

Political Connections and Dividend Payouts in Malaysia: the Influence of Institutional Investors

Purpose - This study examines the agency problem of expropriation using dividends in politically connected firms and the relevance of institutional investors in limiting this problem. The growing presence of institutional investors offers a unique opportunity to test their roles in politically connected firms and its importance in the context of dividend payouts and expropriation.

Design/methodology/approach- This study employs the Tobit regression to test the association between political connection, institutional investors and dividend payouts. Results are also robust to the three-stage-least squares regressions method.

Findings – Based on a random sample of 2458 Malaysian firms-year observations for the period of 2004-2009. The results reveal that politically connected firms have an inclination to pay lower dividends, while institutional ownership are associated with higher dividend payouts. Furthermore, our findings reveal that higher levels of institutional ownership moderates the negative relationship between politically connected firms and dividends.

Implications- Findings has an important implication to regulators as it suggests that the institutional investors can influence the dividends payout in politically connected firms through active monitoring and thus alleviating agency problems. This also provides a positive feedback on the regulators' governance initiatives that quest to strengthen the roles of institutional investors.

Originality/value – This study is the first to examine the effectiveness of the monitoring role of institutional investors in the context of expropriation by politically connected firms from the perspective of dividend payouts.

JEL Classification: G35, G30, G23

Keywords: Political connections, Institutional investors, Dividend payout, Agency costs, Malaysia

1. Introduction

The importance of understanding the role of politically connected (*PCON*) firms in non-Western economies has been spurred by their growth and subsequent importance in the last decade (Bliss & Gul, 2012a). In addition, interest on the influence of political connections in Asian countries is an ongoing topic that attracts researcher attention (Berkman & Galpoththage, 2016). Prior research that explore the role of political connections in organisation are extensive in scope and investigate the relationship between political connections with various financial outcomes. For instance, these studies have looked at the association between political connection and audit fees during and after financial crisis (Gul, 2006); the roles of the audit committee and CEO duality in *PCON* firms (Bliss *et al.*, 2011); the performance of *PCON* firms from the perspective of privatisation (Boubakri *et al.*, 2008); the quality of accounting information in *PCON* firms (Chaney *et al.*, 2011) and the role of political connections in determining the cost of debt and liquidity (Bliss & Gul 2012a; 2012b). However, what has not been studied is the behaviour of firms with political connections in the distribution of dividends, and how expropriation tendencies, if any, can be controlled by the institutional investors.

Dividend payout is essentially a return to all shareholders in proportion to their ownership of shares, and it reduces cash available to firms that might otherwise be expropriated (Jensen, 1986; La Porta *et al.*, 2000). In other words, dividend payment is a monitoring mechanism that restricts expropriation because it removes corporate wealth from insider control (Faccio *et al.*, 2001). Agency theory posits that *PCON* firms may utilise their resources for the benefit of politically connected shareholders and insiders rather than for general shareholders (You & Du, 2012). Prior studies suggest that the governance of these firms is opaque and it is an issue of concern for minority and other shareholders because controlling

shareholders may utilise opaque financial reporting to conceal their expropriation activities and impede prudent monitoring (Piotroski *et al.*, 2015; Chen *et al.*, 2011). This raises the question of whether political connections exacerbate the expropriation of firms' resources at the expense of shareholders (i.e. by paying lower dividends).

Empirical evidence provides several insights into dividend policy, specifically in relation to expropriation. Faccio *et al.* (2001) examine a sample of firms from Europe and Asia and find systematic expropriation by corporation at the base of extensive corporate pyramids. How *et al.* (2008) find that when divergence between ownership rights and control rights is large, firms in Hong Kong pay higher dividends to offset investors' concerns about expropriation. Setia-Atmaja *et al.* (2009) find that Australian family firms pay high dividends to allay concerns over expropriation of minority shareholders. Overall, a firm's dividend policy may reflect its agency problems and conflicts between insiders/shareholders and minority shareholders. Thus, an examination of the expropriation behaviour of *PCON* firms and whether their dividend policy reflects their expropriation motives is necessary.

Institutional investors are another increasingly important factor in capital markets because they have substantial influence in investee firms (Abdul Wahab *et al.*, 2009; Grier & Zychowicz, 1994) and are active shareholders particularly in relation to monitoring firm management (Gillian & Starks, 2003; Karpoff, 2001). Empirical findings also suggest that agency problems between shareholders and managers may be mitigated by institutional investors since they hold large shareholdings (Gillian & Starks, 2003; Shleifer & Vishny, 1986), have expertise (Ferreira *et al.*, 2010) and better firm-specific information (Edmans, 2009). Institutional investors are also likely to be more concerned with high profitability and demonstrate a strong preference for higher dividend payouts (Ayers *et al.*, 2011). As such, it

is likely that the institutional investors will press upon higher dividend payouts to reduce expropriation activity especially in the *PCON* firms.

Despite the availability of evidence documenting the influence of institutional investors on dividend policy in the context of firm wealth expropriation, there is still paucity in the literature on the influence of institutional investors in mitigating expropriation moves in *PCON* firms. Furthermore, evidence documenting the association between political connections and dividend payouts offer conflicting results. For instance, while Su *et al.* (2014) report a positive association between political connections and dividends, Cao *et al.* (2012) document a negative association.

In this paper, we extend this evolving line of research by examining the impact of political connections and institutional investors on dividend payouts. While the political economy literature suggests that *PCON* firms are afflicted by agency problems (Boubakri *et al.*, 2012; Faccio, 2006), there has yet to be a study that explore the effectiveness of the monitoring mechanism by institutional investors as a remedy for these agency problems (expropriation of wealth by *PCON* firms) particularly from the dividend payouts perspective.

Malaysia is an ideal setting to explore this issue because political connections are a common phenomenon in the Malaysian capital market, with an immense influence on firm behaviour. The proportion of public firms with political connections in Malaysia is one of the highest in the world (Faccio, 2006).¹ As discussed above, these firms are highly opaque (How *et al.*, 2014; Chaney *et al.* 2011), where the severity of agency problems are expected to be more pronounced in these firms due to the prevalence of political connection that may expose

¹ Faccio (2006) finds that Malaysia is the fourth highest country with *PCON* firms among sample firms. *PCON* firms in Malaysia account for 28.24 % of the total market capitalization -. (see Faccio, 2006, p. 372).

institutional and other minority shareholders to problems of expropriation, especially in relation to dividend payouts.

Based on a sample of 2458 firms-year observations from year 2004 to 2009, we find a negative and significant relationship between *PCON* firms and dividend payouts. As posited, we find a positive relationship between the fraction of institutional investors' shareholding (*INS*) and dividend payouts. Our findings also suggest that institutional investors positively moderate the negative association between *PCON* firms and dividends, which imply that the presence of institutional investors in the *PCON* firms reduces the agency problem within these firms. Delving further along agency theory arguments, our results differ according to firm's levels of growth opportunity and cash holdings. In our attempt to differentiate overinvestment from other forms of expropriation of firms' resources when dividend payout is lower, we find a negative association between political connection and *CAPEX*, a positive association between *INS* and *CAPEX* and a positive moderating effect by *INS* on the association between political connection and *CAPEX*.

The remainder of the paper is set as follows. The next section discusses the institutional background in Malaysia, which later forms the basis for the development of our hypotheses. Section 3 describes the data and research method. The findings and conclusions are presented in Section 4 and Section 5 respectively.

2. Institutional Background

2.1 Political Connections in Malaysia

Political connections in Malaysian businesses are both ubiquitous and institutionalized, a reflection of and testament to a society that is deeply rooted in a culture of ethnic favouritism, wealth redistribution in the form of rent seeking, and affirmative policies intended to

economically empower the Bumiputras.² In 1969, the government launched its New Economic Policy (NEP) with the objective of closing the economic gap among ethnic groups (Adhikari *et al.*, 2006). The implementation of NEP saw the active intervention by the Malaysian Government in the economy, which created opportunities for political patronage and crony capitalism in Malaysia (Bliss & Gul, 2012a; Gul 2006; Johnson & Mitton, 2003). These firms are sponsored directly or indirectly by the United Malay National Organization (UMNO) to acquire stakes in firms previously owned by the Chinese. Johnson and Mitton (2003) suggest that Bumiputra forms up to 65 per cent of the ‘primary connected major shareholder/director’ component of *PCON* firms in Malaysia and these *PCON* firms have special privileges whereby contracts are awarded by the government at favourable prices (Ebrahim *et al.*, 2014), lighter taxation and relaxed regulatory oversight (Faccio, 2006), special access to inflows of local and foreign financing (Johnson & Mitton, 2003) and implicit guarantee of financial support that substantially reduces bankruptcy risks (Fraser *et al.*, 2006).

The selective favouritism shown to these firms has been documented as resulting in unfavourable outcomes. In particular, these firms have a higher likelihood of reporting a loss, are more likely to be charged higher interest rates by lenders (Bliss & Gul, 2012a), higher audit fees by auditors (Abdul Wahab *et al.*, 2009), and suffered more than their non-*PCON* counterparts during the Asian financial crisis of 1997/98 (Gul, 2006). *PCON* firms also ran into financial troubles and had to be rescued by controversial government bailouts.³ The

² The term Bumiputra or ‘sons of the soil’ was popularized during the 1920s and 1930s by the British colony to distinguish the indigenous people of Malaya (now Malaysia), the majority of whom are Malays, from the Chinese or Indian immigrants, the non-indigenous people.

³ While capital controls and macroeconomic policies were deemed to be adequate in Malaysia, *PCON* firms were rescued without fear of punishment (Pepinsky, 2008). Faccio *et al.* (2006) report 17 out of the 81 (21 percent) of bailed-out *PCON* firms came from Malaysia. In particular these connected firms had financial trouble and were bailed out by the Malaysian government. Some of the examples include; Renong-United Engineers Malaysia with a total of RM 2.34 billion in 1997 (and Malaysian Airlines System with a total of RM 7.41 billion (Jomo, 2006).

general differences in macro-level economic, regulatory and social settings found in the Malaysian *PCON* firms are probably unique as compared to other international *PCON* firms, especially from a democratic-system point of view and there are different variations in institutional settings as well as capital market behaviour.⁴ The ruling coalition party (National Front), dominated by UMNO and MCA is the longest-serving elected ruling party in the world, so *PCON* firms have had an uninterrupted influence over and dominance in the corporate scene for more than 50 years.⁵ In this regards, an examination of the roles of institutional investors under political patronage in relation to the distribution of dividend is a timely and indeed a testable notion.

2.2 Institutional Investors in Malaysia

The presence of institutional shareholders is moderate in Malaysia as compared to other developed countries. In 2009, the total institutional shareholding in Malaysia stood at 16.8% and has become an increasingly important market participant (How *et al.*, 2014). The five largest public institutional investors in Malaysia are Employees Provident Fund (EPF), *Lembaga Tabung Angkatan Tentera* (LTAT), *Permodalan Nasional Berhad* (PNB), *Lembaga Tabung Haji* (LTH), and *Pertubuhan Keselamatan Sosial* (PERKESO). EPF and LTAT are pension funds, while PNB is a unit trust fund aiming to promote savings by Bumiputras. LTH is primarily a savings institution for Muslims to perform pilgrim in Mecca, Saudi Arabia. Finally, PERKESO is an insurance firm for all workers in Malaysia. Collectively, institutional investors contributed 76% of the total value of equities traded in Bursa Malaysia Exchange

⁴ Bliss and Gul (2012a) find that Malaysian *PCON* firms are associated with higher cost of debt, however, the US study by Houston *et al.* (2014) documents contrasting evidence, which indicates that *PCON* firms in the US incur a lower cost of debt.

⁵ *PCON* firms also include large shareholders or top executive including Managing Director, Vice President, CFO, CEO or board of directors that are closely related to UMNO and MCA (Ooi, 2011).

(Bursa Malaysia Stock Exchange, 2014; Abdul Wahab *et al.*, 2009). By December 2013, Bursa Malaysia (2014) reported that institutional investors transacted 75% of the daily trading in the Bursa Malaysia Exchange.

The Board and Investment Panel of Malaysia's major institutional investors are appointed by and report directly to the Ministry of Finance. The onset of Asian Financial Crisis in 1998 has marked some changes in the direction by the Malaysian Government as the Finance Committee on Corporate Governance (FCCG) was established to investigate the cause of the crisis and to provide some recommendations regarding the governance policies and practices in Malaysia. Subsequently, based on the recommendations by the FCCG, the Malaysian Code on Corporate Governance (MCCG) known as "*Green Book*" was introduced in 2000.⁶ Most of the recommendations by the MCCG were adopted by the Bursa Listing Requirements and imposed upon all listed firms. In addition, FCCG made another important recommendations that has led to the establishment of the Minority Shareholder Watchdog Group (MSWG), whose main objective is "*to monitor and combat abuses by insiders against the minority*" (FCCG, Chapter 6 paragraph 9.1). In August 2000, the MSWG was formally formed with five founding members representing the major Institutional investors in Malaysia. MSWG began operation in 2001.⁷ Since then the role of institutional investors has been strengthened. In 2011, the Malaysian Securities Commission issues a recommendation on the corporate governance role of institutional investors. In particular, Recommendation 2.3.1 recommends that institutional investors should effectively exercise their ownership rights to ensure proper functioning of the board of directors, promoting transparency and information disclosure to the market. More recently in 2014, the Malaysian Code for institutional investors was introduced

⁶ The MCCG was revised twice in 2007 and 2013 to further strengthen the business and governance practices in Malaysia

⁷ The five top institutional investors are EPF, LTAT, PNB, LTH and SOCSO.

with aim to promote the leadership in governance and responsible ownership by institutional investors. The formulation of this industry-led Code is a recommendation made under the Corporate Governance Blueprint 2011 and was spearheaded by MSWG and Securities Commission. Indeed, this is a very important landmark in consolidating the role of institutional investors in Malaysia especially in mitigating agency problems in *PCON* firms.

2.3 Hypotheses development

2.3.1 Political connections and dividend payouts

Faccio *et al.* (2001) asserted that the noticeable agency problem in East Asian countries like Malaysia is the expropriation of outside shareholders. *PCON* firms in Malaysia may be susceptible to expropriation risks and elevated levels of agency costs, given their business dealings and outcomes (Bliss *et al.*, 2011; Bliss & Gul, 2012a; 2012b). Dividend distribution reduces the amount of free cash flow available for use at managers' discretion (Jensen, 1986) and the rate at which firms pay dividends thus gives an indication on insider expropriation (Faccio *et al.*, 2001). The phenomenon of influential insiders or individuals is strongly prevalent in *PCON* firms in Malaysia where a leading individual has close ties to a top politician like the Prime Minister(See Gul (2006) Faccio (2006) for a detailed list of *PCON* firms, showing their respective primary connected shareholder/director and primary political connection).⁸ In competing for wealth transfers from politicians or ministers, *PCON* firms may choose to offer political support in the form of money or donations to a politician or political party in exchange for government back-up, priority consideration for projects, or the

⁸ This study adopts the definition of *PCON* firms mainly by Faccio (2006) and Johnson and Mitton (2003) as the primary source to identify *PCON* firms used in this study. Faccio (2006) identifies a firm as *PCON* firms if its controlling shareholders or top directors including Managing Director, CEO, CFO have family or family ties with top politician or the ruling elite.

expectation that they will be bailed out by the government when facing financial distress (Faccio *et al.* 2006).⁹ Unless cash from profits is paid out as dividends, it may be diverted by powerful insiders (Easterbrook, 1984; Jensen, 1986) for personal benefit or invested in unprofitable projects that could channel private benefit to themselves. Furthermore, major shareholders or investors may be agreeable to low dividends as they can use the high trading activity of the firm's stock as 'backdoor' profits to replace the dividends (Banerjee *et al.*, 2007). Following this argument, it can be posited that:

H₁: PCON firms are associated with lower dividend payouts, ceteris paribus

2.3.2. Institutional Investors and dividend payouts

Dividend policy addresses agency problems between controlling owners and managers and outsiders (La Porta *et al.*, 2000; Zwiebel, 1996). In countries with a common law system like Malaysia, minority shareholders have legal power to compel firms to disgorge cash, thus preventing insiders from diverting earnings for private benefit (La Porta *et al.*, 2000). Institutional shareholders, compared with other types of non-controlling or minority shareholder, have a great incentive to monitor firms (Grossman & Hart, 1980; Shleifer & Vishny, 1986). Evidence on the monitoring role of institutional investors in Malaysia has been rather consistent. Abdul Wahab *et al.* (2007) find a positive and significant relationship between institutional ownership and firm performance. Likewise, Abdul Wahab *et al.* (2009) indicate that auditor charge higher audit fees in firms with larger institutional ownership,

⁹ Donation to political parties by *PCON* firms is outside the scope of study because such information are not publicly disclosed and fiercely guarded by restrictive laws in Malaysia. See e.g. Sani (2011) which offers a glimpse of donations by corporations in Malaysian and the legal implications for publicly disclosing such information). Despite the void on the availability of information regarding the magnitude of donations by *PCON* firms, the existence of such donations is an open secret within the corporate circle in Malaysia. Empirical evidence (Aggarwal *et al.*, 2007) suggests firms that donate to political parties have operating characteristics consistent with the existence of free cash flow problems (where these firms are reported to be larger, slowly growing and have higher free cash flows). Our descriptive statistics of *PCON* firms in Table 1 mirrors the operating characteristics mentioned here.

reflecting a demand for higher quality audit by the latter. Institutional investors prefer free cash flow to be distributed in the form of dividends in order to reduce agency cost (Eckbo & Verma, 1994) and Grinstein and Michaely (2005) argue that if institutional shareholders are good monitors, there should be a positive relationship between dividend payouts and institutional shareholding. International studies (e.g., Barclay *et al.*, 2009; Short *et al.*, 2002) indicate that institutional shareholders are also positively associated with dividend payouts. Likewise, findings from two Malaysian studies derived the same conclusion (Leng, 2008; Ramli, 2010). Therefore, the following hypothesis is proposed:

H₂: Firms with higher institutional shareholdings are associated with higher dividend payouts, ceteris paribus

2.3.3 Political connections, Institutional Investors and dividend payouts

The attributes of *PCON* firms have been extensively documented in the extant literature.¹⁰ Among the potential benefits of being *PCON* firms include having government influence to secure lucrative government contracts, imposing tariffs on competitors, incurring lower interests (Goldman *et al.*, 2009); paying less taxes, hence lowering operating costs (Faccio, 2006); and not being sensitive to prevailing competition. Close ties to the government and politicians may be costly to shareholders, especially in *PCON* firms as the grabbing hand of governments and politicians might result in rent extraction of the firms' resources by politicians (Shleifer & Vishny, 1997; Fyre & Shleifer, 1997). These negative traits in *PCON* firms increase agency costs and are detrimental to the minority shareholders.

¹⁰ For extensive review of literature on political connection in Malaysia (see Gomez and Jomo, 1998; Faccio *et al.*, 2001; Gomez, 2002; Johnson & Mitton, 2003; Gul, 2006; Fraser *et al.*, 2006; Faccio, 2006; Abdul Wahab *et al.*, 2009; Mitchell & Joseph, 2010; Bliss, Gul & Majid, 2011; Ebrahim *et al.*, 2014; Bliss & Gul, 2012a; Bliss & Gul 2012b).

Prior studies suggest that institutional investors are monitoring mechanisms and facilitate savings based on consistent earnings and stable returns (Gomez & Jomo, 1999). Abdul Wahab *et al.* (2009) find that *PCON* firms pay 1.005 percent more audit fees than non-politically connected firms when the institutional investors are present. Collectively, these results indicate the institutional investors are an effective monitor in *PCON* firms and that, higher shareholdings of institutional investors in *PCON* firms are expected reduce the rent seeking/expropriation behavior of *PCON* firms.

In addition to the factors outlined above, ever since the Asian financial crisis, the role of institutional investors in Malaysia has changed dramatically whereby they are expected to play a much bigger role in the capital market in order to enhance good governance in firms (How *et al.*, 2014). On the other hand, dividend policies can address the concerns of rationale investors over the higher risk of expropriation by insiders within a firm (Faccio *et al.*, 2001). Additionally La Porta *et al.* (2000) find in a country like Malaysia with strong shareholder protection laws, minority and other shareholders are able to force upon higher dividends when the risk of expropriation is higher. Institutional investors whilst wanting a share of the benefits obtainable from *PCON* firms might be assertive in forcing for higher dividends. In other words, it would be only logical for institutional investors to monitor the expropriation activity of the *PCON* firms and use their interest in the firms to force *PCON* firms to distribute their cash profits in the form of dividends, which otherwise might be used for purposes that are detrimental to the interest of outside shareholders (Shleifer & Vishny, 1997). Based on the notion that institutional investors act as a monitoring mechanism to monitor the expropriation behavior of *PCON* firms (reduce agency costs), we expect that higher proportion of institutional investors' shareholding are likely to moderate the relationship between *PCON* firms and dividend payouts. We test this prediction with the following hypothesis:

H₃: PCON firms with higher institutional shareholdings are associated with higher dividend payouts, ceteris paribus.

3. Data and Methodology

3.1 Sample

We use a sample of 500 Malaysian publicly listed firms from the Compustat database for six years (2004 to 2009) (3,000 firm-years observation). Our sample covers firms from all industrial sectors and comprise of the consumer products, industrial products, trading and services, plantation, property, construction and technology sectors as shown in Panel B of Table 1. Consistent with Bliss & Gul (2012a); Gul (2006); Johnson & Mitton (2003), firms from the financial, regulated utilities, real estate investment funds (REITS) and closed-end funds sectors are not included in our sample. Our sample includes all survivors, new entries and exiting firms, resulting in an unbalanced panel. We imposed a further criterion whereby only firms with at least three years of observations over the study period are included. The final sample size after excluding firms with missing proxies of cash, sales and assets resulted in 2,458 firms-year observations. The data for the classifications of *PCON* firms are derived from the list of *PCON* firms in Faccio (2006) and Johnson and Mitton (2003).¹¹ The data on institutional investors' shareholdings were hand-collected from the 'top thirty shareholders list' available in the annual reports of sample firms. Financial data used to compute various

¹¹ The period of this study coincides with the tenure of the fifth Prime Minister of Malaysia, Abdullah Ahmad Badawi, (His term as the Prime Minister lasted from 31 October 2003 – 3 April 2009) and he is the immediate successor of Mahathir Mohammad. It is expected that the 'controlling insiders and the connected politicians' identified in studies by Johnson and Mitton (2003) and Faccio *et al.* (2006) still continue to enjoy political patronage and influencing power in the country's corporate scene. For instance, Mahathir Mohammad still continued to be one of the most powerful and prominent top politically linked leaders in the country at least until the year 2013 and as such, his associates and those with close ties with him still enjoyed the benefits of political patronage discussed in the preceding section.

measures were extracted from the Compustat database. All continuous variables are winsorized to the 1 and 99 percentiles to control for extreme values.

---Insert Table 1 here---

3.2 Measurement of variables

3.2.1. Dependent variable(s)

Consistent with prior dividend studies (e.g. Choy *et al.*, 2011; Barclay *et al.*, 2009; La Porta *et al.*, 2000), dividend is measured as: (1) dividend to total assets; (2) dividends to sales; (3) industry-adjusted dividends to total assets on a yearly basis, using the industry grouping classification of Bursa Malaysia (Malaysian Stock Exchange). The choice to measure dividend using a number of different proxies is important to assess whether the results are sensitive to the commonly used measures of dividends.

3.2.2 Independent variables

3.2.2 (a) *PCON* firms

PCON firms are classified as a dummy variable. A firm is coded 1 if it is classified as *PCON* firm based on studies by Faccio (2006) and Johnson and Mitton (2003). This study adopts the list of *PCON* firms by Faccio (2006) and Johnson and Mitton (2003) as the study's sample period covers from the years 2002 to 2009. Faccio (2006) and Johnson and Mitton (2003) classify a firm as *PCON* if its controlling shareholders or top directors have family or business ties with top politicians or the ruling elite.¹²

¹² See Gul (2006), Faccio (2006) and Johnson and Mitton (2003) for a detailed list of *PCON* firms, showing the respective primary connected shareholder/director with their primary political connection.

3.2.2 (b) *Institutional investors*

Consistent with prior studies, our measure of institutional investors is the fraction shareholding percentage of the top five institutional shareholders (*INS*) (Abdul Wahab *et al.*, 2008; Cornett *et al.*, 2007; Hartzell & Starks, 2002). This data was hand collected from 30 largest shareholders list as disclosed in the firm's annual report and focuses only on five major institutional investors as other types of institutional investors hold insignificant amount of shareholdings in Malaysia. For the purpose of robustness, we also consider another stringent proxy for institutional investors (*IndependentINS*). *IndependentINS* is measured by the fraction of shareholding of institutional *investors* who do not have business relationship in investee firms and is consistent (Ferreira & Matos, 2008).

3.2.3 *Control variables*

The choice of control variables is driven by prior studies, which have found them to be significant factors in influencing the dividend decision. Consistent with prior studies such as Adjaoud and Ben-Amar's (2010), the lagged one-year of dividends is employed as a control variable, as firms attempt to maintain stable dividends over time (Lintner, 1965). Growth is the average growth rate of net sales in the previous five years $\sum(\text{Sales}_t/\text{Sales}_{t-1}$ for each of the last 5 years)/5, consistent with Choy *et al.* (2011) and is expected to negatively influence dividend payouts because firms with higher growth have lower free cash flow and hence pay lower dividends (Jensen, 1986).

The proxy for earnings is measured as earnings divided by equity, in line with prior studies (Adjaoud & Ben-Amar, 2010; Truong & Heaney, 2007) and expected to positively influence dividend payouts because more profitable firms pay higher dividends. Similar to previous study such as Farinha (2003) cash resource or cash holding is the five-year average of cash and cash equivalents is expected to have a positive influence on dividends as firms

holding high levels of cash experience higher agency costs and hence may use dividend policy to reduce these costs (Adjaoud & Ben-Amar, 2010). Firm size is measured by the natural log of the book value of the firm's assets and is expected to positively influence dividends (Barclay *et al.*, 2009). Debt is measured as total debt to total assets, consistent with Truong and Heaney (2007) and is expected to negatively influence dividends because debt also alleviates the agency costs of free cash flows (Renneboog & Trojanowski, 2007). *PERIOD* is a dummy variable that equals to 1 if the data is from the each of the fiscal years from 2004-2009. *INDUSTRY_DUMMIES* are indicator variables that equal 1 if the observation is from the each of the industry classification of Bursa Malaysia and 0 otherwise.

3.3 Regression model

Since dividend payout is non-negative, the Tobit regression analysis is used and consistent with prior study such as Choy *et al.* (2011). The Tobit regression model used to test the hypotheses is as follows, with the tests variables in bold:

$$Div = \alpha_0 + \alpha_1 \mathbf{LAGGED\ DIV}_{it} + \alpha_2 \mathbf{SIZE}_{it} + \alpha_3 \mathbf{CASH}_{it} + \alpha_4 \mathbf{GROWTH}_{it} + \alpha_5 \mathbf{ROE}_{it} + \alpha_6 \mathbf{DEBT}_{it} + \alpha_7 \mathbf{PCON}_{it} + \alpha_8 \mathbf{INS}_{it} + \alpha_9 \mathbf{PCON*INS}_{it} + \alpha_{10} \mathbf{INDUSTRY_DUMMIES}_{it} + \alpha_{11} \mathbf{PERIOD}_{it} + \varepsilon$$

Div firm's annual dividends divided by book value of assets (*Div/ta*); OR firm's annual dividends divided by net sales (*Div/sales*); OR industry adjusted *Div* on a yearly basis using the industry grouping of the Bursa Malaysia (*Ind Adj Div/ta*)¹³

SIZE natural log of the book value of the firm's assets

CASH 5-year mean of the ratio of cash plus cash equivalents deflated by total assets

GROWTH average growth rate of net sales in the previous 5 years;
 $\frac{\sum(\text{Sales}_t - \text{Sales}_{t-1} \text{ for each of the last 5 years})}{5}$

¹³ The industry adjusted *Div/ta* for each firm is obtained by subtracting the median of dividend rate of sample firms in the same industry and deflated by total assets, consistent with Faccio *et al.* (2001).

<i>ROE</i>	earnings divided by equity
<i>DEBT</i>	total debt divided by total assets
<i>PCON</i>	indicator variable: 1 if the firm is politically connected and 0 otherwise
<i>INS</i>	percentage ownership of the top 5 institutional investors in a firm

4. Results

4.1 Descriptive statistics

A breakdown of the descriptive statistics for the dependent and independent variables are provided for the overall sample, *PCON* and *non-PCON* firms. The sample resulted in 265 (11%) firm-year observations with political connection and 2,193 (89%) firm-year observations without political connections. The breakdown of sample in terms of *PCON* vs. *non-PCON* observations is representative of the fraction of *PCON* firms listed in the Main Market of Bursa Malaysia, which is approximately 11%. This is also comparable with prior Malaysian studies on political connection (See for e.g. Gul 2006). The mean values for *Div/ta* and *Div/sales* for the overall sample are 0.013 and 0.022 respectively. *Div/ta* and *Div/sales* are found to be slightly higher for *PCON* firms than *non-PCON* firms, although the mean is not significantly different for both types. This indifference maybe due to the fact that *PCON* firms are generally bigger in size and thus the magnitude of the dividend are bigger, as larger firms tend to pay higher dividends.

Consistent with prior study (see How *et al.*, 2014; Abdul Wahab *et al.* 2009), the presence of institutional shareholding is significantly higher in *PCON* firms relative to *non-PCON* firms. In addition, *PCON* firms have significantly larger earnings on equity (*ROE*), *DEBT* and *CASH* as compared to their *non-PCON* counterparts. *PCON* firms also show significantly lower growth.

---Insert Table 2 here---

4.2 Correlations

Table 3 reports the Pearson and Spearman correlations for both *PCON* and *non-PCON* firms. *Div/ta* and *Div/sales* are significantly and positively correlated with *INS*, *SIZE*, *CASH* and *ROE*, and negatively correlated with *DEBT* (for *non-PCON* firms). *PCON* firms are significantly and positively correlated with *INS* and *ROE* and negatively with *DEBT*. Overall, more variables from *non-PCON* firms are significantly correlated with *Div/ta* and *Div/sales* than from *PCON* firms, using both the Pearson and Spearman correlations.

---Insert Table 3 here---

4.3 Results

Table 4 represents the empirical results of the Tobit regression with three separate models. Model (a) presents the regressions without the interaction term, while Model (b) includes the interaction *PCON*INS* and finally Model (c) tabulates the regressions that include *PCON*IndependentINS*. The coefficients of *PCON* in Model 1 are negative and statistically significant (Column 1, -0.003, $t = -2.230$, $p < 0.05$; Column 2, -0.007, $t = -2.410$, $p < 0.005$; Column 3, -0.003, $t = -2.150$, $p < 0.05$) supporting the first hypothesis that *PCON* firms are associated with lower dividends, and consistent with Cao *et al.* (2012). This suggests that expropriation does occur in *PCON* firms, and may also suggest that investors in *PCON* firms are willing to accept lower dividends in the anticipation of getting other, less direct, privileges (Benerjee *et al.*, 2007).

Hypothesis 2 predicts a positive relationship between *INS* and dividends. The coefficients for *INS* and dividends are positive and significant (Column 1, 0.092; $t = 2.640$, $p < 0.01$; Column 2, 0.014, $t = 2.240$ $p < 0.05$; Column 3, 0.010, $t = 2.580$ $p < 0.05$). The result

supports hypothesis 2 that INS push for the distribution of higher dividends. This result corroborates the findings of La Porta *et al.* (2000) that in a common law country, all other things being equal, minority and other shareholders are able to influence firms to make higher dividend payouts.

Model (b) introduces the interaction term between *PCON* and *INS* to test hypothesis 3. The coefficients of the interaction term are positive and significant (see Column 4, 0.053, $t=2.100$, $p<0.05$; Column 5, 0.076, $t=2.160$, $p<0.05$; Column 6, 0.005, $t=2.280$, $p<0.05$). This suggests that INS are able to pressure for higher dividends when the risk of expropriation is high in *PCON* firms. The result is consistent with the findings of La Porta *et al.* (2000) and How *et al.* (2014). In our analyses in subsequent tables, the industry adjusted dividends to total assets (*Ind Adj Div/ta*) is used as a proxy for dividend payouts. However our results remain robust when we use *Div/ta* or *Div/sales*.

Institutional investors may differ in their ability to monitor management decisions. Following How *et al.* (2014), the analysis is extended to reflect the heterogeneity of the institutional investors in Malaysia. Independent institutional investors are ‘pressure resistant’ and consider monitoring to cost less than other types of institutional investor (Ferreira & Matos, 2008). This classification is used to denote another variable (*IndependentINS*) to re-examine Hypotheses 1, 2 and 3 and further validate our findings.¹⁴

The coefficient of *PCON* is negative and significant (Column 7, -0.003, $t=-2.170$, $p<0.05$) while *INS* is positive and significant (Column 7, 0.063, $t=2.070$, $p<0.05$) in Model (c) of Table 4. The coefficient of the interaction term is positive and significant (Column 8, 0.037, $t=2.230$, $p<0.05$). Overall the results using *IndependentINS* are consistent with the earlier

¹⁴ Our definition of *IndependentINS* is the fraction of shareholding of institutional investors who do not have business relationship in investee firms and is consistent with the definition of Ferreira and Matos (2008).

findings in Model (a) and (b) with respect to the effects of *PCON*, *INS* and *PCON*INS* on dividends.

---Insert Table 4 here---

4.4 Further analysis

Conventional wisdom asserts that high-growth opportunity firms pay low or no dividends (Fama and French, 2001): stated differently, firms with high growth opportunities may have lower free cash flow and hence pay lower dividends (Jensen, 1986), specifically in common law countries (La Porta *et al.*, 2000). Jensen (1986) suggests that agency conflicts are more likely to occur in firms with low growth opportunities. Consistent with Choy *et al.* (2011) growth opportunities are defined as the average growth rate of net sales in the previous 5 years, and firms are partitioned into low and high growth. The median growth for each year is calculated, and then firms are classified high or low, according to their growth rate. Finally, the low- and high-growth firms for all six years are combined.

---Insert Table 5 here---

Table 5 presents the empirical results of the Tobit regression based on firm's growth. Column 1 shows that the coefficient for *PCON* is negative and significant with dividend (-0.009, $t=-2.26$, $p<0.05$), suggesting that in firms with low growth, the agency cost of expropriation is higher, consistent with the conjecture of Jensen (1986). A significantly positive coefficient of *INS* with dividend (0.017, $t=2.44$, $p<0.05$) is observed; this suggests that *INS* prefer higher dividends when firm growth is low, as expected. The coefficient for the

interaction term between *PCON* and *INS* with dividend in column 2 is positive and significant (0.088, $t=2.46$, $p<0.05$), indicating that *INS* offset concerns of expropriation in *PCON* firms and implies that institutional investors are able to exert power to compel the firms to disgorge higher dividends, limiting expropriation when growth opportunities are low.

The analysis for high growth firms in Columns 3 and 4 indicates the coefficient of *PCON* is positive and insignificant, suggesting the risks of expropriation are not severe in *PCON* firms with high growth. Likewise, the coefficient of *INS* with dividend is positive and insignificant, implying that institutional investors feel safe and opt for lower dividends in the anticipation of higher dividend payouts in the future, corroborating Faccio *et al.* (2001). Similarly, Column 4 shows that the coefficient for the interactions term between *PCON* and *INS* is positive and insignificant, consistent with the conjecture by La Porta *et al.* (2000).

Liquid assets withheld by firms have a private benefit option attached to them that other assets do not have to the same extent (Pinkowitz *et al.*, 2006). Controlling shareholders and insiders are unable to use these funds for personal interest if they are payable as dividends. In this regard cash resources or cash holdings retained by firms may raise concern in shareholders when the risk of expropriation is present, particularly if the holdings are high. A related argument by Jensen (1986) is that agency conflict over dividend payment is particularly severe when firms generate substantial free cash flows. In firms with low cash reserves, the opportunity for expropriation is limited and payment of dividends may strain the firm financially; accordingly, investors' expectation of higher dividends is unlikely. Therefore, we re-examined firms with low and high cash reserves. The median of *CASH* for each year is calculated, providing a different median value for cash each year, and then firms with lower or higher cash than the median are classified as low or high cash firms. Finally, both the low and high cash firms for all six years are combined.

In Table 5, column 5 examines hypotheses 1 and 2 while Column 6 examines hypothesis 3 for firms with low cash. The insignificant coefficients of *PCON* and *INS* in Column 5 is consistent with the prediction that low cash reduces the necessity to pay dividends and limits opportunities for expropriation. These findings corroborate the assertion of Pinkowitz *et al.* (2006) that firms will not transform their liquid assets into private benefits in such a way that they suffer from cash deficiency; accordingly the coefficient of the interaction term *PCON*INS* with dividend is not significant. The results for low cash firms are in stark contrast to high cash firms. In Column 7, the coefficient of *PCON* with dividend is negative and highly significant (-0.013, $t=-3.91$, $p<0.01$) while the coefficient of *INS* with dividend is also positive and significant (0.017, $t=5.22$, $p<0.01$). In Column 8, the interactions between *PCON* and *INS* shows a positive and highly significant effect (0.079, $t=5.48$, $p<0.01$) on dividends. These findings suggest that in *PCON* firms, expropriation occurs when there are high cash reserves. Institutional investors, anticipating higher expropriations in these circumstances, pressure for higher dividends to negate opportunities for expropriation, as Jensen (1986) suggests. The results presented above suggest that the severity of the agency cost of expropriation is higher in firms that experience low growth or hold high cash reserves.

We next examine among sample firms that represent the extreme quartiles of high/low growth and high/low cash matrix. It is conjectured that in firms that experience low growth and possess high cash, the risk of expropriation will be high, holding other factors constant. Similarly, concern of expropriation should be low in firms that experience high growth and possess low cash. Based on the earlier definitions of high and low cash/growth, a reduced panel is examined by extracting two groups of sample firms to test these two propositions. The first group is 'Low Growth and High Cash' and the second 'High Growth and Low Cash'. Column 9 in Table 5 examines 'Low Growth High Cash' firms and shows that the coefficient of *PCON*

is negative and highly significant (-0.009 , $t=-8.45$, $p<0.001$) with dividend. As expected, *INS* shows a positive and significant effect on dividend (0.090 , $t=2.18$, $p<0.05$). The coefficient of interaction term of *PCON*INS* is, as expected, positive and significant (0.010 , $t=4.19$, $p<0.01$). Column 10 examines 'High Growth and Low Cash' firms and finds insignificant coefficients for *PCON*, *INS* and the interaction term of *PCON*INS*. Overall these results indicate that the risk of expropriation and corresponding pressure by *INS* is high in *PCON* firms with low growth and high cash, and that their fears of expropriation and a preference for higher dividends are low in *PCON* firms with high growth and low cash.

4.4.1 Investment decisions, political connections and institutional shareholdings

In the preceding sections note that dividends payments and political connection does not show a significant and positive association, which if otherwise, could suggest that expropriation concerns are absent or low in *PCON* firms. Although *PCON* firms generally experience lower growth opportunities than non-connected firms (as shown in Table 2), these firms have an opportunity to undertake capital investments that could reduce the magnitude of cash resources available for dividends distribution. Arnott and Asness (2003) suggest that low dividend payout leads to inefficient empire building and the funding of below-ideal projects and investments. Higher investment invariably causes firms to grow beyond their optimal size and increases controlling shareholder/insider power by enlarging resources under their control (Jensen, 1986). First, we assess whether *PCON* firms have a positive/negative influence on a firm's investment policy. To differentiate monitoring effects and overvaluation effects, next we assess the influence of institutional investors on investment policy and the former's effect in counterbalancing the effect of political connection on investment policy. Institutional investors are probably better off by receiving higher dividends than to endorse firms to invest

in higher investment, which neither necessarily guarantee good returns nor reduce likelihood of self-benefiting actions. However given that *PCON* firms are associated with lower dividend payouts, institutional investors could push for higher investments if the possibility of expropriation via other schemes like related party transactions and excessive perks, are higher as the former could be possibly viewed as less severe compared to the latter in terms of expropriation. We conjecture that higher investments would at least result in resources to be retained within firms, while other type of expropriating transactions mentioned here are probably worse off for shareholders because these transactions would channel resources out of the firm.¹⁵ Thus, in order to examine how *PCON* firms pursue investment policy in light of the lower dividend payouts associated in these firms, we examine firms' investment decision in this section.

---Insert Table 6 here---

Since prior literature view (1) dividends and capital expenditure (Gugler, 2003) and (2) dividends and institutional shareholding (Grinstein & Michaely, 2005) as possibly jointly determined, the three stages least squares regression (3SLS) is employed. The system consists of dividends, capital expenditure (*CAPEX*) and institutional shareholding (*INS*) models. Following Jensen *et al.* (1992), Gugler (2003) and Setia-Atmaja *et al.* (2009) the dividend

¹⁵ Myers and Rajan (1998) argue that liquid assets (as compared to other assets such as physical assets) not returned to shareholders in the form of dividends can be turned into private benefits at lower cost.

payout system is modelled. The CAPEX model follows Denis and Sibilkov (2009) and Gugler (2003). The INS model is adopted from (Grinstein & Michaely, 2005) system.¹⁶

The dividend regressions using the 3SLS in Model 1 and 2 of Table 6 show similar results for *INS*, *PCON* and the interaction term of *PCON*INS* as our earlier obtained results in Table 2. Model 3 shows the coefficient of *Ind Adj Div/ta* is negative and significant with *CAPEX* (-0.652, $t=-5.58$, $p<0.01$), consistent with Gugler (2003). The coefficient of *PCON* is negative and significant (-0.010, $t=-1.97$, $p>0.05$) while *INS* is positive and significant (0.002, $t=11.63$, $p<0.01$). Our results suggest political *PCON* firms do not show any incremental effect on capital expenditure.¹⁷ In Model 4 the interaction term *PCON*INS* shows a positive and significant coefficient (0.059, $t=2.01$, $p<0.05$). One possible interpretation in relation to our findings is that, although *PCON* firms distribute lower dividends and have lower capital expenditure, the expropriation in these firms probably occurs via other schemes, through donations to fund the activities of their affiliated political party, and excessive perks and privileges. Institutional investors potentially realise these concerns and push for higher capital expenditure.

4.5 Robustness checks

To address the possible concerns regarding the quality of our data and analyses, we have conducted additional robustness checks. First, our univariate test reveals that there is

¹⁵Dividend is a function of endogenous variables (*CAPEX* and *INS*) and a set of exogenous variables comprised of *LAGGED Div*, *SIZE*, *CASH*, *ROE*, *DEBT*, *GROWTH*, *PCON*, *INDUSTRY_DUMMIES* and *PERIOD*. The *CAPEX* model is identified by excluding some of the explanatory variables that determine the dividend model where *CAPEX* is a function of endogenous variables (*Ind Adj Div/ta* and *INS*) and a set of exogenous variables comprised of *ROE*, *GROWTH*, *PCON*, *INDUSTRY_DUMMIES* and *PERIOD* as Denis and Sibilkov (2009) explain current investment is determined by these variables only. The unreported *INS* model is a function of endogenous variable *Ind Adj Div/ta* and a set of exogenous variables comprised of *GROWTH*, *SIZE*, *PCON*, *INDUSTRY_DUMMIES* and *PERIOD*. Despite our best efforts, we cannot claim to have fully solved the issue of endogeneity.

¹⁷ Interestingly, our results are contrary to Ferreira and Matos (2008) that studied 27 countries (excluding Malaysia).

insignificant relationship between the dividend distributed by PCON and non-PCON firms, however the regression finds that PCON firms pay lower dividends. We trust that this is attributed to the fact that *PCON* firms are generally larger than non-*PCON* firms and that our sample comprised of a random sample of 500 Malaysian publicly listed firms. To test this notion, we replicate all our analyses for large firms only to allay concerns of biasness in our sample. In an unreported univariate analysis of our sample by *SIZE*, we find that majority of our *PCON* firms' *SIZE* are higher than the median of *SIZE* for the whole sample. However, our results remain unchanged in all our analyses that we repeated using a reduced panel that was made up of only large firms (i.e. observations above the median of *SIZE*).

Second, since Gristein and Michaely (2005) claimed that institutional shareholding might have a slower effect on dividends payout as they take time to affect a firm' decision making, we re-examine our predictions using the one year lagged value of the percentage institutional shareholding instead of the earlier measure of *INS*. The results remain unchanged.

Third, a more stringent measure independent institutional shareholding (*IndependentIns*) was used in Table 4 to address the heterogeneity of institutional investors in Malaysia, we again run the estimates in Table 5 and 6 replacing *INS* with *IndependentIns*. Fourth, since we have included *CAPEX* in the dividend estimate using the 3SLS regressions in Table 6, we re-examine all the estimates reported in prior tables (refer to tables 4 and 5) by including *CAPEX*. In the many regressions with these alternate methods and specifications, the fundamental results for all the three hypotheses of this study remain unchanged.

5. Conclusion

Although much literature deals with dividends and their relation to the agency costs of expropriation, there is limited evidence in relation to political connections. Our study's investigation of expropriation from the standpoint of dividends, although narrow in scope, presents quantitative evidence linking expropriation to firms with political connections. We show that institutional investors play a crucial and effective mitigating role in alleviating expropriation concerns in *PCON* firms by pressing for higher dividend payouts. This suggests that an increase in the level of shareholdings by institutional investors is likely to limit expropriation behaviour and enhance the value of *PCON* firms.

This study suggests that expropriation of outside shareholders in *PCON* firms is a salient agency problem that may alert and guide regulators in formulating future regulations. It provides insight into the role of institutional investors in alleviating expropriation concerns in *PCON* firms. Corporate decision makers in such firms should be aware of the need for higher dividends as investors consider them effective in limiting the agency problem of expropriation and of the importance of attracting institutional investors in general. For policy makers, the finding that *PCON* firms are associated with lower dividends could justify initiatives to improve governance within these firms, while encouraging the participation of institutional investors will encourage higher dividends and limit expropriation. These findings are relevant for countries with an institutional environment similar to that of Malaysia, where corporate political connection is common.

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Table 1: Sample description of Malaysian firms (2004–2009) (n=2458)

A: Sample	firm-year observations (n)
Original sample size (500 firms - 6 years)	3,000
Less:	
financial institutions, regulated utilities sectors, REITS and closed-end funds	-180
missing annual reports and sample without minimum 3 years of firm-year observations	-109
firms with zero or negative book value of total assets, cash	-253
Final sample size (n)	2,458
B: Distribution of sample by industry	
Plantation (7%)	166
Construction (7%)	179
Trading/ Services (22%)	542
Property (3%)	84
Industrial Products (40%)	980
Consumer Products (17%)	418
Technology (4%)	89
Final sample size (n)	2,458

Table 2: Descriptive Statistics

Variable	Full sample			Non- <i>PCON</i> firms (N= 2,193)			<i>PCON</i> firms (N = 265)			<i>t</i> -test	Mann-Whitney
	Mean	Std dev	Median	Mean	Std dev	Median	Mean	Std dev	Median		
<i>Div/ta</i>	0.013	0.023	0.004	0.013	0.023	0.004	0.015	0.030	0.004	-0.928	-0.884
<i>Div/sales</i>	0.022	0.042	0.005	0.022	0.042	0.005	0.025	0.039	0.009	-0.910	-1.090
<i>INS</i>	15.515	16.228	10.527	15.741	18.141	10.447	16.44	14.479	12.742	-0.434	-1.761 *
<i>SIZE</i>	2.548	0.576	2.463	2.516	0.5611	2.433	3.110	0.565	3.001	-11.830 ***	-11.520 ***
<i>CASH</i>	0.114	0.119	0.079	0.112	0.119	0.076	0.145	0.104	0.127	-3.043 ***	-5.395 ***
<i>ROE</i>	0.086	0.219	0.095	0.085	0.209	0.094	0.111	0.358	0.118	-1.328 **	-2.836 ***
<i>DEBT</i>	0.420	0.207	0.418	0.414	0.205	0.411	0.527	0.211	0.538	-6.148 ***	-4.891 ***
<i>GROWTH</i>	0.118	0.463	0.068	0.123	0.465	0.070	0.040	0.413	0.030	1.991 **	2.068 **

Div/ta = annual dividends divided by book value of assets. *Div/sales* = the annual dividends divided by net sales. *SIZE* = natural log of the book value of firms' assets. *CASH* = 5 year mean of the ratio of cash plus cash equivalents deflated by total assets. *GROWTH* = average growth rate of net sales in previous 5 years. *ROE* = earnings divided by equity. *DEBT* = total debt divided by total assets. *PCON* is an indicator variable, 1 if the firm is politically connected; 0 otherwise. *INS* = the percentage ownership of the top 5 institutional investors in a firm. The column for *t*-test shows the t-statistics while Mann-Whitney shows the z-statistics for both samples, *Non-PCON* and *PCON*. ***, ** and * denote statistical significance at 1%, 5% and 10% respectively.

Table 3: Correlations

Variable	Div/ta	Div/ sales	INS	SIZE	CASH	ROE	DEBT	GROWTH	CAPEX
A: Pearson correlation									
Non-PCON firms (N = 2,193)									
<i>Div/ta</i>	1.000								
<i>Div/sales</i>	0.700***	1.000							
<i>INS</i>	0.130***	0.112***	1.000						
<i>SIZE</i>	0.155***	0.174***	0.279***	1.000					
<i>CASH</i>	0.363***	0.364***	0.128***	0.006**	1.000				
<i>ROE</i>	0.322***	0.173***	0.100***	0.233***	0.155***	1.000			
<i>DEBT</i>	-0.302***	-0.380***	-0.030	0.135***	-0.442***	-0.038*	1.000		
<i>GROWTH</i>	-0.035	-0.009	0.028	0.107**	-0.005	0.196***	0.054***	1.000	
<i>CAPEX</i>	-0.089***	-0.003*	0.085***	0.127**	-0.038	0.115***	0.047**	0.073***	1.000
PCON firms (N = 265)									
<i>Div/ta</i>	1.000								
<i>Div/sales</i>	0.793***	1.000							
<i>INS</i>	0.218***	0.217***	1.000						
<i>SIZE</i>	0.075	0.066	0.179**	1.000					
<i>CASH</i>	0.069	0.059	0.237**	0.325***	1.000				
<i>ROE</i>	0.331***	0.212***	0.055	0.137*	0.096	1.000			
<i>DEBT</i>	-0.211***	-0.336***	-0.116	0.312***	-0.069	-0.065	1.000		
<i>GROWTH</i>	-0.001	-0.018	-0.039	0.249**	-0.004	0.238***	0.169**	1.000	
<i>CAPEX</i>	-0.096	-0.131	0.241	0.029	-0.023	-0.006	-0.152	0.075	1.000
B: Spearman correlation									
Non-PCON firms (N = 2,193)									
<i>Div/ta</i>	1.000								
<i>Div/sales</i>	0.953***	1.000							
<i>INS</i>	0.180***	0.183***	1.000						
<i>SIZE</i>	0.246***	0.256***	0.273***	1.000					
<i>CASH</i>	0.362***	0.351***	0.160***	0.092***	1.000				
<i>ROE</i>	0.417***	0.346***	0.137***	0.339***	0.213***	1.000			
<i>DEBT</i>	-0.380***	-0.418***	-0.046**	0.185***	-0.415***	-0.093	1.000		
<i>GROWTH</i>	-0.197*	-0.168*	0.088***	0.176***	0.057	0.344***	0.060***	1.000	
<i>CAPEX</i>	-0.217	-0.169*	0.132***	0.199***	0.054	0.267***	0.036***	0.211***	1.000
PCON firms (N = 265)									
<i>Div/ta</i>	1.000								
<i>Div/sales</i>	0.937***	1							
<i>INS</i>	0.332***	0.293***	1.000						
<i>SIZE</i>	0.134***	0.254***	0.279***	1.000					
<i>CASH</i>	0.200***	0.225***	0.319***	0.354***	1.000				
<i>ROE</i>	0.304***	0.286***	0.011	0.264***	0.230***	1.000			
<i>DEBT</i>	-0.465***	-0.408***	-0.121	0.159*	-0.084	-103	1.000		
<i>GROWTH</i>	-0.164	-0.154	0.001	0.253	-0.136	0.452***	0.088	1.000	
<i>CAPEX</i>	-0.413	-0.355	0.261***	0.157	-0.021	0.235***	-0.165*	0.246***	1.000

Div/ta = annual dividends divided by book value of assets. *Div/sales* = annual dividends divided by net sales *SIZE* = natural log of the book value of firms' assets. *CASH* = 5 year mean of the ratio of cash plus cash equivalents deflated by total assets. *GROWTH* is the average growth rate of net sales in previous 5 years. *ROE* is earnings divided by equity. *DEBT* = total debt divided by total assets. *PCON* is an indicator variable, 1 if the firm is politically connected; 0 otherwise. *INS* = the percentage ownership of the top 5 institutional investors in a firm. ***, ** and * denote statistical significance at 1%, 5% and 10% respectively.

Table 4: Political Connections, INS and Dividends

	Without interactions (Model a)						With interactions (Model b)				<i>IndependentINS</i> (Model c)	
	<i>Div/ta</i>	<i>Div/sales</i>	<i>Ind Adj Div/ta</i>	<i>Div/ta</i>	<i>Div/sales</i>	<i>Ind Adj Div/ta</i>	<i>Ind Adj Div/ta</i>	<i>Ind Adj Div/ta</i>	<i>Ind Adj Div/ta</i>	<i>Ind Adj Div/ta</i>	<i>Ind Adj Div/ta</i>	
	1	2	3	4	5	6	7	8				
<i>Intercept</i>	-0.039	-0.066	-0.030	-0.042	-0.071	-0.034	-0.006	-0.006				
	-5.460 ***	-5.120 ***	-3.380 ***	-5.790 ***	-5.520 ***	-3.810 ***	-2.680 ***	-2.570 ***				
<i>LAGGED Div</i>	0.591	0.685	0.637	0.588	0.686	0.631	0.508	0.508				
	14.540 ***	16.890 ***	12.690 ***	14.470 ***	16.910 ***	12.570 ***	16.560 ***	16.550 ***				
<i>SIZE</i>	0.014	0.027	0.013	0.013	0.027	0.013	0.005	0.005				
	11.220 ***	11.830 ***	7.870 ***	11.150 ***	11.780 ***	7.780 ***	6.900 ***	6.940 ***				
<i>CASH</i>	0.030	0.068	0.033	0.030	0.069	0.033	0.044	0.044				
	5.180 ***	6.390 ***	4.480 ***	5.250 ***	6.440 ***	4.510 ***	10.570 ***	10.610 ***				
<i>ROE</i>	0.104	0.109	0.142	0.103	0.107	0.141	0.024	0.024				
	21.740 ***	12.400 ***	20.860 ***	21.580 ***	12.250 ***	20.780 ***	12.470 ***	12.440 ***				
<i>DEBT</i>	-0.079	-0.139	-0.118	-0.078	-0.138	-0.117	-0.021	-0.021				
	-18.420 ***	-17.550 ***	-17.690 ***	-18.280 ***	-17.440 ***	-17.610 ***	-8.790 ***	-8.790 ***				
<i>GROWTH</i>	-0.003	0.001	-0.004	-0.003	-0.001	-0.004	-0.002	-0.002				
	-2.080 **	-3.390 ***	-2.090 **	-2.030 **	-2.440 **	-2.040 **	-2.240 **	-2.240 **				
<i>PCON</i>	-0.003	-0.007	-0.003	-0.009	-0.015	-0.010	-0.003	-0.001				
	-2.230 **	-2.410 **	-2.150 **	-2.340 **	-2.130 **	-2.360 **	-2.170 **	-2.120 **				
<i>INS</i>	0.092	0.014	0.010	0.088	0.014	0.010						
	2.640 ***	2.240 ***	2.580 **	2.550 **	2.170 **	2.280 **						
<i>IndependentINS</i>							0.063	0.007				
							2.070 **	2.290 **				
<i>PCON*INS</i>				0.053	0.076	0.005						
				2.100 **	2.160 **	2.280 **						
<i>PCON*INS(Independent)</i>											0.037	
											2.230 **	
<i>Period dummies</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes			Yes	
<i>Industry dummies</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes			Yes	
<i>X²</i>	1311.42	1279.04	1075.05	1315.84	1282.00	1078.23	1032.43	1089.43				
<i>N</i>	2458	2458	2458	2458	2458	2458	2458	2458				

Div/ta = annual dividends divided by book value of assets, Div/sales = annual dividends divided by net sales; Ind Adj Div/ta = the industry adjusted Div/ta on a yearly basis using the industry grouping of the Malaysian Stock Exchange. *LAGGED Div* = lagged one-year value of the corresponding *Div/ta*, *Div/sales* or *Ind Adj Div/ta*. *SIZE* = natural log of the book value of the firms' assets. *CASH* = the 5 year mean of the ratio of cash plus cash equivalents deflated by total assets. *GROWTH* = average growth rate of net sales in previous 5 years. *ROE* = earnings divided by equity. *DEBT* = total debt divided by total assets. *PCON* is an indicator variable, 1 if the firm is politically connected; 0 otherwise. *INS* = the percentage ownership of the top 5 INS in a firm. *IndependentINS* = the fraction of shareholding of INS who do not have business relationship in investee firms. *t-values* are reported under the coefficient estimates, where ***, **and* denote statistical significance at 1%, 5% and 10% respectively.

Please note that Model 1 represents the experimental variables with all control variables, Model 2 includes the interactions effect between *PCON* and *INS*. Model 3 uses *IndependentINS*, a more stringent proxy of *INS* replacing the earlier experimental variable (*INS*) as a proxy for institutional shareholders. The interaction for Model 3 is *PCON * IndependentINS*.

Table 5

Effect of *PCON* and *INS* on dividend by *GROWTH* and *CASH*

	Low growth		High growth		Low cash		High cash		Low Growth High Cash	High Growth Low Cash
	1	2	3	4	5	6	7	8	9	10
<i>Intercept</i>	-0.041	-0.055	-0.214	-0.039	-0.011	-0.009	-0.203	-0.192	-0.002	-0.007
	-2.460 **	-2.610 ***	-167.200 ***	-2.440 **	-0.620	-0.510	-119.230 ***	-112.990 ***	-0.320	-0.780
<i>LAGGED Div</i>	0.615	0.609	0.799	0.791	1.022	0.970	0.582	0.576	0.516	0.577
	6.580 ***	6.330 ***	72.460 ***	5.500 ***	7.400 ***	7.250 ***	58.280 ***	58.140 ***	9.940 ***	8.180 ***
<i>SIZE</i>	0.019	0.019	0.014	0.014	0.011	0.011	0.018	0.017	0.003	0.008
	5.540 ***	5.460 ***	31.430 ***	4.270 ***	1.660 *	1.680 *	30.300 ***	30.090 ***	2.560 **	4.520 ***
<i>CASH</i>	0.040	0.040	0.037	0.037	0.241	0.234	0.037	0.038	0.007	0.033
	2.840 ***	2.840 ***	10.880 ***	2.040 **	2.040 **	2.010 **	8.040 ***	8.290 ***	2.260 **	1.930 **
<i>ROE</i>	0.181	0.181	0.200	0.198	0.198	0.199	0.194	0.193	0.069	0.013
	8.980 ***	9.040 ***	59.340 ***	8.560 ***	4.570 **	4.610 ***	41.230 ***	40.940 ***	13.150 ***	5.100 ***
<i>DEBT</i>	-0.158	-0.157	-0.168	-0.167	-0.170	-0.171	-0.159	-0.158	-0.024	-0.023
	-9.890 ***	-9.860 ***	-55.460 ***	-7.850 ***	-5.750 ***	-5.780 ***	-37.610 ***	-37.390 ***	-5.440 ***	-4.990 ***
<i>GROWTH</i>	-0.008	-0.008	-0.007	-0.007	-0.002	-0.001	-0.010	-0.010	-0.002	-0.001
	-1.990 **	-2.000 **	-3.470 ***	-3.710 ***	-0.280	-2.240 **	-11.670 ***	-11.410 ***	-2.040 **	-2.920 ***
<i>PCON</i>	-0.009	-0.022	0.003	-0.008	-0.014	-0.098	-0.013	-0.025	-0.009	0.003
	-2.260 **	-2.180 **	0.310	-0.520	-1.140	-0.050	-3.910 ***	-3.850 ***	-8.450 ***	0.580
<i>INS</i>	0.017	0.016	0.020	0.020	0.021	0.020	0.017	0.016	0.090	0.063
	2.440 **	2.300 **	1.040	1.130	1.510	1.380	5.220 ***	5.020 ***	2.180 **	1.430
<i>PCON*INS</i>		0.088		0.062		0.001		0.079	0.010	-0.033
		2.460 **		0.680		1.330		5.480 ***	4.190 ***	-0.890
<i>PERIOD</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>INDUSTRY_DUMMIES</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>X²</i>	1219.42	1182.43	1231.79	1209.93	1029.97	1185.32	1265.42	1284.91	1194.74	1154.93
<i>N</i>	1,229	1,229	1,229	1,229	1,229	1,229	1,229	1,229	501	422

LAGGED Div = lagged one year value of *Ind Adj Div/ta*. *SIZE* = natural log of the book value of firms' assets. *CASH* 5-year mean of the ratio of cash plus cash equivalents deflated by total assets. *GROWTH* = average growth rate of net sales in previous 5 years. *ROE* = earnings divided by equity. *DEBT* = total debt divided by total assets. *PCON* is an indicator variable, 1 if the firm is politically connected; 0 otherwise. *INS* = the percentage ownership of the top 5 *INS* in a firm. T-values are reported under the coefficient estimates, where ***, ** and * denote statistical significance at 1%, 5% and 10% respectively.

Table 6
Effect of *PCON* and *INS* on dividend and CAPEX with the 3SLS

	<i>Ind Adj Div/ta</i>		<i>Ind Adj Div/ta</i>		<i>CAPEX</i>		<i>CAPEX</i>	
	1		2		3		4	
<i>Intercept</i>	-0.009		-0.008		0.002		0.026	
	-3.390	***	-3.000	***	2.700	***	4.260	***
<i>Ind Adj Div/ta</i>					-0.652		-0.767	
					-5.580	***	-6.280	***
<i>LAGGED Div</i>	0.472		0.473					
	15.580	***	15.610	***				
<i>CAPEX</i>	-0.089		-0.055					
	-2.170	**	-1.750	*				
<i>SIZE</i>	0.003		0.002					
	2.350	**	2.750	**				
<i>CASH</i>	0.039		0.040					
	7.350	***	7.500	***				
<i>ROE</i>	0.025		0.024		0.023		0.027	
	11.990	***	11.530	***	4.080	***	4.650	***
<i>DEBT</i>	-0.017		-0.017					
	-7.440	***	-7.440	***				
<i>GROWTH</i>	-0.001		-0.001		0.003		0.004	
	-2.070	**	-1.770	*	2.180	**	2.430	**
<i>PCON</i>	0.035		-0.005		-0.010		-0.005	
	-1.960	**	-1.910	**	-1.970	**	-2.130	**
<i>INS</i>	0.036		0.033		0.002		0.003	
	1.980	**	1.810	*	11.630	***	12.400	***
<i>PCON*INS</i>			0.063				0.059	
			3.070	***			2.010	***
<i>PERIOD</i>	Yes		Yes		Yes		Yes	
<i>INDUSTRY_DUMMIES</i>	Yes		Yes		Yes		Yes	
<i>N</i>	2458		2458		2458		2458	
<i>R</i> ²	0.225		0.262		0.074		0.077	

Table 6 reports a series of three-stage-least squares regressions with *Ind Adj Div/ta* as the dependent variable. The sample period is from 2004 to 2009. *LAGGED Div* is the one year lagged value of *Ind Adj Div/ta*. *SIZE* is the natural log of the book value of the firms' assets. *CASH* represents the five-year mean of the ratio of cash plus cash equivalents deflated by total assets. *GROWTH* is the average growth rate of net sales in previous five years. *ROE* is earnings divided by equity. *DEBT* is total debt divided by total assets. *CAPEX* is capital expenditure deflated by total assets. *PCON* is an indicator variable, which equals to 1 if the firm is politically connected and 0 if otherwise. *INS* is the percentage ownership of the top 5 *INS* in a firm. The instruments for the dividend equation are *LAGGED Div*, *SIZE*, *CASH*, *ROE*, *DEBT*, *GROWTH*, *PCON*, industry dummies, year dummies; with an additional instrument - *PCON*INS* for the moderating regression. The instruments for the *CAPEX* equation are *SIZE*, *ROE*, *GROWTH*, *PCON*, industry dummies and year dummies; with an additional instrument - *PCON*INS* for the moderating regression. The instruments for the unreported *INS* equation are *SIZE*, *GROWTH*, *PCON*, industry dummies and year dummies. Both the rank and the sufficient order conditions are satisfied. *Z-values* are reported under the coefficient estimates, where ***, ** & * = denote the statistical significance at the 1%, 5% & 10% levels, respectively.