

## **OWNERSHIP STRUCTURE AND DIVIDEND PAYMENT OF NON-FINANCIAL COMPANIES IN SRI LANKA**

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### **ABSTRACT**

Shareholders are the principal of corporations, and they interest more in dividend decisions to receive a good return for their investment. Furthermore, dividend decision is a major device to alleviate agency problems between management and shareholders and between large shareholders and minority shareholders. The current study aims to understand the ownership structure of non-financial companies in Sri Lanka and to investigate its impact on dividend payment to realize whether to what extent the results contribute to mitigating agency problems. The independent variables comprise institutional ownership, managerial ownership, foreign ownership and ownership concentration representing ownership structure characteristics. Dividend payment is the dependent variable proxied by dividend per share. The study also selects firm size, profitability, and previous year's dividend payment as control variables. The study was carried out on an annual data of 72 non-financial companies for a period from 2015 to 2019. The descriptive statistics of ownership characteristics reveal the majority of institutional shareholders are Sri Lankan citizens and they are major and concentrated ownership while individual shareholders have minor ownership in non-financial companies in Sri Lanka. Management body has very little holding of equity shares. Results of fixed panel regression analysis show that ownership structure does not have a significant impact on dividend payment, but profitability and previous year's dividend payment evidence a positive relation. Dividend payment does not seem to be subjective to firm size. The results of the study are supported to mitigate the agency problems between managers and shareholders and between large shareholders and minority shareholders. The results are useful to policy makers, regulators and other corporate interested parties.

***Keywords: Ownership Structure, Dividend Payment, Non-Financial Companies, Agency Problems***

### **1. INTRODUCTION**

The primary objective of corporate finance is to maximize the shareholders' return which helps to attract existing and new shareholders to flow more capital funds into the corporation. Dividend decision is one of the corporate financial decisions, and it is much more supported than other corporate decisions to attract shareholders. Livereaf et al., (2014) specified that shareholders have no more interest in keeping their capital in such corporations under the unstable dividend policy. It shows that shareholders are more interested in dividend payout decisions than other corporate decisions. Further, dividend payment is a key device to mitigate the agency conflict

(Jensen 1986; Rozeff 1982; Tijjani & Bello 2019). Agency theory also describes that dividend is used by means of alleviating agency problems between shareholders and managers and between controlling shareholders and minority shareholders. Oh and Shin (2021) reported corporate governance plays a role as a control mechanism to solve or alleviate the agency problems. These studies attempt to understand the relationship between corporate governance, dividend payment and agency problems.

Shareholders and board of directors are two components of corporate governance. The board of director's act as an agent of shareholders by involving in all corporate decision makings. However, shareholders are the end decision makers to approve decision makings of the board at the annual general meeting. Shareholders are keen about managerial behavior as they may act for their personal benefits. Therefore, stakeholders have to understand the impact of ownership structure on dividend payment and whether it helps to mitigate the agency problems.

### ***1.2. Problem Statement***

In relation to Sri Lanka, Atchuthan, Karoshanth and Nirosan (2015) selected listed hotel and travel companies to examine the impact of ownership structure on dividend policy while Gunathilaka (2014), Gunathilaka and Gunaratne (2009) and Kulathunga and Azeez (2016) selected listed non-financial companies. One of the ways of classifying ownership structure is institutional ownership and individual ownership. The studies of Gunathilaka (2014) and Gunathilaka and Gunaratne (2009) found that institutional ownership has significant and positive relation with dividend policies. Kulathunga and Azeez (2016) found that institutional ownership has significant and negative relation with dividend policies while the study of Atchuthan, Karoshanth and Nirosan (2015) found that institutional ownership is insignificantly related with dividend policies. The individual ownership can be further classified as inside individual ownership (managerial ownership) and outside individual ownership (public ownership). The studies of Gunathilaka and Gunaratne (2009) and Atchuthan, Karoshanth and Nirosan (2015) found that managerial ownership is significantly and positively related with dividend policies while the studies of Gunathilaka (2014) and Kulathunga and Azeez (2016) found that it is significantly and negatively related with dividend policies.

The next way of classifying ownership structure is foreign ownership and domestic ownership based on the residence. The study of Atchuthan, Karoshanth and Nirosan (2015) selected foreign ownership as an ownership structure characteristic, and they concluded that foreign ownership is insignificantly related with dividend policies. In addition to above classifications, corporate annual reports also display large shareholding (ownership concentration) information under the title of top twenty shareholdings. The study of Kulathunga and Azeez (2016) only selected it as an ownership structure characteristic and found that ownership concentration is significantly and positively related with dividend policies.

All above studies concluded that very few studies examined the relationship between ownership structure characteristics and dividend payment in Sri Lanka. Furthermore,

the studies of Gunathilaka (2014), Gunathilaka and Gunaratne (2009) and Kulathunga and Azeez (2016) had provided mixed results between ownership structure characteristics and dividend payment in the sample of non-financial companies. Thus, as a beginning step to fill the research gaps within the non-financial companies, the current study was intended to investigate the impact of ownership characteristics on dividend payment decisions of non-financial companies in Sri Lanka and also to extend the findings to support to align the agency conflicts. Accordingly, the study attempts to address the research question of “to what extent ownership structure characteristics influence dividend payment decisions of listed non-financial firms in Sri Lanka”.

## 2. LITERATURE REVIEW

Shareholders are the ultimate judges of a corporation in the corporate performance success. Thus, it is a vital component in corporate governance. Various forms of ownership exist in today's modern corporations. Types of ownership structure are designed by the vision of the corporation. Many studies have examined the impact of ownership structure characteristics on dividend payment in both developed and developing countries. However, there are some research gaps for future studies.

One of the main ownership characteristics is institutional ownership which is the number of shares held by institutional investors including mutual funds, unit trusts, pension funds, banks, insurance companies, finance companies and other companies over the total number of shares outstanding in a company. Institutional investors are the large shareholders in Sri Lanka. They come from financial institutions having large amounts of money to invest in different corporations. Michaely and Shaw (1994) stated that institutional investors are better than individual investors because institutions are having more available resources and knowledge. Michaely and Shaw (1994) and Stouraitis and Wu (2004) stated institutional investors are not only monitor but also sometimes influence in corporate information but individual investors do not.

The literature of Jensen and Meckling (1976) acknowledged the relationship between ownership structure and dividend policy. They argued institutional investors and dividend payout are supported to control the agency cost and implied a negative relationship between both variables. However, Eckbo and Verma (1994) stated institutional shareholders prefer to distribute the free cash flow in the form of dividend to reduce the agency conflict between the management and shareholders. Thanatawee (2013) found institutional shareholding and domestic institutional shareholding have positive significant impact while foreign institutional shareholding has an insignificant relation with dividend payout in Thailand. The study of Al-Gharaibeh, Zurigat and Al-Harashseh (2013) found a positive significant impact of institutional ownership on dividend decision at partial adjustment model while it was a negative significant impact on dividend decision at full adjustment model in Jordanian firms. In Sri Lanka, the studies of Gunathilaka (2014) and Gunathilaka and Gunaratne (2009) found a positive significant relation between institutional

ownership and dividend policies and the study of Kulathunga and Azeez (2016) found a negative significant relation between institutional ownership and dividend policies while the study of Atchuthan, Karoshanth and Niroshan (2015) found an insignificant relation between institutional ownership and dividend policies.

The next ownership characteristic is managerial ownership. When managers have equity share investment, they may increase corporate performance due to the better alignment of the monetary incentives between the manager and other equity owners by best distributions of dividend and reduce management's scope in making unprofitable investments out of internal funds (Jensen 1986; Jensen & Meckling 1976; Fenn & Liang 2001). The study of Ahmed and Javid (2010) also revealed that as managers are stock owners, the free cash flow problem will eliminate and distribute more dividends since they are mutually interest with shareholders. Li and Zhao (2008) stated managers maintain higher dividend payout in management controlled firms.

Rozeff (1982) developed the cost minimization model for a regression of dividend payout ratio and selected inside and outside ownership as proxy of agency costs for the sample of 1000 US firms. The study found that insider ownership has a negative relation with dividend payout while outside shareholders has a positive relation with target payout ratio. Later Jensen (1986) and Jensen, Solberg and Zorn (1992) also found a negative relationship between managerial ownership and dividend policy in the US firms. The findings revealed that higher insider ownership has a smaller effect on reducing agency cost through dividend. On the other hand, Fenn and Liang (2001) forwarded a mechanism that was managerial ownership. Because of that, managers tend to act in the best interest of the firm and shareholders to eliminate the free cash flow problem toward distributing more dividends.

However, the study of Al- Gharaibeh, Zurigat and Al-Harashsheh (2013) found a positive significant impact of managerial ownership on dividend decisions at full adjustment model while it was a negative significant impact on dividend decisions at partial adjustment model in Jordan. In Sri Lanka, the studies of Gunathilaka and Gunaratne (2009) and Atchuthan, Karoshanth and Niroshan (2015) found a significant positive relationship between managerial ownership and dividend policies while the studies of Gunathilaka (2014) and Kulathunga and Azeez (2016) found a significant negative relationship.

Another ownership characteristic is concentrated ownership that plays an important role in corporate policies; especially in dividend payout policies. Because of that they are controlling shareholders by holding the majority of shares. Concentrated ownership / block-holders tend to hold at least 5% of the firm's stocks, and hence, they tend to be more concerned about the management decisions for the purpose of protecting their investments (Ullah, Fida & Khan, 2012). In Sri Lanka as well as some other countries, the institutional owners are the concentrated owners while they are capable of investing large amounts of money in shares. Fan and Wong (2002) stated that concentrated ownership is supported to mitigate the agency conflict between the

management and shareholders. However, it raises another problem between majority shareholders and minority shareholders while large shareholders are willing to implement their own interests.

Maury and Pajuste (2002) reported that large shareholders prefer lower dividend payment since the dividend is not needed as a monitoring tool, as block-holders are well symbolized on board and monitor management practices easily. Ramli (2010) conducted a study for the sample of 245 public listed non-financial companies in Bursa Malaysia and the study found the largest shareholder has around 40 percent of the company paid-up capital. Further, at random-effects to bit regression, the results revealed large shareholders and substantial holding of other large shareholders who have minimum 5 percent share capital, have a significant and positive impact on dividend payout while second largest shareholding has an insignificant impact on dividend payout. Thanatawee (2013) found a positive and significant relation of top large shareholders and top large institutional shareholders with dividend payout while five top shareholders have no significant relation with dividend payout in Thailand. In Sri Lanka, the study of Kulathunga and Azeez (2016) selected concentrated ownership and it had a significant positive relation with dividend policies.

Another ownership structure characteristic is foreign ownership which is the number of shares held by foreigners over the total number of shares outstanding in a company. It consists of foreign partners, foreign financial entities, foreign nationalities and those who do not inhabit Sri Lanka. Hussain and Nivorozhkin (1997) stated that firms with foreign ownership perform better than domestic ownership. Firms with foreign ownership have less rigorous financial constraints and more easily overcome financial distress (Bebczuk 2005). Further, this study stated foreign ownership is brought to their firms to pay higher dividends than domestically-owned companies due to the interest in recovering investments faster in economically and politically unstable countries. In Sri Lanka, nearly one fourth of companies are foreign dominated firms. However, in some countries more than half of the companies are foreign-owned firms.

Ullah, Fida and Khan (2012) found a significant positive relationship between foreign share ownership and dividend payout in Pakistan. Further, the study stated that foreign ownership has higher explanatory power than other two ownership types; managerial ownership and institutional ownership. In general, foreign investors prefer to invest in highly profitable firms. On the contrary, in Malaysian context, Mat nor and Sulong (2007) reported that ownership types namely ownership concentration, government ownership, foreign ownership and managerial ownership have low explanatory power on dividend and also revealed foreign ownership has an insignificant relationship with dividends in the year 2002, but it had a significant effect in 2005. However, the final result reported a negative significant effect of foreign ownership on dividend, and it fails to support the agency argument. Thanatawee (2013) found that foreign ownership and foreign institutional ownership are insignificantly related with dividend payout while foreign individual ownership has a negative significant relation with dividend payout in Thailand. Atchuthan,

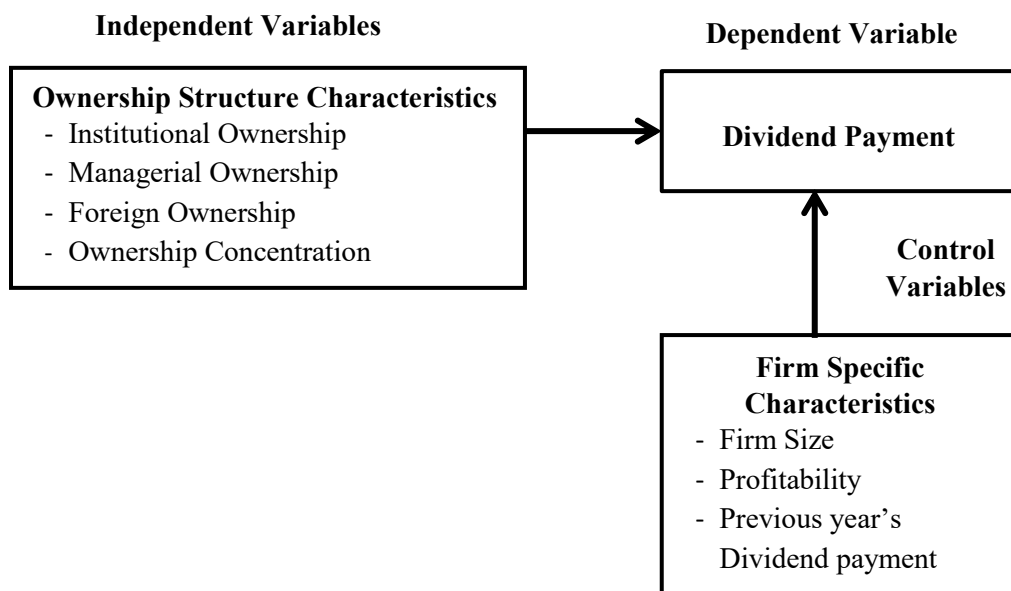
Karoshanth and Niroshan (2015) reported an insignificant relationship between foreign ownership and dividend policies in listed hotel and travel companies in Sri Lanka.

**3. METHODOLOGY**

To achieve the objectives, the study selected institutional ownership, managerial ownership, foreign ownership, and ownership concentration as ownership structure characteristics which were employed as independent variables. Dividend payment was employed as the dependent variable which was measured by dividend per share. In addition, the study selected firm size, profitability and previous years’ dividend payment as control variables. In Sri Lanka, there were ninety-six (96) listed non- financial companies paying dividends in regular intervals from 2015 to 2019. However, the study covered only seventy-two (72) companies due to data accessing problems. Ultimately, the panel data window consisted of 360 firm-year observations.

**3.1. Conceptual Diagram**

The study designed the following conceptual diagram to examine the impact of ownership structure characteristics on dividend payment of non- financial companies in Sri Lanka.



**Figure 1: Conceptual Diagram**

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### 3.2. Operationalization

The following measurements were used for the selected variables of the study.

**Table 1: Operationalization**

	Variables	Measures
Ownership Structure Characteristics (Independent variables)	Institutional ownership	Number of equity shares held by institutional investors including mutual funds, unit trusts, pension funds, banks, insurance companies, finance companies and other companies / Total number of equity shares outstanding
	Managerial ownership	Number of equity shares held by board of directors, managers, executives and their spouse and minor children of corporation / Total number of equity shares outstanding
	Foreign ownership	Number of equity shares held by non-resident / Total number of equity shares outstanding
	Ownership concentration	Number of equity shares held by shareholders who have at least 5% shareholding / Total number of equity shares outstanding
	Dividend Payment (Dependent variable)	Dividend per Share = Total amount of dividend paid for equity shareholders / Total number of equity shares outstanding
Firm Specific Characteristics (Control variables)	Firm size	Natural logarithm of total assets
	Profitability	ROE = Net income / Total equity fund
	Previous year's dividend payment	Previous Year's Dividend per Share = Total amount of dividend paid for equity shareholders in previous year / Total number of equity shares outstanding in previous year

**Sources:** Gunathilaka (2014), Atchuthan, Karoshanth and Niroshan (2015), Gunathilaka and Gunaratne (2009), Kulathunga and Azeez (2016), Al- Gharaibeh,



Zurigat and Al-Harabsheh (2013), Ullah, Fida and Khan (2012), Ahmad and Javid (2010), Xuan Trang (2012), Ehsan et al., (2013)

### Regression Model

The following panel regression model was developed with regards to the above conceptual model.

$$DP_{it} = \beta_0 + \beta_1 ISOWN_{it} + \beta_2 MNOWN_{it} + \beta_3 FOWN_{it} + \beta_4 OC_{it} + \beta_5 FS_{it} + \beta_6 PROF_{it} + \beta_7 PYDP_{it} + \varepsilon_t$$

Where,

DP = Dividend payment

ISOWN = Institutional ownership

MNOWN = Managerial ownership

FOWN = Foreign ownership

OC = Ownership concentration

FS = Firm size

PROF = Profitability

PYDP = Previous year's dividend payment

$\beta$  = Regression coefficient

$\varepsilon$  = Error term.

## 4. FINDINGS AND DISCUSSIONS

Table 2 presents descriptive statistics of the data window. It shows an average Rs.5.906 dividend was distributed by non-financial companies in Sri Lanka for each ordinary share over the sample period. The minimum value of dividend payment reveals all selected non-financial companies were distributed dividend in regular intervals over the sample period. The mean value of institutional ownership shows 76.8% of equity ownership was institutional shareholders in the non-financial companies of Sri Lanka. It is further explained that the remaining 23.2% of equity ownership was individual owners. In the mean value of individual ownership, 7.2% of equity shares were managerial owners while remaining 16% of equity ownership was outside individual ownership (public owners). The maximum value and minimum value of institutional ownership indicate none of the selected non-financial companies had fully controlled either by institutional owners or individual owners. However, many non-financial companies had a higher institutional shareholding while few selected non-financial companies' majority of shares was held by individual shareholders. It is consistent with the prior studies of Sri Lanka by Gunathilaka (2014), Gunathilaka and Gunaratne (2009) and Kulathunga and Azeez (2016). The minimum value of managerial ownership indicates Directors or CEO



(Executive Officers) of some selected companies did not hold any equity shares in their companies.

**Table 2: Descriptive Statistics**

<b>Variables</b>	<b>Mean</b>	<b>SD</b>	<b>Median</b>	<b>Max</b>	<b>Mini</b>
Dividend Payment	5.906	11.620	2.475	68.500	0.001
Institutional Ownership	0.768	0.235	0.851	0.993	0.037
Managerial Ownership	0.072	0.160	0.001	0.704	0.000
Foreign Ownership	0.242	0.315	0.064	0.987	0.000
Ownership Concentration	0.748	0.156	0.762	0.967	0.066
Firm Size	22.304	1.124	22.430	25.360	19.655
Profitability	0.189	0.314	0.125	3.685	0.075
Previous Year's Dividend Payment	5.639	11.177	2.000	68.500	0.000

Moreover, the mean value of foreign ownership reveals 24.2% of equity owners were foreigners while 75.8% of equity owners were Sri Lankan citizens. The minimum value indicates Sri Lankan citizens had fullest control in some non- financial companies. However, the foreigners had maximum control power about 98.7% which implies all non- financial companies had domestic ownership too. The mean value of ownership concentration reveals 74.8% of ownership of non-financial companies was concentrated owners who had at least 5% shareholdings in total equity shares outstanding. It suggests that the share ownership in Sri Lanka was highly concentrated (Gunathilaka & Gunaratne 2009; Kulathunga & Azeez 2016). Moreover, the mean value of institutional ownership and ownership concentration indicate concentrated institutional shareholders were the major shareholders of the non-financial companies in Sri Lanka. The maximum value of institutional ownership and foreign ownership reveal all selected non- financial companies had institutional, individual and domestic shareholders. Eventually, the profitability (ROE) had a mean value of 18.9%, which ranged from 0.075 to 3.685 at the standard deviation of 31.4%. Maximum return of non- financial companies was Rs.3.685 per Rs.1 of equity share.

As the next step, the study tested the stationarity of the data, multicollinearity problem and autocorrelation problem before running the regression model. The normality and heteroscedasticity problem were not tested here since the study used a panel data set. Gujarati and Porter (2009) stated normality and heteroscedasticity tests are not much necessary while the study covers cross and time series data.

The study used the panel unit root test to confirm the data set of all selected variables are stationary. The study employed four methods which were Levin, Lin & Chu  $t^*$ ,

Im- Pesaran and Shin W-stat, ADF-Fisher Chi-Square and PP-Fisher Chi-square. The results of the panel unit root test reported all selected variables are stationary at 1% significance level. Then, the study used collinearity diagnostic statistics to confirm no strong correlation between independent variables. The statistics confirmed the absence of strong correlation (no multicollinearity) between selected independent variables including control variables since tolerance and VIF of all selected variables were greater than 0.1 and less than 5 respectively. The autocorrelation result is presented under the regression results in table 4. The Durbin-Watson value was 1.530 which lies within the acceptable range of 1.5 and 2.0. It reveals that there was no autocorrelation problem in the data set used in the regression equation.

All of the above pre-testing of the regression model had confirmed that the study can run the regression model with all selected variables to investigate the impact of ownership structure characteristics on dividend payment of non- financial companies in Sri Lanka and to understand whether the findings support the agency problems. Thus, as the next step, the study presents result of Hausman test and Wald test in table 3 to select the appropriate regression model among fixed effect model, random effect model and pooled effect model for the panel data set. Then, finally the study presents result of panel regression analysis of selected regression model in table 4 to examine the objectives of the study.

**Table 3: Results of Hausman Test and Wald test**

Test type	Test statistic	Degree of freedom	P-value	Test result
Hausman test	154.454	7	0.000	Fixed effect model
Wald test (F-statistics)	140.911	(7, 352)	0.000	Fixed effect model

Table 3 shows statistics of Hausman and Wald tests are significant at 1% significance level. Thus, it reveals the fixed effect model was better than the random effect model and pooled effect model to investigate the objectives of the study. Thus, the following table 4 shows the results of panel regression analysis of fixed effect model for the hypotheses testing.

**Table 4: Results of Fixed Effect Regression Analysis**

Variables	Coefficient	P-value
Constant	-32.794	0.2272
Institutional Ownership	-1.299	0.7133
Managerial Ownership	1.909	0.7372
Foreign Ownership	4.662	0.4018
Ownership Concentration	-2.774	0.5803
Firm Size	1.728	0.1674
Profitability	6.517	0.0149

Previous Year's Dividend Payment	0.132	0.0325
R-squared	0.833	
Adjusted R-squared	0.787	
F-statistic	18.027	0.000
Durbin-Watson stat	1.530	

Table 4 shows that F-value is 18.027 with a significant at 1% significance level. It was statistically concluded that the selected regression model was fit to investigate the objectives of the study. The value of adjusted R Square is 0.787. It was statistically concluded 78.7% of the variation in the dividend payment (dividend per share) was explained by ownership characteristics and control variables after adjusting to sample size and number of independent variables. Further, the remaining 21.3% of the variation in the dividend payment was attributed to other variables which were not considered in this study.

The coefficients of institutional ownership, managerial ownership, foreign ownership and ownership concentration were insignificant at 5% significance level. Thus, it was revealed none of the ownership characteristics has a significant impact on dividend payment of non- financial companies in Sri Lanka. Furthermore, the coefficients of profitability (ROE) and previous year's dividend payment were significant at 5% significance level and positive impact on current dividend payment while the coefficient of firm size was insignificant at 5% significance level.

## 5. CONCLUSIONS

The coefficients of all selected ownership characteristics revealed ownership structure has no significant impact on dividend payment of non- financial companies in Sri Lanka. Furthermore, the mean values of descriptive statistics reported that the majority of institutional shareholders were Sri Lankan citizens and they were major and concentrated shareholders while managerial and outside shareholders were minor shareholders in non- financial companies in Sri Lanka in the sample period. Thus, the findings further reveal large and minor shareholders had no significant impact on dividend payment of non- financial companies in Sri Lanka. Thus, the results concluded ownership structure was not an important variable in dividend payment decisions of non-financial companies in Sri Lanka in the sample period of the study. The findings are consistent with findings of Atchuthan, Karoshanth and Niroshan (2015) which also found institutional and foreign ownership were insignificant relation with dividend per share of hotel and travel companies in Sri Lanka. The findings are inconsistent with findings of Kulathunga and Azeez (2016), Gunathilaka (2014) and Gunathilaka and Gunaratne (2009) which found ownership characteristics had a significant impact on dividend policies of non-financial companies in Sri Lanka. However, in foreign context, the findings are consistent with findings of Xuan Trang (2012) and Ramli (2014) which also reported ownership characteristics were insignificant in dividend decisions. The findings of selected control variables are consistent with findings of Ahmed and Javid (2008) and Mirzaei (2012) which found profitability and previous year's dividend were significant and positive impact on

dividend policy, Ehsan et al., (2013) which found firm size was insignificant impact and profitability was significant and positive impact on dividend policy. The findings are inconsistent with findings of Gunathilaka and Gunaratne (2009) and Gunathilaka (2014) which found profitability and lagged dividends had a significant and negative impact on dividend policies of non- financial companies in Sri Lanka.

The results of the study concluded that with insignificant impact of ownership structure, non- financial companies in Sri Lanka increase (or reduce) dividend payments with increase (or decrease) of net earnings and previous year's dividend payments. The findings of the study support to mitigate the agency problems between shareholders and managers and between large shareholders and minority shareholders in non- financial companies in Sri Lanka since the ownership structure had no significant impact on dividend payment.

The future studies can apply the same conceptual framework in financial companies and comparative studies between financial companies and non- financial companies. Furthermore, the future studies can do the sector wise comparison or country wise comparison. The future studies can examine objectives of current study in all listed dividend paying and non-paying non-financial companies. The sample period of current study was restricted to five years from 2015 to 2019 due to the unavailability of disclosed information for the early years as it is not compulsory to disclose. Thus, the future studies can increase the sample periods from collecting annual reports by direct visit to the companies to provide more reliable results. The current study used the panel regression model. Thus, the future studies can be applied to various methodologies such as full adjustment model, partial adjustment model, earning adjustment model.

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