proxies to quantify corporate governance. (Zhang, 2008; Abor and Fiador, 2013; Mehdi et al., 2017). According to free cash flow theory, there is a positive relationship between corporate governance and dividend policy.

Coulton and Ruddock (2011) examine that Australian firm has more inclination of paying dividend rather than comparison with non-paying firms. Size of firms has act as proxy of asymmetric information to shareholders and managers. Small firms has pay more dividend to their shareholders and has share more information with illegal way to increase their market values. The size is mixed evidence and has either negative or positive impact on firm values and dividends decisions in Australian listed firms. As firm has more time of registered in exchange commission then this firm has more to pay dividend and has stable performance and growth. They also face less risk rather than those firms who have introductory stage (Grullon et al., 2002). This point is called life cycle theory of firm. The firms those hold more cash there may be a more chance to pay a dividend rather than investing in project (Farinha, 2003).

Gompers et al. (2003) initiated that a causal association among corporate governance factors and firms financial policy found interesting results. Many studies such as (Bebchuk and Cohen 2005) and Bebchuk et al. (2009) find that governance play an important role in USA listed firms.

Firms board structure may be influence more and significant positive impact on dividend payout ratio in USA country firms by (Jiraporn and Chintrakarn, 2009).

Kiel and Nicholson (2003) study the board size and company performance factors and a result suggests that there is positive relationship among size and performance. Board decision has a critical and they sometime has negative impact on company performance due to expectation of shareholders is indifferent.

Adams and Ferreira (2007) explain that more independent directors have good impact on company performance and able to do dividend decisions due to high level of free cash flow. Setia- Atmaja et al. (2009) establish that a positive association between board independent and payout decisions among firms listed in Australia during 2000-2005.

Donaldson (1990) assume a theory of stewardship and explain that if a board of director member has both chairman and chief executive office then there is a negative impact on dividend decisions. CEO duality has a negative relationship among no conflict between managers and shareholders. Studies such as Kulathunga et al. (2017) and Baker et al. (2019) investigate how corporate governance affects dividend policy in Sri Lanka and finds that negative association of corporate governance on dividend and investment decision of the firms.

Myers and Majluf (1984) submit that capital market rubbings will clue for the rivalry for firm resources, there may be a forcing factors that force to choose one option either to pay dividend or invest this amount in new projects. Mostly firm may try to balance the both dividend and investment decision but it depends on the current market situations.

Brav et al. (2005) studied the US firms through a survey method and find that managers decide emphasize more on investment in new projects and not to maintain the dividend. So this way noted that agent role is more and the separation principle due to direct effect of dividend on firm level of investment. So firm want to invest more rather than pay dividend to shareholders. DeAngelo and DeAngelo (2006, 2007)find that when firm has constant dividend and investment policy then there will be no effect on value of firms. This also leads close to Miller and Modigliani irrelevance theorem. Studies such as (Fama and French,2002; DeAngelo et al., 2004) indication that both dividend decisions and volatility of firm earning strong associated with time and cross sections with not cause found.

Al-Najjar and Hussainey, (2009) study the main and now a days more focus conflicting factors in many studies such directors independence with dividend and investment.

According to the "directors" independence criteria's genuine intent their research deepens new knowledge of the connection across payments of dividend and independence on boards Abdelsalam et al. (2018). Jiraporn and Chintrakarn (2009) study among dividends as well as his association with governance corporate structures and find the reason a weak relation with this dividend decision is explained. This is against of the studies such as previous authors explores (Al-Najjar and Hussainey, 2009; Leng, 2008; Abdelsalam et al., 2008).

Yap, (2012) study that importance of dividend stable policy in Japan and Malaysian stock exchange listed firms and find a positive significant effect on firms value.

Knyazeva, (2007), explain that as the number of board meeting increase the monitoring of board is expected to high. This leads the better performance of the firm due to high control; effective monitoring, monitoring and reporting the decision taken in the previous meeting must be accomplished. Laksmana (2008) examine that board meetings have a positive influence on the director's compensations and their decision about investments and dividends.

As number of board of director has independent plays vital role to decrease the agency problem cost and conflict among shareholders concept early made by some renowned authors such as (Jensen and Meckling, 1976).

(Abdelsalam et al., 2008; Farinha, 2003) explain that independent director has vast knowledge and higher number of years' experience in that environment so they have easily worked with management. They also have influence the director's quality of decisions, appreciations, deliver best direction of strategic decision and enhance more efficiency in the best of firm and shareholders (Ghosh, 2006; Zahra and Pearce, 1989). Many researchers argue that independent director serve for both but mainly to protect the right of minority shareholders (Setia-Atmaja, 2009a).

After some renowned study below are the hypothesis which can be tested on Pakistan stock exchange firm behavior during the period of 2015 to 2021.

Hypotheses Development

H1. Firms with higher number of information share with public have higher dividend and investment in Pakistan.

H2. Firms with higher board size have lower dividend but higher investment in Pakistan.

H3. Duality of the firms leads to lower impact on both decisions dividend and investment.

H4. Higher the total holders of share by corporation, lower dividend and investment policy in Pakistan.

H5. There is a positive relationship between cash flow and dividend and investment policy in Pakistan.

H6. There is a positive relationship between size and dividend and investment policy in Pakistan.

H7. There is a positive relationship between total number of shares and dividend and investment policy in Pakistan.

H8. Firms with boards of director that meet more frequently pay lower dividends but higher investment decision in Pakistan.

H9. Firms with higher proportion of independent directors pay lower dividends and more investment.

H10. There is a positive relation between company shares and both dividend and investment policy.

3. Research methods and data description

In this study we focus on Pakistan stock exchange listed firm behavior of corporate governance, ownership structure, size, free cash flow, and number of information shared with public on dividend, investment of firm. For this purpose we use secondary data using convenience sampling technique to select firms both Islamic and non-Islamic included. The data was taken from state bank of Pakistan website, Pakistan stock exchange website, and from different periods published annual reports of the companies because data is not available on one source of data stream. This study use date from the period of 2015 to 2021. So, data was consisting on both period and number of firms so this is in a panel data shape. So panel least square is utilized to find out the study hypothesis relationship. First we check the stationary of each variable then we compare our result with least square, fixed effect and random effect and then decide which one is appropriate for this data. The panel least square equation estimated is used to further analyse the hypotheses are:

Estimation Equation:

$$TDVD = \beta0 + \beta1*BOD + \beta2*Duality + \beta3*Meetings + \beta4*FCF\_1 + \beta5*Sheld + \beta6*Shares + \beta7*Size + \beta8*Indd + \beta9*Info + \mu$$

Estimation Equation:

$$Investment = \beta0 + \beta1*BOD + \beta2*Duality + \beta3*Meetings + \beta4*FCF\_1 + \beta5*Sheld + \beta6*Shares + \beta7*Size + \beta8*Indd + \beta9*Info + \mu$$

Here β0 is intercept while β are beta coefficients of the study

In this study dividend and investment was the dependent variable.

Independent variables were board of director size, firm size, number of meetings, cash flow, independent directors, total shares, total number of shareholders, duality of the directors and number of information share with public in a particular periods while

Explanation of the Variables

Meetings: Total meetings attended by the board members during the period

Independent Directors: Independent directors in the board members

Board Size: BOD =Maximum directors in the board of the corporation

Size: Log of the firm's annual sale during the period

FCF: Operating cash flow in a year t

Investment: Total investment of firm in a year

Duality: Board member who is also chairman and chief executive officer of firm

Share held =SHED Number of persons holding company shares

Independent Directors =Indd = Number of independent directors in the board

Shares = Total number of shares holding by company

Info: Total number of information such as dividend, profit, meeting announcement in a year **Dividend: TDVD=**Total dividend amount of firm in a year

4. Results and Findings

We apply panel regression model and estimate which one is well define our data. We compare the results of Regression least square, fixed effect model and random effect on our data. The output show that fixed effect model is appropriate for our data and both regression and random is not associated our study data. The findings of Hausman test prob value is less than 0.05 which shows that fixed effect model is appropriate. So based on Hausman test result, we reported the results of fixed effect model. Below output and their interpretation is given.

Table 1: Result FE Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	626316.3	555111.2	1.128272	0.2593
BOD	-48462.65	35271.65	-1.373983	0.1696
DUALITY	-75773.42	432954.9	-0.175015	0.8611
MEETINGS	-54008.21	23752.57	-2.273784	0.0231
FCF_1	0.091724	0.002083	44.03501	0.0000
SHELD	-3.21866	3.017903	-1.066522	0.2863
SHARES	0.097185	0.004908	19.80281	0.0000
SIZE	27030.98	12478.75	2.166161	0.0304
INDD	-40366.91	61398.34	-0.657459	0.5109
INFO	-2299.109	4885.496	-0.470599	0.638
Adjusted R-squared	**0.519357**	**F-statistic P. value**		**204.4305(0.00)**
Total panel (unbalanced) observations: 2825		**Cross-sections included: 404**		
Dependent variable: Dividend				

Substituted Coefficients:

TDVD = 776891.057929 - 47637.4392966*BOD - 138088.720591*DUALITY - 35480.2787898*MEETINGS + 0.0503512611402*FCF_1 - 2.07937779977*SHELD + 0.107261037543*SHARES + 7304.36957775*SIZE + 3708.14637313*INDD - 3219.11868408*INFO + Errors

The above results suggest that board size, duality, meetings, total shareholders, and number of information share with public have negative impact on dividend of firm decision but all non-significant relation with dividend only board meeting has significant relation. This also means if anyone independent increase then dependent will decrease by the coefficient value. In other hand cash flow, shares, number of holding shares, and size have positive relation and it means that any independent variable change in positive then dependent will also increase. Shares, cash flow and size has significant role and other has non-significant role on dividend.

This model explain variation in dividend 52% and remaining 48% variation was not explained by this model and may be other variable which is not taken in this study. The model is good fit and show dependent and independent has a good relation and there is chance of autocorrelation in the model.

Table 2: Result FE Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	135501.8	1393687	0.097225	0.9226
BOD	11858.46	88554.57	0.133911	0.8935
DUALITY	-477838.2	1086996	-0.439595	0.6603
FCF_1	0.253245	0.00523	48.42491	0.0000
INDD	378350.5	154149.4	2.45444	0.0142
INFO	-2158.972	12265.74	-0.176016	0.8603
MEETINGS	-24653.79	59634.24	-0.413417	0.6793
SHARES	0.061455	0.012321	4.987659	0.0000
SHELD	-2.224189	7.57688	-0.293549	0.7691
SIZE	9966.854	31329.7	0.318128	0.7504
Adjusted R-squared	0.492824	F-statistic P. value		183.9389(0.0000)
Total panel (unbalanced) observations: 2825		Cross-sections included: 404		
Dependent variable: Investment				

Estimation Equation:

TDVD = 776891.057929 - 47637.4392966*BOD - 138088.720591*DUALITY - 35480.2787898*MEETINGS + 0.0503512611402*FCF_1 - 2.07937779977*SHELD + 0.107261037543*SHARES + 7304.36957775*SIZE + 3708.14637313*INDD - 3219.11868408*INFO + Errors

Investment = 135501.78304 + 11858.4568236*Bod - 477838.187804*Duality + 0.253244513283*Fcf_1 + 378350.472075*Indd - 2158.97175232*Info - 24653.790973*Meetings + 0.0614548194789*Shares - 2.2241888073*Sheld + 9966.85419627*Size+ Errors

The above results suggest that duality, meetings, total shareholders, and number of information share with public have negative impact on dividend of firm decision but all are non-significant relation with investment. This also means if anyone independent increase then dependent will decrease by the coefficient value. In other hand board size, cash flow, shares, number of holding shares, and size have positive relation and it means that any independent variable change in positive then dependent will also increase. Shares, cash flow and independent directors has significant role and other size and board size has non-significant role on investment.

The secondary data analysis results show a favourable relationship between the index of structure of board of corporation and both the payment of profit to shareholder (dividend) willingness as well as payout ratio of dividend. As a result, the findings mostly similar with the previously researched conducted by the researcher with the dividend model of outcome rather than the substitute model, as reported in Australia by Yarram (2015), Yarram and Dollery (2015), and Shamsabadi et al. (2016), in

Brazil by Zagonel et al. (2018), in Ghana, Kenya, and South Africa by Abor and Fiador (2013), and in India by Roy (2015). To alleviate agency worries, the study's complimentary findings are largely consistent with agency theory. Furthermore, the positive relationship between policies of dividend (DPR and DY) with CG of corporation in favour of the free cash flow hypothesis by discouraging investments in projects with negative net present value and private advantages of control. Meanwhile, the studied results from Nigeria, Indonesia, Iran, and Malaysia find an opposite relationship between board governance and dividend policy and investment opportunity decisions in all studies: Abor and Fiador (2013), Setiawan and Phua (2013), Heidary and Jalilian (2016), and Benjamin and Zain (2015).

So the above output regarding dividend and investment decisions suggests that only H1 is rejected and not favor the firms of Pakistan and all other hypotheses have been accepted.

5. Conclusions

In this research, we have taken into account financial factors mentioned in literature of dividend as well as shareholder structure, firm related information announced and board characteristics (board size, board independence number of board meetings, number of yearly information shared with public FCF, total shares, total number of shareholders and role of duality) that are frequently discussed in writing about governance of board. This study employ panel regression model to test the hypothesis and suggests that both corporate dividend decisions and investment is critical and crucial decisions for firms board of directors. So we check empirically using firm data of board size, duality, independent directors, numbers of board meeting where they decide for future of the firm. They all have acting as firm benefits and also for shareholders. This study show that firm corporate governance more focus on investment in new projects or development of the old one but less focus on dividend paying decision. Managers want to maximize their firm value so best project is favorable for management to increase their wealth if they pay dividend then cash will decrease and may be firm will not be eligible to improve their values. This may affect negative on stock prices of firm due to interest of shareholders more on dividend rather than investing in new proposals.

Study results inputs for both publically listed firm that they can change their structure of governance and more flexible in the best of shareholders. Firm's governance decision may be negative impact on firm value so management should take action against them. The tax is also being avoided through investment decision rather than double taxation against dividend. Firm may add more members of foreign investor in board due to enhancing more investment from foreigners. This will lead better for the country and firms. Future research may be shareholder structure such as individuals, foreign share, institutions, board member and family shares for both financial and non-financial firms.

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