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THE INFLUENCE OF THE CEO AND THE LARGEST SHAREHOLDER ON DIVIDEND PAYOUT POLICY IN THAILAND

Abstract:

In a setting of weak law enforcement and low investor protection, minority shareholders may find it difficult to extract cash from a company. This paper examines whether or not the CEO and the largest shareholder affect dividend decisions. Using a sample of Thai firms, I find that the CEO tenure and the ownership of the largest shareholder increase the likelihood of a dividend payout. As a result of high commitment and incentives, CEOs and the largest shareholder use dividend payments as a mechanism to mitigate free cash flow problems and reduce potential expropriation of minority shareholders. In addition, the possibility of a dividend payout decreases if firms are controlled by domestic financial institutions. Domestic financial institutions seem to play a significant role in monitoring management teams; consequently, the need for a dividend payment in alleviating agency costs is lower than other firms. Moreover, firms are more likely to pay dividends when they have higher profitability and a lower leverage ratio.

Keywords:

Dividend, CEO, large shareholder, agency costs, Thailand

JEL Classification: G30, G35

Introduction

Prior research documents that the relationship between the principal and the agent determines the dividend payout policy of firms around the world (Goyal and Muckley, 2013; Truong and Heaney, 2007). The possibility that a firm will pay dividends is related to agency problems. The dividend is paid as a result of lower agency costs and better corporate governance (La Porta et al., 2000). The dividend payout policy is likely to be different between firms because of the influence of CEOs, who are involved in the company's decision making. In a setting of ownership concentration, the largest shareholder would generally have sufficient incentive to control and monitor the firm's management. The largest shareholder would be able to influence the dividend decision by exercising their rights.

The objective of this study is to investigate whether a CEO and the largest shareholder have an influence on the dividend payout policy, focusing on the incentives of CEOs and the identity of the largest shareholder. In response to concern about expropriation of (minority) shareholders during the 1997 Thai financial crisis, I doubt that a CEO and the largest shareholder intend to resolve poor corporate governance in the wake of the crisis.

Using non-financial firms listed on the Stock Exchange of Thailand, what factors determine the possibility that a firm will pay dividends is investigated using a Probit model? The results show that CEO tenure and the ownership of the largest shareholder increase the likelihood of dividend payout. The longer-tenured CEOs have greater incentive to alleviate agency problems, thus they are willing to pay dividends to shareholders. Moreover, an increase in ownership of the largest shareholder leads to a greater incentive to distribute free cash flow to all shareholders and to lessen conflicts of interest, thus leading to a stronger influence on dividend payouts. In addition, the likelihood of dividend payout declines if a domestic financial institution is the largest shareholder of firms, implying that domestic financial institutions could play an efficient monitoring role in reducing agency costs so that the payment of dividends is no longer necessary to mitigate agency problems. More profitable and lower leveraged firms are more likely to pay dividends.

This study contributes to various aspects of the literature. Firstly, previous work examines the impact of the largest shareholder and dividend policy (Truong and Heaney, 2007). In addition to the role of the largest shareholder, I also investigate in this study whether a CEO, as the agent of shareholders, affects the likelihood that a firm will pay dividends. Secondly, the results of this study provide an understanding about dividend policies of Thai firms and complement prior single-country studies, such as Austria (Gugler, 2003), Germany (Goergen et al., 2005), China (Su et al., 2014; Chen et al., 2005), Jordan (Al-Malkawi, 2008) and Egypt (Abdelsalam et al., 2008). Thirdly, the 1997 Thai financial crisis cast some doubts that CEOs and large shareholders attempt to pursue their own interests, resulting in agency costs and poor firm performance (Pomerleano, 1998). This study provides additional evidence to reflect the role of CEOs and the largest shareholder in mitigating agency problems.

The results suggest that CEOs and the largest shareholder of Thai firms do not expropriate minority shareholders.

Literature Review

According to agency theory, dividend payout could reduce agency problems between shareholders and managers or between controlling shareholders and minority shareholders (Jensen, 1986). Distributing free cash flow to shareholders limits a possibility of investing in unproductive projects and expropriation by managers. A dividend payment is therefore preferable to earnings retention because it reduces the free cash flow available for managers to over-invest. When the interests of managers and shareholders are aligned, free cash flow problems are likely to decrease. Hence, the decline in agency costs could result in a higher possibility that a firm pays dividends.

Agency theory explains that a longer tenure gives CEOs greater commitment and incentives to maximize shareholder wealth (Hambrick, 1991). Thus, the length of CEO tenure is likely to reduce agency costs. However, a longer tenure may induce CEOs to be entrenched and to pursue their own interests (Kaplan and Minton, 1994; Yermack, 2004). If longer tenured CEOs act as good agents for shareholders, they would be willing to minimize free cash flow problems, resulting in a greater possibility of dividend payout.

CEOs would have interest alignment with shareholders when they are company shareholders. CEO ownership would then help reduce conflicts of interest between managers and shareholders (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). Higher CEO ownership provides incentives for CEOs to increase shareholder wealth and to share the company's free cash flow with all shareholders. It is likely that an increase in CEO ownership will lead to a greater possibility of dividend payout.

Prior research documents that CEO duality provides the power and leadership to managers to achieve the best stewardship role, enhancing firm efficiency and firm performance (Donaldson and Davis, 1991; Stoeberl and Sherony, 1985). However, CEO duality raises a concern about corporate governance because the dual role as chairman and CEO could affect their monitoring and leadership roles. The effect of CEO duality on agency costs is still unclear (Chen et al., 2008; Rashid, 2013). If the presence of CEO duality is detrimental to firms and increases agency costs, it could therefore decrease the possibility of dividend payout.

Individual investors like to receive cash dividends (Dong et al., 2005). However, it is difficult for minority shareholders to influence dividend policy. Previous research documents that large shareholders have an impact on dividend policies (Su et al., 2014; Truong and Heaney, 2007; Pindado et al., 2012). The high ownership percentage of large shareholders provides considerable control and power over a company's financial decisions. The dividend payout policy could be influenced by the largest shareholder through their voting rights to reduce private consumption of firm management and to mitigate agency costs. Also, the largest shareholder could force

the management team to pay dividends to show that he/she has high commitment to minority shareholders. The higher ownership proportion of the largest shareholder provides a greater incentive to exert their control to increase shareholder wealth. Thus, the ownership percentage of the largest shareholder may positively affect the probability that a firm will pay dividends.

In addition, the largest shareholder may act as an effective monitor to improve corporate governance and lessen the possibility of expropriation. They may not have to use dividend payout in controlling agency problems. For example, the presence of institutional investors enhances monitoring effectiveness; consequently, dividend payments may not be required in reducing agency costs (Easterbrook, 1984; Goergen et al., 2005). The identity of the largest shareholder may reflect good governance mechanisms. It is possible that the largest shareholder could affect the likelihood of dividend payout.

Data and Methodology

The sample firms are non-financial firms listed on the Stock Exchange of Thailand between 2001 and 2005. This sample period represents a normal economic period after the 1997 Thai financial crisis and before the more recent uncertainties in the global economy, Thai political turbulence and the revision of Thai accounting standards.¹ Financial and ownership data are collected from the SETSMART database and CEO data is from 56-1 forms that all listed firms have to submit to the Stock Exchange of Thailand.

To estimate the possibility of dividend payout, I use a Probit model as shown below.

$$\text{Probability (Connection)} = \Phi(\beta x) \quad (1)$$

where x is a vector of independent variables and Φ is the standard normal cumulative distribution function. The dependent variable is a dummy variable that is equal to 1 if a company pays a dividend in that year. The independent variables are defined as follows. Lagged Tobin's ratio is a ratio of the market value of total assets to the book value of total assets in the previous year. ROA is the ratio of earnings before interest and tax to total assets. Lagged leverage ratio is the ratio of long term debt to total assets in the previous year. CEO tenure is the number of years a CEO is in office. CEO ownership is the shareholding of the CEO. CEO duality is a dummy variable that is equal to 1 if the CEO holds a chairman position, and zero otherwise. Ownership of the largest shareholder is the ownership percentage of the shareholder with the highest shareholding. The large shareholder must hold a shareholding of at least 10% to reflect sufficient power.² The largest shareholder is a dummy variable that is categorized into six groups as follows: 1) a family, 2) a group of unrelated

¹ The political instability has affected the Thai economy and stock market since the coup announcement in 2006. The US 2008 financial crisis greatly hits the Thai stock market and, more importantly, accounting standards in Thailand are revised starting from 2009. The revised standards affect financial reporting of Thai listed firms and their financial and accounting data are not comparable to previous years (a period of 2001-2008), such as assets, sales, equity and profit.

² I follow La Porta et al. (1999) and Claessens et al. (2000) in defining a large shareholder.

families, 3) the government, 4) a domestic financial institution, 5) foreign investors and 6) foreign financial institutions. Financial variables are winsorized at 5% and 95%.

Empirical analyses

Table 1: Descriptive statistics

Variables	Mean	Standard deviation	Median	Minimum	Maximum
Lagged Tobin's Q ratio	1.132	0.495	0.995	0.520	2.426
ROA	0.084	0.073	0.084	-0.062	0.230
Lagged leverage ratio	0.335	0.198	0.305	0.071	0.755
CEO tenure	6.682	5.244	6.000	0.000	47.000
CEO ownership	0.066	0.115	0.008	0.000	0.709
CEO Duality	0.237	0.425	0.000	0.000	1.000
Ownership of the largest shareholder	0.417	0.207	0.425	0.000	0.956

Table 1 shows descriptive statistics of firm characteristics and the main variables used in this study. On average, the Tobin's Q ratio in the previous year of these sample firms is 1.132, implying good investment opportunities. The mean value of return on assets (ROA) is 8.4%; while that of the leverage ratio in the previous year is 33.5%. The average CEO tenure is 6.68 years and CEOs of Thai listed firms, on average, hold 6.6% shareholding. Approximately 24% of firms allow CEOs to be the chairman of the board of directors. The largest shareholder of Thai listed firms has an average ownership of 42%.

Table 2 reports the results of the Probit model of the determinants of dividend payout. The coefficients of continuous variables show the marginal effects of a one unit change from the mean of each independent variable and those of dummy variables demonstrate the discrete change on the probability of dividend payout. Model (1) in Table 2 shows that profitability is a major factor determining dividend policy. Consistent with previous research, the possibility of dividend payout is positively related to ROA (Su et al., 2014; Denis and Osobov, 2008). I also find that highly leveraged firms are less likely to pay dividends, which is similar to the results of Al-Malkawi (2008) and Truong and Heaney (2007). The effects of ROA and the lagged leverage ratio on dividend payout are held in models (2) – (9). Only in model (1), the lagged Tobin's Q ratio is marginally related to the probability of dividend payout. An increase in the Tobin's Q ratio, as an indicator of investment opportunities, reduces the likelihood that a firm will pay dividends. However, the results are insignificant in other models.

Table 2: The influence of CEOs and the largest shareholder on dividend payout

Likelihood of dividend payout	(1)	(2)	(3)
Lagged Tobin's Q ratio	-0.037 *	-0.030	-0.033
	(0.096)	(0.190)	(0.144)
ROA	3.133 ***	3.071 ***	3.059 ***
	(0.000)	(0.000)	(0.000)
Lagged leverage ratio	-0.697 ***	-0.706 ***	-0.697 ***
	(0.000)	(0.000)	(0.000)
CEO tenure		0.011 ***	0.012 ***
		(0.000)	(0.000)
CEO ownership		0.071	-0.035
		(0.583)	(0.791)
CEO Duality		0.029	0.040
		(0.405)	(0.240)
Ownership of the largest shareholder			0.215 ***
			(0.003)
Year dummy	Yes	Yes	Yes
Industry dummy	Yes	Yes	Yes
Number of observations	1,284	1,284	1,284
Wald chi-square (13)	289.6	307.88	306.77
Prob > chi-square	0	0	0
Pseudo R ²	0.288	0.298	0.304

* Indicates significance at level of 10%.

*** Indicates significance at level of 1%.

Model (2) examines whether the characteristics of CEOs determine the dividend payout policy. The results show that the coefficient of CEO tenure is significantly positive (at the 1% level), while other CEO factors do not determine dividend policy. In fact, the effect of CEO tenure on the probability of dividend payout is held in models (3) – (9). The longer the CEO tenure, the greater is the likelihood that a firm will pay dividends.

The finding of model (3) shows that ownership of the largest shareholder influences dividend payments. The greater the ownership of the largest shareholder, the greater is the propensity of dividend payout. The positive effect of ownership levels of the largest shareholder on dividend policy remains significant at the 1% level in models (4) – (9).

The results of models (4) – (9) show the effect of the identity of the largest shareholder on dividend payout. Only domestic financial institutions in model (7) influence firms to pay dividends; while other types of largest shareholder do not affect dividend payout policy. The coefficient of the domestic financial institution dummy is negatively related to the likelihood of dividend payments at a significance level of 1%. This result is consistent with Goergen et al. (2005).

Table 2: Cont.

Likelihood of dividend payout	(4)	(5)	(6)
Lagged Tobin's Q ratio	-0.033 (0.150)	-0.033 (0.148)	-0.033 (0.145)
ROA	3.051 *** (0.000)	3.041 *** (0.000)	3.046 *** (0.000)
Lagged leverage ratio	-0.696 *** (0.000)	-0.696 *** (0.000)	-0.705 *** (0.000)
CEO tenure	0.012 *** (0.000)	0.012 *** (0.000)	0.013 *** (0.000)
CEO ownership	-0.019 (0.890)	-0.022 (0.870)	-0.026 (0.844)
CEO Duality	0.040 (0.247)	0.038 (0.267)	0.041 (0.229)
Ownership of the largest shareholder	0.217 *** (0.003)	0.211 *** (0.004)	0.210 *** (0.004)
Family	-0.013 (0.652)		
A group of unrelated families		0.049 (0.354)	
The government			0.081 (0.241)
Year dummy	Yes	Yes	Yes
Industry dummy	Yes	Yes	Yes
Number of observations	1,284	1,284	1,284
Wald chi-square (13)	307.23	308.71	309.37
Prob > chi-square	0.000	0.000	0.000
Pseudo R ²	0.304	0.305	0.305

* Indicates significance at level of 10%.

*** Indicates significance at level of 1%.

Table 2: Cont.

Likelihood of dividend payout	(7)	(8)	(9)
Lagged Tobin's Q ratio	-0.036 (0.120)	-0.033 (0.143)	-0.033 (0.144)
ROA	3.092 *** (0.000)	3.060 *** (0.000)	3.059 *** (0.000)
Lagged leverage ratio	-0.704 *** (0.000)	-0.696 *** (0.000)	-0.698 *** (0.000)
CEO tenure	0.012 *** (0.000)	0.012 *** (0.000)	0.012 *** (0.000)
CEO ownership	-0.048 (0.720)	-0.025 (0.857)	-0.035 (0.790)
CEO Duality	0.036 (0.299)	0.039 (0.250)	0.040 (0.241)
Ownership of the largest shareholder	0.214 *** (0.003)	0.211 *** (0.004)	0.215 *** (0.003)
Domestic financial institutions	-0.324 *** (0.000)		
Foreign investors		0.012 (0.748)	
Foreign financial institutions			-0.001 (0.989)
Year dummy	Yes	Yes	Yes
Industry dummy	Yes	Yes	Yes
Number of observations	1,284	1,284	1,284
Wald chi-square (13)	306.63	307.31	307.33
Prob > chi-square	0.000	0.000	0.000
Pseudo R ²	0.308	0.304	0.304

* Indicates significance at level of 10%.

*** Indicates significance at level of 1%.

Conclusion and Recommendations

CEOs and the largest shareholder use dividends to mitigate agency problems. The longer the CEO tenure and the greater the ownership of the largest shareholder, the greater is the likelihood of dividend payout. While domestic financial institutions are effective in reducing the expropriation of shareholder wealth, firms controlled by them are less likely to pay dividends.

If minority shareholders are concerned about potential expropriation, they should invest in firms that are run by long-tenured CEOs, firms where the largest shareholder holds a substantial ownership percentage, or firms that are controlled by a domestic financial institution. The findings also suggest to the firm's management that the largest shareholder with a high ownership percentage prefers dividend payments to earnings retention. The largest shareholder considers dividends as a controlling

mechanism to alleviate agency problems, to maximize all shareholders' wealth and to develop a reputation for providing minority shareholders fair treatment. Longer-tenured CEOs seem to have greater commitment to firms and, as a result, they influence dividend payments in the interests of shareholders.

Financial factors are also major determinants of dividend payout in Thailand. Like firms in other emerging markets, Thai firms are more likely to pay dividends when they generate higher profits (or have more free cash flow) and when they do not have to maintain high free cash flow to pay for their financial obligations (Denis and Osobov, 2008; Al-Malkawi, 2008; Su et al., 2014; Abdelsalam et al., 2008).

The findings suggest that there is no evidence showing that the CEOs and large shareholders of Thai firms exploit their interests at the expense of minority shareholders during the normal economic period. However, policy makers should encourage other types of largest shareholder to play a monitoring role similar to domestic financial institutions in preventing the possibility of expropriation.

This study yields additional evidence to the literature; however, there is room for further investigation. Future research on the role of the board of directors and other external monitoring mechanisms in reducing agency costs could be investigated. Interestingly, I do not find a difference in the likelihood of dividend payout between family and non-family firms. Claessens, Djankov, Fan, & Lang (2002) argue that, in family firms, managers (who are typically members of the controlling family) have more opportunity to extract corporate assets for their own (or family) interests. The effect of family owners on investment policy could be further examined to understand their role in managing the company's free cash flow.

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