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Dividend Payout Policy and Operating Performance at Kuala Lumpur Stock Exchange

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Abstract — The proportion of dividend-paying firms listed at Kuala Lumpur Stock Exchange (KLSE) has consistently been above the 50 percent level. Dividend payers are generally profitable and bigger firms, while non-payers have higher investment opportunities. The post-operating performance of dividend-increasing (decreasing) firms is found to improve (deteriorate) following the dividend change year. This evidence supports the dividend-signaling hypothesis. A change in dividend payout signals a change in future operating performance.

Keywords: Dividend payout, Operating performance, Dividend-signaling hypothesis, KLSE

1. Introduction

The dividend payout policy has been extensively researched in the field of corporate finance. It is an important topic because the decision to distribute cash to shareholders affects the financing and investment decisions of firms. The management is responsible for deciding how much should be distributed and how to maintain the level of dividend over time. Many firms are reluctant to change their dividend payout level because these changes will be treated as signals by outsiders.

Bhattacharya (1979), Miller and Rock (1985), and John and Williams (1985) developed a signaling theory known as the "dividend-signaling" hypothesis; this hypothesis suggests that firms change their dividend policy to reflect their future prospects. Based on this premise, there should be a positive relationship between dividend changes and operating performance. However, empirical evidence on the subsequent operating performance of dividend changing firms yields mixed evidence. In their study on the declining trend of the cash dividend payout trend in the U.S. markets, Fama and French (2001) have argued that the percentage of dividend payers has declined over the years; the percentage dropped from 66.5 percent in 1978 to 20.8 percent in 1999. Dividend payers are found to be bigger and profitable firms, while non-payers are associated with higher investment opportunities. However, the most interesting finding of Fama and French (2001) is that firms have a lower propensity to pay dividends, irrespective of their characteristics.

This paper examines the dividend payout policy from the perspective of an emerging market. The objectives of the paper are twofold. First, I analyze the cash dividend payout trend at Kuala Lumpur Stock Exchange (KLSE) from 1997 to 2005. Following Fama and French (2001), I consider the time trend of cash dividend and examine the characteristics that distinguish dividend payers from non-payers. Unlike the situation