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Agency Problems, Product Market Competition and Dividend Policies in Pakistan

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Abstract
The present study investigates the influence of product market competition on the dividend policies of the listed companies at KSE 100 index in Pakistan. It identify whether product market competition mitigates agency problems between controlling shareholders and minority shareholders. In particular, we examine firm dividend policies in competitive market, the study use three statistical measures for the analysis of 30 textile firms. The result shows that the product market competition have no significant impact on dividend policies of Pakistan. This study recommends that the product market competition can be an effective tool that can force the managers to give cash to shareholders.
Keywords: Agency Problem, Dividend Policy, Corporate Governance, Product Market Competition, Textile Industry

Introduction
Cash dividend is the most important gauge that the investors can use to evaluate the financial health of the company. Investors earn cash from their stock investment without having to sell them. Dividends are not only the source of generating income but they also signal an impression that investing in company will be profitable for them. Dividend policy of the firm is basically the decision of the management to pay out cash to shareholders either in shape of cash dividend or a share repurchase. Age of corporation, Extent of share distribution, Trends of profits, Need for additional capital, changes in Government policies, Business cycle, Type of industry, Taxation policy, Future requirements and Cash balances are the important factors that decide the dividend policy. But Agency Problem is one of the most important determinants of corporate dividend policy.

Agency problem arises when there is a conflict of interest between the management and the shareholders. It has been observed that dividend payment is a great solution to the agency problems. Minority shareholders and the investors receive the dividend which basically depends upon how the country's regulations and company's corporate governance force the manager to distribute cash. Bartram et al., (2012) explain that poor corporate governance and agency problem intensity force the company to pay the smaller cash dividends. It has also been proved that Minority shareholders have to face the cost of agency conflicts and the market forces which force the corporate insider to make dividends are in the best interest of the shareholders.

Another important phenomenon is product market competition. Firms are competing with each other for the attainment of some common standard goals. We basically have the aim to check how the agency problems and perfect market competition affect the cash dividends.

We study with the perspective of Pakistan and investigate is product market competition, an easily specialized market mechanism that can force the company to pay cash dividend. In a country like Pakistan, where there is a political instability, poor laws and regulations regarding protecting the rights of shareholders of corporations, weak corporate governance, rigid agency conflicts, it becomes very important to test the impact of market competition on corporate dividend policy and define the ways to extract the dividend from the corporations (Allen and Gale, 1999).

Grullon and Michaely (2007) suggested that extreme product market competition will compel the managers to give cash because it increases the overinvesting and risk for two reasons:

i. Overinvesting in the projects having negative NPV, will make the firm less competitive and disturb the repute of the firm in the industry.

ii. High competition provides better opportunities to the investors to compare the performance of different firms competing in the market.

Grullon and Michaely (2007) examined agency conflicts between Shareholders and Managers primarily, but it might be possible it has the same influence and application on Controlling and Minority shareholders.

We study the effect of product market competition on dividend policy in Pakistan. We select the study in the Pakistani market because it fails to protect the right of the shareholders and having severe intensity of agency conflicts.

In Pakistan the major businesses are controlled by a family, which often assign an apex manager. Therefore, Pakistani managers mostly represent the interest of controlling shareholders. It has been observed that the managers and the controlling shareholders are involved in misappropriations of company accounts for their own interest. Therefore there should be such a mechanism of corporate governance that minimizes agency conflicts between the shareholders and managers. The same is the case with controlling shareholders and minority shareholders for reducing the agency conflicts. At the end we anticipate finding that Pakistani firms have fewer agency conflicts in competitive markets and pay more cash dividends to minority shareholders.

The most of the study in Pakistan is done basically on the determinants of dividends and effect of the dividend policy on shareholders wealth. The objective of the study is to investigate whether the product market competition an important factor that influence the cash dividend of the corporations. This research contributes in the area of the Finance.

The study is further divided into different sections. Chapter two is of Literature Review. Chapter three includes Data and Research Methodology. Chapter four discusses Results and discussion and at the end chapter five is based on conclusion and future directions.

Literature Review

Theoretical Review

The literature on dividend policy is based on some basic theories. The first and most important theory which is presented by Miller and Modigliani (1961) relates to dividend irrelevance hypothesis.

Dividend Irrelevance Theory

The dividend irrelevance theory describes that any payment of cash dividend have little or no impact on share price. Modigliani and Miller approach is based upon basic assumptions of a perfect capital market and rational investors.

Bird in Hand Theory

Gordon, Paradis, and Rorke (1972) present a theory in contrast with Modigliani and Miller, which assumes that investors are indifferent to whether their returns from holding a share arise from dividends or capital gains. Moreover they state that dividend payments are relevant for the valuation of the firms.

Tax Preference Theory

The basic assumption of this theory is difference in tax treatment between capital gains and dividend taxes exist and affect the value of the firm and dividend policy. In real life there is often a differential in tax treatment between dividends and capital gains, because most of the time investors are interested in after-tax return. It has also been assumed that rate of tax on dividend is high as compare to the capital gains.

Agency Theory

Agency theory is concerned with resolving problems that can exist in agency relationships. Agency theory describes the basic problem in the organizations. Manager working on behalf of the shareholders focus on their personal goals rather than group goals. So, there is a conflict of interest between these two groups.

Dividend Signaling Theory

This theory suggests that a dividend announcement by a company gives a positive signal about the company and its increased future earnings. It also creates a positive image of the company regarding stability growth and shareholders satisfaction.

Empirical Review

He (2012) examines whether product market competition mitigates agency conflicts between minority shareholders and controlling shareholders in Japan. In a huge sample of Japanese firms, he analyze that firms in industries where competition is very much extensive pay more dividends as compare to the less competitive industries. Moreover, the effect of firm-level agency problems on cash dividends is less affective in highly competitive industries. The results indicate that product market competition is a useful control Instrument at industry level that can force managers to pay cash dividend to shareholders.

Grullon and Michaely (2007) analyzes whether product market competition influence managers' policy to give cash dividends to shareholders. There is a positive relationship between the corporate payouts and industry competition. They suggest that firms in more concentrated industries have considerably lesser payout ratios than firms in less concentrated industries. They also find that there is a stronger impact of product market competition on cash dividends for the firms having the high agency cost. They state that a strong legal system put a pressure on controlling shareholders to give out excess cash to minority shareholders.

Obembe, Imafidon and Adegboye (2014) investigate the influence of product market competition on cash dividends. They use the pooled ordinary least square regression model (OLS). The results show that market competition is positively correlated with dividend policy. The market competition has negative influence on the dividend payout of Nigerian firms. The profitability and firm size have positive and significant influence on the Dividend.

Griffith (2001) investigates the relationship between product market competition, growth rate and productivity. SMP (single market program) is used as the instrument for the change in product market competition. He used the ordinary least square regression model find out the positive correlation between the two variables.

Easterbrook (1984) describes the dividend payouts in Malaysian listed Banks. He observed the impact of prudential regulation and product market competition on the dividend policy in the banks over the period of (1995-2007). Ordered probity modeling technique and Target Adjusted Model are used to interrogate the study. The results showed significant difference in the payouts of Islamic Banks (non interest based) and banking products based on interest.

Byun, Lee and Park (2014) study the relation between corporate governance, Product market competition and the corporate dividend policy. The corporate governance is inversely proportion to corporate dividends. This relation is strongly exists in concentrated markets and diminishes in competitive markets.

Januszewsk, Koke and Winter (2002) examine how the productivity growth of German firms is effected by product market competition and corporate governance. Using a panel of almost 500 firms over the years 1986 to 1994, they found that increased productivity is the result of higher competition. Moreover, they suggest that firms under control of a strong ultimate owner reach high productivity levels, but not when the ultimate owner is a financial institution.

Bartram et al., (2012) examine that the corporate dividend policy is shaped by the roles of firm and firm level agency conflicts. They discover that in strongly protected countries, shareholders are able to use their legal rights to obtain cash from firms but their ability to do so can be significantly slowed down when at the firm level cost of agency conflicts are high. In underdeveloped countries, investors can seek protection in firm by reducing agency conflicts.

Liu (2002) suggests that corporate dividend policies are affected by external corporate governance environment. He presents two different models. The outcome model predicts an increase in external corporate governance lead to an increase in cash dividends because monitoring shareholders are better able to force controlling shareholders to give cash. In contrast, the substitute model states that an increase in the external corporate governance minimizes the role of dividends in monitoring agency costs, leading to a decrease in dividends.

Halim and Bino (2013) investigate the relationship between the corporate governance mechanism and firm's dividend policy which is measured by firm's ownership structure. They used econometric models with different attributes. They find a significant negative relationship between capital owned by block holders and firms cash dividends.

Kumar (2006) examines the probable link between corporate governance, structure of ownership dividend payout policy. He states a positive relationship exist between earning trends and dividends

Grullen and Michaely (2007) analyze the strong association between the corporate dividend payout policy and the product market competition. By using the sample of manufacturing firms they suggest that the less competitive industries have lower payout ratio. Industry concentration levels and corporate cash dividends are negatively correlated. They suggest that agency problems have strong influence on the managers to distribute cash to shareholders.

Wang and Wang (2015) for the first time investigate the impact of three types of state ownership on firms' dividend pay-out. This study analyzes different payout behaviors of owners of different states. They found if the state enterprises are governed by local government and frontline staff officials, pay dividend more as compare to states governed by private owners.

Allen and Gale (1999) argue that different countries have different nature of corporate governance systems. In the United States and United Kingdom it has been observed that managers have the threat of takeover and they work in the best interest of the shareholders. In Germany, Japan and France the banks and the other institutions are performing the role of monitors. There are evidence neither system is effective.

Review/Studies in context of Pakistan

Afza and Mirza (2010) investigate the major definite features of the firms that significantly impact on cash dividend behavior in emerging economy of Pakistan. The data is obtained from Karachi Stock Exchange. Cash dividend has the positive relationship with profitability and operating cash flows, whereas has negative relationship with managerial and individual ownership, size cash flow sensitivity and leverage.

Yuan and Zafar (2010) examine the impact of earnings management on cash dividend both for Pakistani and Chinese firms. The results show for both the countries that earnings management has no impact on dividend payout policy.

Imran (2011) examines the factors that determine the cash dividends by using the data of thirty six firms listed on Karachi Stock Exchange from engineering sector. He found that the size of the firm, cash flow, sales growth, profitability, dividend per share and the earnings per share are the most significant factors that determine dividend policy in the engineering sector of Pakistan.

Literature Gap

In Pakistan most of the research is focused on the determinants of dividends and effect of dividend earnings on shareholders wealth. But currently in Pakistan the effect of product market competition on dividend payouts is not yet researched. This study is helpful for the investors for their investment in profitable ventures. Because the product market competition is very influential factor that significantly affect corporate dividend payouts.

Data and Research Methodology

The study is conducted on the Textile Sector of Pakistan. This chapter includes data and methodology, variables description, development of hypotheses, and the statistical description of the variables under study.

The data from 2010-2014 is used in the study. The data consists of annual financial reports of 30 textile firms of Pakistan listed at Karachi Stock Exchange.

Variables Description

The variables used in this study are generally measures by following the past studies. Three types of variables are used, discussed below:

Category	Variable Name	Description
Dependent Variable	Cash Dividend	Div/LTS, Div/LTA, Div/E
Independent Variable	Product market competition	Sales Growth
Control variable	Return On Asset	Net profit / Total Asset

Note: Cash dividend is the amount that is paid to the shareholders of the company against their investment in the company. Three measures of dividend payouts are used: (i) Dividend scaled by Net income (DIV/E), (ii) Dividend scaled by Lagged Total Sales (DIV/LTS) (iii) Dividend scaled by Lagged Total Assets (DIV/LTA). Product Market Competition is a situation where the firms producing similar products are competing with each other for some desired common goals.

Development of Hypothesis

Ho=Product Market Competition has no significant impact on firms cash dividends.

H1= Product Market Competition has significant impact on firms cash dividends.

Empirical Results and Discussion

This part of the study includes Descriptive statistics outcomes, Pearson correlation analyses and the Regression analyses.

Descriptive analysis

Table 4.1 reports the descriptive statistics results on annual basis (2010-2014).

Table 1: Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
DIV/LTS	150	-0.000004	0.002682	0.000029	0.000268
DIV/LTA	150	-0.000006	0.000025	0.000001	0.000004
DIV/E	150	-0.000498	0.000549	0.000015	0.000097
GROWTH	150	-0.743562	839.430214	8.568394	83.929855
ROA	150	-0.289244	19.002644	0.372666	2.357101

Table 4.1 illustrates a summary of all the variables engaged in the model. During the five year period the mean value of Growth which is independent variable is maximum i.e 8.568394. On the other hand if we look at dependent variables, Div/LTS has the mean value of 0.000029. Div/LTA is another dependent variable and mean value of it is 0.000001. Div/Net income is also a dependent variable and mean value of it is 0.000015. The mean value for return on assets is 0.372666. Return on asset is being defined as the proportion of net income to total

asset. As for standard deviation concern it ranges from 0.000004 to 83.929855.

Correlation Matrix

Table 4.2 displays the Pearson correlation analysis of all the variables over five years period ranging from 2010 to 2014. The dependent variable Dividend lagged to total sales is positively correlated with Dividend lagged to Total Asset. The table shows that Div/LTS has positive but not significant relation with Div/E.

Table 2: Correlation Matrix

	DIV/LTS	DIV/LTA	DIV/E	GROWTH	ROA
DIV/LTS	1				
DIV/LTA	0.086438	1			
DIV/E	0.084522	0.376664**	1		
GROWTH	-0.011119	-0.025081	-0.015352	1	
ROA	-0.015226	-0.017560	-0.018667	-0.028255	1

* Correlation is significant at the 0.01 level.

This Dependent variable is negatively correlated with Growth and Return on Asset. Div/LTA is also a dependent variable and is positively correlated with Div/E at 1% level of significance. Moreover the dependent variable Div/LTA is negatively correlated with Growth and control variable Return on asset. The dependent variable Div/E is negatively correlated with Growth and ROA at -0.015352 and -0.018667 respectively. The growth independent variable which is the proxy of perfect market competition is negatively correlated with ROA.

Regression Analysis

Table 3: Regression Analysis

VARIABLES	PANEL A DIV/LTS			PANEL B DIV/LTA			PANEL C DIV/E		
	Coefficient	t-stat	p-value	Coefficient	t-stat	p-value	Coefficient	t-stat	p-value
INTERCEPT	0.000030	1.095902	0.275835	0.000001***	2.513611	0.013597	0.000015	1.506396	0.135215
GROWTH	-0.011558	-0.113813	0.909621	-0.025597	-0.252125	0.801478	-0.015892	-0.156504	0.875961
ROA	-0.015552	-0.153141	0.878605	-0.018284	-0.180088	0.857459	-0.019116	-0.188253	0.851071
R^2	0.000365			0.000963			0.000601		
Adjusted R^2	-0.020246			-0.019636			-0.020005		

Note: *Significant at 0.10; **Significant at 0.05; ***Significant at 0.01

Table 4.3 presents three panels for the regressed value of dividends. Panel A explains the regressed value for Div/LTS. The data reveals that there is a relation between Div/LTS and Growth (coef.=-0.011558 at t= -0.113813and p=0.909621) for all the selected companies. Similarly Div/LTS has negative impact on return on assets (coef.=-0.015552 at t=-0.153141and p=0.878605). The value of R square is 0.000365 and adjusted R square is -0.020246. The above results show that lagged to total sales has no significant impact on Growth and ROA. Panel B and C explains the regressed value of Div/ LTA. The result shows the there is no relation between the variables under study. The value of R square and adjusted R square is 0.000963 and -0.019636 respectively.

Conclusions and Future Directions

In this study we investigate whether product market competition can play an important role in minimizing agency problems between controlling shareholders and minority shareholders in Pakistan. We select the country Pakistan because here the legal system is very weak for investor's rights. We suppose that product market competition mitigates agency conflicts and force the manager to give cash. But in Pakistan mostly the businesses are family owned and top managers are sometimes hold more than 50% of the company holdings. More over the assumptions of Perfect Market Competition are very difficult to implement in a country like Pakistan. Our results show that the product market competition has no impact on companies' dividend policies. The sample size in the study is very small and limited. There is a need to include more other variables to measure product market competition. There is also a need to apply this study in other market of the world.

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