

# **Dividend Payout Policy, Investment Opportunity Set and Corporate Financing in the Industrial Products Sector of Malaysia**

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## **Abstract**

There are various factors that influence dividend payout policy of corporations; investment opportunity set and corporate financing are among the important ones. Numerous studies have been conducted on the topic of payout policy but less attention is paid on developing countries. In this paper the impact of investment opportunity set and corporate financing on dividend payout policy of Malaysian industrial products sector is investigated. The sample consists of 62 companies which were listed on the main board of Bursa Malaysia. The dependent variable is dividend payout which is measured by dividing dividend per share by earnings per share. On the other hand the independent variables are investment opportunity set and corporate financing. Tobin's q is used to measure investment opportunity set and financial leverage and debt maturity were used to measure corporate financing. Two proxies of profitability and risk were utilized as the control variables. The results suggest that investment opportunity set and debt maturity are the factors that significantly influence dividend payout policy of the sample firms. In addition, profitability and risk play significant role in determining dividend policy in the industrial products sector of Malaysia.

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## **1 Introduction**

Dividend payout policy has been an interesting topic in the field of finance that attracted several scholars (i.e. see Lintner, 1956; Miller and Modigliani, 1961; Baker, Farrelly and Edelman, 1985; Allen and Michaely, 1994). Dividends are an issue of concern to investors since they provide a source of income and more importantly they give the investors an insight about the company's performance. Setting a proper dividend policy is a crucial task for the managers since it has a major touch on the company's share price and it also can influence the asset pricing, capital structure, mergers and acquisitions, and capital budgeting (Allen and Michaely, 1994). There are several factors that impact dividend payout policy of firms including company's profitability, risk, ownership and size. Investment opportunities and corporate finance are two elements which are known to play important role in determining dividend policy. Investment opportunities are potentially profitable projects that firms should discover and utilize them for economic rents (Myers, 1977). Investment opportunities available to the firms are one of the essential factors of company's growth and the companies with potential growth opportunities have generally higher share price. Some believe that investment opportunity set has a clear impact on the dividend payout policy of firms. The increases in investment opportunity set of a firm result in rise of dividend payout ratio and also increase of their dividend yield (Abbott, 2001).

There are various opinions about the financing policy and decisions of companies and their relationship with the firm's value. One of the major theories was presented by Miller and Modigliani (1961) which asserts that in a perfect capital market there is no relationship between the firm's value and the way its productive assets are financed. However there are many scholars who have the opposite idea. Thus, we cannot ignore the fact that financing policy of the firms influences the payout of dividends. Higgins (1972) mentions firm fund requirements for investments as one of the elements that influences the dividend payout. Debt financing and agency costs are the other factors that play a role in defining dividend payout ratio. Although many studies have tried to prove the relationship between investment opportunities, corporate finance and dividend payout policy, still no clear link is found to support this relevance (Abor and Bokpin, 2010).

In spite of the fact that there have been many studies conducted on the topic of dividend payouts, most of these researches have been on the developed markets of USA and European countries and very little attention has been paid to the emerging markets and in this case the developing country of Malaysia. As a matter of fact there are a few studies on dividend payout policy of Malaysian firms that almost none of them have focused on specific sectors of the listed companies in the Kuala Lumpur stock exchange. As long as firms in the emerging markets act differently in terms of setting dividend payout policy, further research in this context could be useful. This study aims to fill this gap by providing evidence from the emerging market of Malaysia to compare and prove the similarities and differences between the available literature and findings of this research.

The purpose of this paper is to investigate the impact of investment opportunity set and corporate financing on dividend payout policy of firms in the industrial products sector of Malaysia for the time period between 2006 and 2008. The rest of this paper is organized as follows. The second section elaborates the literature on dividend payout policy, investment opportunity set and corporate finance. Third section discusses the methodology and methods which are used to conduct this study. Section four explains the

results and findings of this research and finally, the conclusion of this whole study is presented in section five.

## **2 Literature Review**

Dividend policy is a complicated issue which has always been debatable. Not only the amount of money involved and the repetitive nature of dividend payout makes this topic important, payout policy has a close relation with most of the firm's investment and other financial policies (Allen and Michaely 1994). Out of the several studies on dividend policy topic, the irrelevance theory of Miller and Modigliani (1961) raised a lot of controversy. According to their theory, in a perfect market where there are no transaction costs and taxes or information asymmetry, the dividend policy of a firm has no effect on its value and that a firm has no optimal dividend policy. However, a perfect market where all information is instantly available to investors for free and there are no taxes or transaction costs included (Vasicek and McQuown, 1972) is far out of reach.

According to the irrelevance theory, under uncertainty, this is not the dividend policy that determines the market value, but the firm's investment policy is what that really matters. The companies which have low level of earnings but at the same time offer higher stock price gain their value from the future expansion opportunities (Aretz and Bartram, 2010). It is generally accepted that the main objective of all companies is maximizing the shareholders wealth (Brealey and Myers, 1996). The result of Fama and French (1998) shows that the stock prices change in the same trend as the changes in the dividends and their results are consistent with that of Baker et al., (1985). Fairchild (2010) believes that dividends might increase the firm value by sending positive signals of the current income and decreasing the free cash flow problem.

The information content of dividends is supported by many scholars namely Miller and Modigliani (1961) Michaelsen (1961) and Asquith et al., (1986). The signaling theory asserts that dividends are a tool for managers to signal shareholders about the expected future performance and profitability of the corporation (Bhattacharya, 1979). However it is noted that dividends might also provide misleading signals to the shareholders. Investors might consider a dividends rise as a result of increase in the current income or elimination of cash flow problems or sense it as a negative sign of lack of investment opportunities or absence of growth options. Bernheim and Wantz (1995) propose that high taxes on dividends could be a signal of corporate health in that only the profitable and healthy firms have this capability to afford high dividend payouts.

Companies can select repurchasing the shares instead of paying dividends which would impose them less taxation costs (Allen and Michaely, 2003) but the reason why companies choose to pay dividends instead of repurchases is lying in clientele effect (Allen et al., 2000). In tax clientele theory, the assumption is that the investors choose their portfolios according to marginal tax rate of the stocks (Subramaniam et al., 2011). The investors in low tax brackets are more interested in stocks with high dividend payouts compared to the investors in high tax brackets (DeAngelo et al., 2000).

Klein et al., (2002) brings up the concept of adverse selection which is a result of information asymmetry. The definition of asymmetric information in corporate finance is that the managers of the firm have better and more complete information about the firm's value and its investment opportunities compared to the outsiders known as the market participants (Klein et al., 2002). Companies which are controlled by shareholders try

internal financing sources instead of debt financing and outside capital in order to prevent mispricing losses (Noe and Rebello, 1996). On the other hand when there is no information asymmetry, what counts in choosing the financial policy are just the factors affecting the share of rents collected by the manager. One of the consequences of conflicts between corporate insiders and shareholders is growth of agency costs. The cost of monitoring by the principal, bonding expenditures by the agent and the residual losses from slippage are agency costs carried by the investors. In fact agency cost occurred when a conflict is developed between the management and the shareholders who have no voice in the management (Jensen and Meckling, 1976).

The mature firms that are able to generate enough income to cover their investment financing needs through their operations, should spend their free cash flows in the form of dividends (Jensen, 1986). When the corporate insiders decide to retain the excessive free cash flows to use for their private benefit, it would lead to poor corporate governance and at these times the agency problems occur. The agency cost that Jensen (1986) mentions in his theory refers to the management's intention to invest in negative NPV projects, but dividend payouts can eliminate this problem by controlling the cash available to managers (Fairchild, 2010). As Lang and Litzenberger (1989) studies show, the share price of the firms who have increased their dividend payouts while having excess cash flows had risen; this is while there were a few profitable investment opportunities available.

## **2.1 Investment Opportunities and Dividend Payout**

One of the most important elements of market value is the investment opportunities available to the firm. The common assumption of investment opportunity set is making a capital expenditure to produce a new product or expand an existing production line (Kallapur and Trombley, 2001). As a matter of fact, investment opportunities are potentially profitable projects that firms should discover and utilize them for economic rents (Myers, 1977). The value of investment opportunity set depends on the future discretionary expenditures by managers in case further investment on the assets is not required (Myers, 1977). The discretionary expenditures of managers depend on the internal funds of the firm and also the corporate capacity to issue low risk debt (Triantis, 2000). A firm with financial slack has cash or quick assets or extra debt capacity available so that it can use the investment opportunities as they come across, in fact firms with financial slack have the opportunity to invest in positive net present value projects without issuing risky securities (Smith and Kim, 1994).

Kallapur and Trombley (2001) mention that investment opportunity impacts remarkably on the perspective of managers, owners, investors and creditors about the firm's value. The firms with potential profitable expansion opportunities have higher share prices although they might currently have low earnings (Aretz and Bartram, 2010). Investment opportunity set has a clear effect on the dividend payout policy of firms. The increases in investment opportunity set of a firm result in rise of dividend payout ratio and also increase of their dividend yield (Abbott, 2001). In contrast (Smith and Watts, 1992) and (Gaver and Gaver, 1993) believe that investments and dividend payouts are competitors in using the cash resources of the firms; it is more probable for the firms to reduce their dividend payout to take advantage of the investment opportunities available to them. Firms that have the opportunity to grow need to utilize the free cash flows in investments, so it is expected that these firms pursue lower dividends (Jones and Sharma, 2001). Subramaniam et al., (2011) also have found strong negative relationship between dividend

policy and growth opportunities. In a market with asymmetric information, dividend payouts could be interpreted as a sign of lack of positive net present valued investment opportunities for the firm (Fairchild, 2010). While a company that cuts dividends is sending the signal to the investors that there are attractive investment opportunities available that dividend payments will spend up the free cash flows necessary for undertaking that investment (Black, 1976).

The identity of shareholders has an impact on dividend payout policy of firms regarding the available investment opportunities. When there are good investment opportunities available to the firms, the shareholders might decide to overlook the dividends in favor of profitable growth opportunity (Jensen, 1986). In contrast, when there are no growth opportunities available to a firm, the shareholders might decide to put the managers under pressure to disburse dividends so that those earning could not be used to benefit corporate insiders (Gugler, 2003). The theory of Miller and Modigliani (1961) is supportive of the fact that once the optimal level of investment has been determined, the dividend payouts are the first to drop out. However, firms rather to have steady dividend payouts instead of setting new rates each quarter (Lintner, 1956). It is believed that firms with stable dividend policy have better reputation and value in the market and that is why managers try to apply the concept of smoothing hypothesis. According to smoothing hypothesis, earnings lead to dividends. Smoothing hypothesis promise that firms make changes to the dividend payout policies rather cautiously since managers are reluctant to cut dividends when the corporate earnings decline (Basse and Reddemann, 2011).

The first hypothesis this study aims to establish is:

H1: There is negative relationship between investment opportunity set and dividend payout policy.

## **2.2 Corporate Finance and Dividend Payout**

Miller and Modigliani (1961) were the first scholars who suggested that in a perfect capital market there is no relationship between the firm's value and the way its productive assets are financed. They also believed that the growth rate of the firm is not the same as the growth rate of dividends per share except the conditions when all the financing is internal. Under asymmetric information financing decisions would result in signaling of firm value to the market thus impact on the securities value (Woolridge, 1983); while according to the irrelevance theory of Miller and Modigliani (1961) in a perfect capital market where there is no asymmetric information, under a given investment decision, the corporation value is independent from the financing decisions so dividend payouts would not have any impact on the firm value or shareholder wealth.

In an imperfect capital market which is the realistic condition where there exists asymmetric information, transaction and agency costs and taxes and assets are not divisible perfectly, it is probable that there exists a relationship between financial structure of a firm and its investment decisions (Wang, 2010). As a matter of fact, market imperfections have significant impact on the relevance of investment and financing decisions (Peterson and Benesh, 1983)

According to capital structure signaling model, it is expected that firms with higher value would have more financial leverage (Klein et al., 2002). When the equity is underpriced, in presence of asymmetric information debt and retained earnings are better methods of financing compared to issuing new equity (Miller and Modigliani, 1961). While paying out dividends has a negative impact on the investment opportunity of a firm, external

financing could have a positive effect on investment since it increases the funds available to be used (McCabe, 1979). The general assumption in analyzing dividend policy is that firms have to satisfy the financial needs of existing and future investment through external financing which is going to be costly for the corporation. The firms that go through new long term debt will have to cut the dividend payouts (McCabe, 1979). According to Jensen (1986) financial leverage has a significant impact on reducing agency costs in a firm. On the other hand as mentioned earlier the level of debt has an impact on the payout policy of dividends in corporations. However, while there are so many researches done in the field of financial leverage and dividend payout policy, there are various theories and ideas on this topic. Thus the following hypothesizes are proposed:

H2: There is negative relationship between dividend payout and corporate finance.

H3: There is positive relationship between dividend payout and profitability.

### **3 Methodology**

#### **3.1 Data and Variable Construction**

In this study the impact of investment opportunity set and corporate finance on dividend payout policy is examined. The sample population of this study is comprised of 62 dividend paying companies listed in the Bursa Malaysia Stock Exchange for the industrial products sector for the time period over 2006 and 2008. Industrial products sector has a remarkable importance in Malaysian economic growth and not many studies have been conducted in this context so far. There are three main sources where the data needed for this study is collected namely, Datastream, Bloomberg and the Star newspaper. For the information which could not be gained on these data bases, Bursa Malaysia is used to extract specific data on particular companies.

The dependent variable is dividend payout which is measured by dividing dividend per share by earnings per share. Dividend payout can give a good insight to the shareholders about the company's performance and how much of its earnings are paid back to the shareholders. Investment opportunity set and corporate financing decisions are the independent variables of this study. Tobin's q is used to measure investment opportunity set and to measure corporate finance two ratios are used namely: financial leverage and debt maturity ratio. Financial leverage is measured by total debt divided by the total shareholder equity which indicates the amount of debt and preferred stock used in a firm's capital structure. Debt maturity is measured by dividing long term debt (debt due after 1 year) by total debt.

In setting the corporate payout policy, managers always take in to account the current and historical profits (Pruitt and Gitman, 1991). The level of expected earnings has also a significant impact on dividend payout (Baker et al., 1985). Profitability as one of the factors that have always been considered as a major factor in company's ability in paying out dividends is used as control variable as well as risk which is measured by means of Beta. A firm with history of steady earnings could be considered less risky since future earnings could be positively predicted. Such firm is expected to payout dividends at higher rates comparing to a firm with unstable earnings (Pruitt and Gitman, 1991).

### 3.2 Model Specification

To investigate the impact of corporate finance and investment opportunity set on dividend payout policy, this study employs the following panel data multiple regression models:

$$\text{Model (1) } DP = \alpha_0 + \beta_1 IO + \beta_2 Lev + \beta_3 Pro + \beta_4 Risk$$

$$\text{Model (2) } DP = \alpha_0 + \beta_1 IO + \beta_2 Debt\ Matu + \beta_3 Pro + \beta_4 Risk$$

DP is a measure of dividend payout and IO represents the investment opportunity set. Corporate financing proxies are shown as Lev which is a measure of leverage and Debt Matu as debt maturity measure. In terms of control variables Pro represents profitability and Risk which is measured by Beta.

### 3.3 Statistical Tools

Statistical software STATA 12 is used to analyse the data. The data analysis of this study comprises of assumptions of multiple regression analysis, descriptive statistic, correlation analysis, multiple regression and robustness tests, respectively.

To apply the multivariate regression, following prior studies ordinary least square regression (OLS) is utilized. However to justify the choice and validity of the results of OLS regression a number of assumptions are taken into consideration. These assumptions are linearity; normality multicollinearity and homoscedasticity.

The normal P-P plot of regression residuals is used to test the linearity of bivariate relationship and the results are indicative of absence of linearity. The second assumption which is normality is examined by skewness test and to normalize those variables which were not normally distributed logarithm transformation is employed. Table 1 presents the normal distribution data before and after transformation.

Table 1: Normal distribution data before and after transformation

	Skewness					
	Dividend Payout	Investment Opportunity (Tobin Q)	Leverage	Debt Maturity	Profitability	Risk (Beta)
<b>Original</b>	1.891	2.529	1.082	0.887	0.508	0.146
<b>Transformation by Natural Log</b>	-0.522	0.642	-	-	-	-

Table 1 shows that all variables are normally distributed except for the dividend payout and investment opportunity. However, after natural log transformation of the mentioned two variables all the variables are within the range of -1 and 1 which are considered normal.

The next assumptions of OLS regression are multicollinearity and homoscedasticity tests. In order to detect the issue of multicollinearity, this study reported the Variance Inflation Factor (VIF) of each variable. There will be no issue of multicollinearity if the variable inflation factor (VIF) value is less than 10 and tolerance value of variables is more than 0.10 (Neter et al., 1983). The result of multicollinearity test reveals no evidence of multicollinearity problem between predictor variables. The next step is to check for the homoscedasticity issue. This study uses Breusch and Pagan (1979)/ Cook-Weisberg test to detect the heteroscedasticity issue in each regression model. In case of presence of heteroscedasticity issue, least square estimator with robust standard error would be able to resolve this problem (Wooldridge, 2002). However, according to the result of this test, as

long as the p-value is insignificant, we do not have heteroscedasticity issue in our models. Now that the preliminary assumptions of OLS regression are adequately fulfilled OLS regression is conducted in the next step.

## 4 Empirical Results

### 4.1 Descriptive Analysis

Table 2 indicates the descriptive statistics of the dependent and independent and control variables of this study. The sample covers 62 listed companies across the industrial products sector of Malaysia over the period of 2006 and 2009. Two variables of dividend payout policy and investment opportunity set are log transferred in order to match the normality assumption.

Table 2: Descriptive statistics

Variable	Mean	SD	Min	Max
<b>Dividend payout</b>	-0.47 (1.32)	0.35 (0.38)	-1.95 (0.01)	0.30 (2)
<b>Investment opportunity (Tobin's Q)</b>	-0.08 (0.98)	0.25 (0.72)	-0.67 (0.21)	0.65 (4.44)
<b>Leverage</b>	0.45	0.44	0.00	1.85
<b>Debt maturity</b>	0.30	0.30	0.00	1.00
<b>Profitability</b>	0.06	0.04	-0.01	0.16
<b>Risk (Beta)</b>	0.99	0.69	-1.37	3.05

(Note: numbers shown in parenthesis are values before log transformation)

The mean, standard deviation, minimum and maximum level of each variable is illustrated on this table. The mean value for dividend payout which is the dependent variable of this study is 1.32. It indicates that the average dividend payout for the sample companies under investigation has been 1.32 ringgit. Standard deviation of 0.38 implies the variation in the dependent variable for the time period of study which has changed from 0.01 to 2. The mean value of investment opportunity set which is measured by Tobin's q is 0.98 with standard deviation of 0.72. Leverage which is measured by dividing total debt to total equity has mean value of 45 percent with standard deviation of 0.44 and it has been varied from 0 to 1.85 for the 62 companies investigated in this research. Mean value of debt maturity is 0.30 implying that 30 percent of total debt belongs to the short term debt category. It has standard deviation of 30 percent and varies between 0 and 1. Profitability is measured by return on asset ratio and has mean value of 0.06 with standard deviation of 0.04 and risk that is defined by beta indicates mean value of 0.99.

Table 3: Correlation Matrix

	<b>Log Dividend Pay out</b>	<b>Log Investment Opportunity</b>	<b>Leverage</b>	<b>Debt Maturity</b>	<b>Profitability</b>	<b>Risk (Beta)</b>
<b>Log Dividend Pay out</b>	1.0000					
<b>Log Investment Opportunity</b>	0.1568 (0.0346)	1.0000				
<b>Leverage</b>	-0.1050 (0.1618)	0.0660 (0.3744)	1.0000			
<b>Debt Maturity</b>	-0.2157 (0.0035)	-0.0164 (0.8241)	0.2492 (0.0007)	1.0000		
<b>Profitability</b>	-0.1093 (0.1476)	0.2340 (0.0015)	-0.3257 (0.0000)	-0.1117 (0.1342)	1.0000	
<b>Risk (Beta)</b>	-0.2988 (0.0000)	-0.0720 (0.3286)	0.2533 (0.0005)	0.1150 (0.1182)	-0.0664 (0.3742)	1.0000

(Notes: p-values are shown in parenthesis. Dividend payout is measured by the dividend payout ratio; investment opportunity is calculated using Tobin's q and financial leverage is measured by the ratio of debt to equity. Debt maturity is short-term debt on top of total debt. Profitability is measured as the proxy of return on assets and risk is measured by Beta).

## 4.2 Correlation Analysis

Table 3 presents the correlation matrix for all the variables of this study at 5% level of significance. There is a significant and positive relationship between investment opportunity set and dividend payout. Leverage has a negative correlation with dividend payout which is not statistically significant. Debt maturity shows a significantly negative correlation with dividend payout and a positive significant correlation with leverage. Profitability shows a negative but not significant relationship with dividend payout. The correlation between investment opportunity set and profitability is positive and significant and leverage and profitability have significant negative correlation. Risk has negative correlation with profitability, investment opportunity set and significantly with dividend payout. But it has significant positive correlation with leverage. All in all, the result of correlation analysis proves the absence of multi-collinearity problem among regressors.

## 4.3 Panel Regression Result

Variables of this study are tested in two models for regression analysis. For each of these models the tests of multicollinearity and homoscedasticity are done and after checking for the preliminary assumptions, the regression is conducted for each model using Ordinary Least Squares method. Table 4 presents the results of OLS regression at 5 percent level of significance.

Table 4: OLS regression result for the two models

	Model (1)		Model (2)	
	Coef.	t	Coef.	t
<b>Investment opportunity</b>	0.2608*	2.40	0.2497*	2.35
<b>Leverage</b>	-0.0828	-1.32		
<b>Debt maturity</b>			-0.2274*	-2.69
<b>Profitability</b>	-1.9373*	-2.44	-1.8373*	-2.50
<b>Risk</b>	-0.1475*	-3.94	-0.1402*	-3.84
<b>Constant</b>	-0.1397	-1.79	-0.1268	-1.77
<b>R<sup>2</sup></b>	0.14		0.16	
<b>F-statistic</b>	7.29		8.28	
<b>Prob &gt; F</b>	0		0	

According to the prior literature it is believed that investment opportunity set and dividend payout have negative relationship. As long as companies have the opportunity of investing in positive NPV projects, they would prefer to keep the free cash flows inside the organization in order to use them for satisfying the financing needs. Surprisingly though, the result of this study shows the opposite relationship. Hence hypothesis 1 which states that there is a negative relationship between investment opportunity set and dividend payout policy is not supported. With regards to the findings of this research, investment opportunity has a statistically significant and positive relationship with dividend payout. This suggests that the companies with positive expected growth opportunities are eager to payout dividends. This is consistent with the view of Jensen (1986) who is on the belief that mature firms that can generate more income than their financing requirements through their operations should payout dividends from the source of those free cash flows. Morck and Yeung (2005) also note that the act of disbursing the free cash flows in the shape of dividends, signals the good governance of the firms to investors. Most of the theoretical and empirical researches in this field admit that the relationship between dividend payout and share price is positive which in other words means increase in dividend payouts results in rise of share price (Fairchild, 2010). This could be another reason for the unexpected outcome of the relationship between dividend payout and investment opportunity in this study.

Two measures of corporate finance which includes financial leverage and debt maturity were used in this study to find the relationship between corporate finance and dividend payout. The results show negative relationship with dividend payout for both measures while debt maturity has significant correlation with dividend payout. Thus it could be concluded that the second hypothesis is accepted. Contrary to Higgins (1972), Rozeff (1982) and Mullah (2011) who found a negative relationship between financial leverage and dividend payout, there is not enough evidence to support such relationship in this study. Although the coefficient was negative, it was not significant. Based on the analysis of this research, debt maturity shows stronger relationship with statistically significant and negative relationship. This is consistent with studies conducted by McCabe (1979) and against the findings of Barclay and Smith, Jr. (1995) and also Abor and Bokpin (2010). It is ideal for the firms that their liabilities mature as the new investment opportunities appear so that the managers do not have to reject positive net present valued projects (Myers, 1977). Jensen (1986) mentions debt as a factor that reduces the amount

of free cash flows. What could be inferred here is that the higher the debt maturity gets, the lower the level of free cash flows become; thus, managers prefer to cut on dividend payouts in order to maintain the fund resources within the company as the firm's financing needs rise.

With regards to the fact that this study is conducted in the context of Malaysia, Al-Twaijry (2007) claims that dividends are influenced by their past and future trend. On the other hand Malaysian investors are more in favor of increase in earnings per share rather than counting on dividends (Isa et al, 2006; Ku Ismail and Chandler, 2005) and this could be the reason for the significantly positive relationship between dividend payout and investment opportunity set.

Profitability had significantly negative correlation with dividend payout. It is inferred that the higher the profitability of the company, the less they prefer to payout dividends. It could be due to the fact that profitable firms have more opportunities for growth, so they would prefer to invest the free cash flows in the future growth projects (Rozeff, 1982).

The result of this study suggests statistically significant and negative association between risk and dividend payout implying that firms with higher risk tend to payout less dividends. This finding is consistent with the result of studies conducted by Rozeff (1982), D'Souza and Saxena (1999) and Amidu and Abor (2006). Firms would payout lower dividends when the rate of market risk is high (Collins et al, 1996). Rozeff (1982) points out that the companies with higher betas set lower dividend payouts since high beta is a sign of high operating and financial leverage and that these firms are more likely to undergo external financing.

## **5 Conclusion**

This research tried to highlight the importance of dividend payout policy in the fast growing market of Malaysia. The sample covered 62 dividend paying companies in the industrial products sector for the time period from 2006 to 2008. Investment opportunity set as one of the major determinants of dividend payout has significantly positive relationship with payout policy. Although all the companies had positive investment opportunities, they all opted to payout dividends. The general perception is that as investment opportunities rise, the firms usually cut off payouts in order to keep the financial resources available for reinvestment. The result of this study implies that proper operations and good governance of these companies have provided them with the possibility of investing in new projects while at the same time disbursing the remaining free cash flows to the investors (Laporta et al., 1997). On the other hand increase in dividend payout results in share price incline which is in favor of the Malaysian investors (Isa, Haron and Yahya, 2006; Ku Ismail and Chandler, 2005). The finding of this study is also in the same line with results of Morck and Yeung (2005).

The proxies of corporate finance had negative relationship with dividend payout while it was only debt maturity that indicated significant relationship with dividend payout policy. With reference to the implication of debt maturity, it is conclusive that higher level of debt restricts dividend payout. On the other hand, higher debt implies higher risk among financially distressed companies in Malaysia (Abdullah et al., 2008). Risk being one of the control variables of this study showed significant negative relationship with dividend payout. The negative and significant relationship of profitability and dividend payout is indicative of the importance of this factor on corporate payout policy.

This study revealed Investment opportunity set, debt maturity, risk and profitability as the important factors that influence payout policy of companies in industrial sector of Malaysia. This paper provides beneficial information for professionals, boards of directors and academics on issues relating to dividend payout policy, investment opportunity and corporate finance among Malaysian public firms.

However, like any other research this paper was subject to some limitations. Since there are not many studies on the topic of dividend payout policy conducted in the context of developing countries especially Malaysia, not all the results of previous studies are applicable to this paper. Limited scope of study and the use of secondary data are the other limitations to this research. However, to shed more light on the topic of dividend payout policy and better understanding of this issue in the developing country of Malaysia, further studies are required.

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