

Role of State and Foreign Ownership and Dividend Policy: Supply Chain Strategies in Emerging Market Perspective

Haidar Hamza Jody Al-dulemy

Department of Business Administration, College of Administration and Economics, Al-Mustansiriyah University, Iraq

drhaidarjody@uomustansiriyah.edu.iq

Abstract— This investigation is aimed to shed light on the relationship between dividend policy and ownership structure based on the supply chain strategy in the emerging markets. This study hypothesizes the concept that concentrated foreign ownership have different dividend policy as compared to state-owned companies. Moreover, state ownership is also examined with respect to dividend policy. The phenomenon is explored by using a panel data of 2001 to 2015 of companies listed in Iraqi stock exchange. A strong impact of ownership structure was noticed in dividend policy. Companies with higher government ownership are more tilted to pay cash dividends and create tunneling effect. However, foreign ownership concentrated firms are more likely to pay stock dividends. Further, firms with growth opportunities are likely to pay stock dividends while the negative relationship with growth and cash dividend was noticed. This study has significant policy guidelines for investors, managers and academics. The findings of this study are also significant from emerging market perspective.

Keywords— *Dividend Policy, Supply Chain Strategies, State Ownership, Foreign Ownership, Emerging Market*

1. Introduction

Capital market and corporate behavior researchers have been interested in corporate dividend policy for almost half a century. However, this interest has increased markedly because of many accounting and financial scandal. Agency theory (from here on referred to as AT) drives and underpins most of the research in the field of corporate governance, which gives us the tool for creating and monitoring a strong strategy that can survive uncertainty and incomplete information [10, 23, 38] However, research has also shown that dividends reduce problems related to investors in countries with strong financial regulations geared towards protecting investors; however, they are not so effective in countries with weak investor protection

regulations [20]. It can be assumed that there will be lower dividend payouts in Iraq as its law and regulations are weak, when it comes to investor protection. However, [6] has reported high cash dividend payout ratios in emerging countries.

Prior researches have found that firms prefer paying stable dividends in many developed countries however, most of the researchers documented American perspective [4, 5, 28, 31, 36, 37, 38]. This behavior (of paying stable dividends) has spawned many theories which look into the reasons for paying stable dividends. However, most of the research (and theories) related to corporate dividend policy has been focused on developed countries while the underdeveloped world remains unexplored. Iraq is one such country where this kind of research-gap exists. Therefore, this study tries to examine this dividend-policy research gap in underdeveloped countries by looking at Iraq.

Studies have shown that there is a significant role of the ownership type (state or foreign) on the choice of dividend policies. However, the role of ownership structure to determine dividend policy is inconclusive [5, 25, 28, 29, 31, 36, 37, 38, 40, 41]. Furthermore, the effects of foreign ownership have, mostly, been ignored in emerging markets. Ferguson et al. (2002) have reported a signaling effect in foreign listed and state-owned companies while corporate disclosure [11]. If we assume that dividend policies signal certain behaviors, then it could be assumed, too, that foreign-listed firms affect dividend policies and practices more as compared to those which are not. State ownership of a firm can be seen as being similar to large-investor ownership - but with some major differences. Moreover, it has been observed that cash dividends decrease agency problems in some cases - especially when large investor/shareholder (such as a state) are involved. Dividend payments

are unable to decrease agency problem, leading to large shareholders abusing investors. This possibility of using dividend payments (i.e., cash flows) to benefit the state (or the state actors) could be seen as a reason why states continue to own significant portions of the corporate economy in many countries. Consistent with the above argument, state-owned companies are increasingly choosing to pay dividends. These findings support AT, with respect to dividend policy, which claims that dividend payments can be used by large shareholders (such as a state) to accrue undeserved benefits from state-owned firms at the expense of the investors. Hence, there is a need to explore these differences.

The importance of Iraq's economy is due to its status as a major oil producing/importing country. However, despite being center-stage in global oil production, the workings of Iraq's economy remain closed to the outside world (e.g., what is the role and interaction of Iraq's corporate policies, and the state in the economy). This paper, therefore, contributes to the field of dividend policy by exploring the part that foreign ownership plays a role in the selection of dividend policies. Specifically, we contribute to the field by exploring the differences between foreign ownership and state ownership and trying to find out if they follow the same policies. This paper adds to the existing literature on Iraq's corporate economy by finding out the effects of state and foreign ownership on dividend policies. This paper explores this problem by studying the effects of corporate ownership on corporate dividend policies.

2. Supply chain strategy in Dividend policies

Dividend policies are affected by institutional features. Firstly, if the shareholder happens to be the state, it plays a major role in devising the policies. Particularly a great number of state-owned companies in an economy dictate the dividend policies by the government [43]. Several theories (such as bird-in-the-hand) try to comment on the issue of why firms would opt to go ahead with certain dividend policies. And notwithstanding the conclusions of the "dividend irrelevance" theory [32], the bird-in-the-hand theory claims that shareholders consider dividends less risky as compared to gains on selling the stock. Hence, firms believe that they might increase the price of their stock by giving more dividends [37]. Even

though the bird-in-hand theory might reflect beliefs held by many firms and their management, the theory itself has been discredited among researchers as a result of the lack of real-life instances with high dividends payout [26, 27].

There are three theoretical models in dividend policy literature which explain the behavior related to corporate dividends. The full information models claims that shareholders expect huge returns on stocks that pay dividends because of the higher taxes on dividends (De Angelo and Masulis, 1980; 34). The information asymmetry models is about the relation between market incompetence and asymmetric information [21, 24]. The behavioral models claims that attitude of the people who invest is substantially dependent on socioeconomic factors [39]. Therefore, dividends can be seen as a societal/economic effect of corporate change [12]. The literature on dividend policy has shown that taxes are an important factor in investors' demand for an increase in profits which are counted before taxes [8, 34]. This gives the impression that tax rates and dividend payouts are inversely proportional to one another. However, research on US companies shows that even though tax differentials are a concern, but they are not a top-tier concern in dividend payment decisions [4]. Furthermore, the literature gives models which are based on market inefficiency hypothesis which is connected to information asymmetry (e.g., dividend signaling models), this information is in line with agency theory [21, 24]. Several researchers hold this opinion that dividends can signal about a firm's potential. For example, dividends could signal information about a firm which was unknown in the market, even if the management is not openly claiming it [33]. On the other hand, dividends can also be used as a signal to change the market's expectations about future earnings [13, 22].

As per the signaling theory, dividend payouts give signals to the prospective buyers of the stock about how the firm could perform in the future. Even though it is apparent that prospective buyers of the firms' stocks glean information from how firms' dividend policies are set. It remains unclear why firms would select signaling as a basis for deciding on the dividend policy when there exist other cheaper methods to pass on this information [35].

The preference for delayed dividend income goes up when dividends are taxed at a higher rate [1]. Therefore, investors who are in low-tax brackets prefer cash dividends, whereas others prefer capital gains. Investors in the U.S. prefer small cash dividends to capital gains, despite there being tax advantages on capital gains. On the other hand, even when the taxes are the same on dividend

and the profit one makes from selling one's stocks, shareholders prefer taxes which are delayed [30]. Agency theory states that dividends have the ability to weaken agency-related issues as they stop managements from doling out discretionary and suboptimal funds [3, 7, 9, 15, 20, 37]

There are a few reasons explained by the researchers; cash dividends can assume an unexpected job in comparison to stock dividends. Firms can utilize stock profits to flag positive insider news to signal the market [16]. Firms with better projections are more likely for flagging on the grounds that the decrease in retained income coming about because of stock dividends will oblige their future profit distributions. In contrast, firms with poorer projections think found it harder to imitate this conduct as their undistributed benefits cannot be replenished. As stock profit declaration frequently builds stock costs while cash dividends regularly diminish stock costs, stock dividends can expand the cash brought up in a consequent rights issue. In entirety, money profits and stock profits assume distinctive jobs.

AT and its implications on the dividend policy are further complicated when it comes to large-block shareholders [19, 20, 27]. Large-block shareholders benefit all the shareholders as they play the role of a monitor on the firm's activities [18]. However, it has also been noted that the benefits accrued to large-block shareholders are disproportionate in nature because of their size, which might negatively impact the value of the firm [2, 14, 17, 42]. But some researchers see this as the cost of the monitoring that they do on behalf of the rest of the shareholders [44]. In this manner, state investors would probably utilize money profits as a vehicle of tunneling in firms with higher state possession. Thus, on the basis of signaling annotation, foreign ownership concentrated and higher state ownership firms would have distinctive dividend strategies. Consequently, foreign ownership is more attracted towards growing firms then stable and mature firms, which may lead to preferred stock dividends over cash dividends.

3. Methodology

This paper investigates the dividend policy of Iraqi listed companies from 2001 to 2015. The sample selection begins with the entire population of companies listed on Iraqi stock exchange. The selected companies have at least one year of age being listed on stock exchange and announced a dividend. Further, we exclude the financial companies as the structure and nature of operations are dissimilar with other companies. We do not

include the effect of tax policies in our model as there are no significant tax reforms has been observed during the study time period. Further, to control information asymmetry effect in the model, we include control variable (growth, capital structure). According to Wei et al, previous dividend trends also determine the future policy of company hence the effect of the previous trend has also been corroborated in our model [43]. The following econometric model is utilized to investigate the phenomenon under study:

$$DIVC_t = \beta_0 + \beta_1 OWNF_t + \beta_2 OWNS_t + \beta_3 G_t + \beta_4 D_t + \beta_5 DIVC_{t-1} + \epsilon_t \quad (1)$$

$$DIVS_t = \beta_0 + \beta_1 OWNF_t + \beta_2 OWNS_t + \beta_3 G_t + \beta_4 D_t + \beta_5 DIVS_{t-1} + \epsilon_t \quad (2)$$

Equation 1 measures the relationship of ownership structure with cash dividend where DIVC represents cash dividend payout ratio, OWNF understood as foreign ownership percentage, OWNS represents state ownership percentage, G represents growth of company measure as the market to book value and D explains the debt percentage. Equation 2 is utilized to measure the relationship of stock dividend payout ratio with ownership structure. DIVS represents the stock dividend payout ratio.

The OLS regression model was used to investigate the relationship among variables of interest. The data was first normalized by using inter-quartile rage.

4. Results and Discussion

The correlation estimation using Pearson's correlation techniques has been presented in Table 1. It is found that the cash dividend payout ratio is significantly and positively associated with state ownership. Which explains that higher state ownership concentrated firms are more likely to pay cash dividends. Further, a negative relationship has been diagnosed with cash dividend payout ratio and foreign ownership. Accordingly, a negative association has been noticed among growth and cash dividend payout ratio. In Contrast, the relationship among stock dividend payout ratio and

state ownership percentage is negative. Furthermore, the positive association among foreign ownership and stock dividend payout ratio has been noticed. Hence, it clearly said that state ownership concentrated firms are more likely to

pay cash dividend while foreign ownership concentrated firms are more likely to go for the stock dividend. The lag of cash dividend and stock dividend also show that previous dividend policy is inculcated in the present year's dividend policy.

Table 1. Correlation Matrix

	DIVC	DIVS	OWNF	OWNS	G	D	DIVC _{t-1}	DIVS _{t-1}
DIVC	1	0.064***	0.032***	0.132***	-0.023***	0.012***	0.24***	0.023***
DIVS	0.00	1	0.067***	-0.093***	0.034***	-0.031***	0.042***	0.21***
OWNF	-2.215	-3.829**	1	-3.936**	-6.73*	-2.87	2001	-4.02
OWNS				1	0.001**	0.048***	0.16***	-0.002***
G					1	-0.012	-0.20***	-0.011***
D						1	0.034***	0.013***
DIVC _{t-1}							1	0.262***
DIVS _{t-1}								1

*, **, *** represents level of significance at 10%, 5% and 1% respectively.

The association among the variables on the basis of correlation analysis needs to be further diagnosed with regression analysis because association among variables is on individual basis. Table 2 illustrates the regression results in details. Four (4) models have formulated whereas, model 1 and 2 correspond equation 1 and model 3 and 4

corresponds equation 2. Model 1 includes only ownership variables and control are included in model 2 to present the intensity of control variables in the model. Similarly, model 3 infers the stock dividend and ownership variables using equation 2. Whereas, model 4 includes all the dependent and control variables.

Table 2. Regression Results

	DIVC		DIVS	
	1	2	3	4
OWNS	0.0183***	0.0214***	-0.0015***	-0.00136***
OWNF	-0.0011***	0.0012***	0.0267***	0.0272***
G		-0.0198***		0.2815***
D		-0.257***		0.5811***
DIVC _{t-1}		0.364***		
DIVS _{t-1}				0.2893***
R ²	0.27	0.42	0.33	0.59
F-Statistics	72.2***	89.81***	57.92***	71.42***

The OLS regression result for both cash dividends and stock dividends are presented in Table 2. It is mentioned that cash dividends are significantly and positively influenced by state ownership as presented in model 1. The inclusion of control variables in model 2 illustrates the significance of

the control variables. The value of R² has increased from 27% to 42%. This explains that state ownership concentrated firms are more likely to tunnel cash to shareholders. Therefore, this might prefer cash dividends in a particular situation when cash dividend is not a good option for firms. Similarly, regression results for stock dividend as

mentioned in model 3 show a positive relationship of foreign ownership while a negative relationship is explained with state ownership. The value of R2 has increased from 33% to 59% which explains the goodness of model fit with control variables. The relationship of stock dividend with foreign ownership and state ownership is consistent with the previous literature. This research has demonstrated that dividends can help in stopping company insiders from wasting retained earnings on unproductive ventures or personal enrichment. Furthermore, a negative relationship of growth and debt with cash dividend has revealed. The firms with growth opportunities are more likely to pay a stock dividend while mature firms prefer to pay cash dividends.

5. Conclusion

Increased supply chain costs and risks are the price of admission when operating in emerging markets. Companies that anticipate threats and implement strategies to contain costs and mitigate risks may be better positioned to succeed than companies that neglect to recognize the importance of supply chain risk management. This investigation is carried out with the objective to measure the role of ownership structure on dividends policy. For state ownership dividends play a tunneling role for major shareholders. In addition to this, the results show the particular situation of dividend policy in developing markets. Foreign ownership tends to reduce the tunneling effect so that the foreign capital could be raised. The state-owned firms are more likely to pay cash dividends. The results showed that foreign shareholders preferred a low cash dividend, suggesting that foreign investors helped to reduce the tunneling activity of companies from developing markets. Therefore, this investigating supports the benefits of foreign ownership in companies having concentrated state ownership. These results have a significant impact on researchers, investors, policymakers and regulators. Additionally, the result of this investigation gives a brief understanding with dividend policy with respect to the ownership structure in special contextual environment.

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