Faculty of Economics and Business

Dividend Payout and Distance to Default of Listed Companies in Bursa Malaysia

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Dividend Payout and Distance to Default of Listed Companies in Bursa Malaysia

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DECLARATION

I declare that the work in this thesis was carried out in accordance with the regulation of Universiti Malaysia Sarawak. It is original and the result of my work, unless otherwise indicated or acknowledged as referenced work. This thesis has not been accepted for any degree and is not concurrently submitted in candidature of any other degree.

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DEDICATION

I dedicate this work to almighty Allah for His countless blessings upon me and my family. The Prophet (PBUH) who taught us the purpose of life.

And

Every challenging work need self-effort as well as guidance of elders especially those who are close to my heart. My humble effort, I dedicated to my sweet and living

Father and Mother

My Mother

A strong and gentle soul who taught me to trust Allah, believe in hard work and that so much could be done with little.

My Father

For earning an honest living for us, supporting and encouraging me to believe in myself.

Parent's affection, love, encouragement and prays of the day and night make me able to get such success and honor.

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ABSTRACT

Bonds and dividend payout have become an extensively accepted measure of a firm's business risk, and it is considered as an important issue in firms. The goal of this study is the corporate bonds' distance to default (DtD) for firms listed on the Bursa Malaysia, founded on data obtained from 297 issuing firms during ten years period from 2006 to 2015. In this study, the factors of dividends payout on bonds in the Malaysian sectors are investigated on the base of agency theory and signalling theory. This study employs the stata panel estimator for the experimental testing of the hypothesis that can investigate the financial behaviour of the firms. This study has used Bharath and Shumway (2008) DtD mixtures model, combining both accounting and market-based evidence to unravel the Malaysian corporate bonds DtD quality. The independent variable, dividends Payout, is the measure to check its relationship on distance to default (bonds). In addition, three control variables, leverage *(lev*), equity beta (*eβ*) and market to book (*mtb*) are examined to evaluate their influence on the Malaysian corporate bonds' riskiness. The results indicated that dividends payout have significant and positive relationship on the distance to default (DtD) (bonds). Additionally, three controlled variables *lev*, *mtb* and *eβ,* the two control variables *lev* and *mtb* and *eβ* significant effect on DtD.

Keywords: Distance to default, bonds, dividend payout, Bursa Malaysia, leverage, Market to Book, Equity Beta.

Pembayaran Dividen dan Jarak Ketidakupayaan Membayar Balik bagi Syarikat Tersenarai di Bursa Malaysia

ABSTRAK

Bon dan pembayaran dividen telah menjadi ukuran yang diterima secara meluas terhadap risiko perniagaan firma, dan ia dianggap sebagai isu penting dalam firma. Matlamat kajian ini ialah jarak korporat kepada syarikat ingkar (DtD) bagi syarikat-syarikat yang tersenarai di Bursa Malaysia, yang diasaskan pada data yang diperoleh daripada 297 firma yang dikeluarkan dalam tempoh sepuluh tahun dari 2006 hingga 2015. Dalam kajian ini, faktor-faktor pembayaran dividen bon di sektor Malaysia disiasat dengan model teori agensi dan teori isyarat. Kajian ini menggunakan penganggar panel stata untuk ujian eksperimen hipotesis yang boleh menyiasat tingkah laku kewangan firma. Kajian ini telah menggunakan model campuran Bharath dan Shumway DtD, yang menggabungkan kedua-dua ketepatan perakaunan dan berasaskan pasaran untuk membongkar kualiti DtD bon korporat Malaysia. Pembolehubah bebas, pembayaran dividen, adalah ukuran untuk memeriksa kesannya pada jarak ke mungkir (bon). Di samping itu, tiga pemboleh ubah kawalan, leverage (lev), beta ekuiti (eβ) dan pasaran untuk buku (mtb) telah diperiksa untuk menilai pengaruh mereka terhadap risiko korporat bon korporat Malaysia. Hasilnya menunjukkan bahawa pembayaran dividen mempunyai positif dan kesan yang signifikan pada jarak ke lalai (DtD) (bon). Sebaliknya, daripada tiga pemboleh ubah terkawal lev, mtb dan eβ, kedua-dua pemboleh ubah kawalan lev dan mtb mempunyai kesan ketara terhadap DtD, dan pembolehubah eβ terkawal yang ketiga mempunyai kesan yang signifikan terhadap DtD (bon).

***Kata kunci**: Jarak ketidakupayaan membayar balik, bon, pembayaran dividen, Bursa Malaysia, Leverage, pasaran untuk buku, beta ekuiti*

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LIST OF ABBREVIATIONS

DPO	Dividend payout
DtD	Distance to Default
eβ	Equity Beta
Lev	Leverage
MARC	Rating Authority Malaysia
mtb	Market to Book
OBG	Oxford Business Group
PD	Probability of Default
SA	Signaling Approach

CHAPTER 1

INTRODUCTION

1.1 Introduction

Bonds credit risk refers to the possibility that borrowers are unable to pay the required payments of loan. When a company issues bonds, it is obligated to make regular interest payments to bondholders and repay their principal investments once the bonds come due. Whenever a company fails to uphold its obligations to bondholders, whether it's in the form of a missed interest payment or a missed principal payment, it's considered a bond default, and should this occur the lenders may lose mot only interest payments but the principal as well. (Khedher et al., 2016) noted that the bonds default is a key issue, which is being faced by the firms, and it leads them towards bankruptcy.

Bond market is a major source of financing in the rising world economy. The corporate sector and government both have active utilization of bonds as a key source for long term financing in strengthening the financial organization of the country and to decrease the vulnerabilities (Fabella & Madhur, 2003). Moreover, Hale (2007) noted that, bond market is capable to provide fund to corporations due to its flexibility and at a lower cost compared to banks and other financial institution loans.

This is partly because fee of checking is not required for bonds while banks forced extra cost for reserve and capital requirement, working, and observing expenses, which are usually passed through to their customers.

Malaysia suffered lack of well-balanced economic machine because of over dependence on bank’s financing (Zainuddin, 2009).

Learning from the experience of the economic disaster in 2009 to 2011, the authorities of Malaysia have realized the significance of having a productive capital market

for quick monetary development, and have enhanced the strong improvement of the bond market so as to offer a competitive source of long-term financing to the economic system. Some literatures argue that the likelihood of corporate bonds default increases with firms leverage (Dennis and Mihov 2003) but at some time a high rate of leverage can arguably be an indicator of a good credit standing and borrowing capacity of firms. Moreover, firms with high leverage could have higher roll-over need and therefore may have greater demand of additional funding from corporate bonds markets.

Malaysia is an emerging market, yet its capital marketplace is greatly evolved than many other developing markets. Malaysia's capital market incorporates traditional and Islamic capital markets. Efficient and effective support by the government guide and the implementation of the Capital market master Strategy from (2000 to 2010) have facilitated the capital market to increase its size from of RM 717.5 billion (US$239 billion) in 2000 to RM 2.0 trillion (US$667 billion) in 2010 (Security Malaysia, 2013). Between 2000 and 2010, Malaysia's equity market rose by 11.1; percent each year, making it the 5th fastest-growing capital market in Asia (Security Malaysia, 2013). Malaysia's capital market capitalization has tripled within 10 years and is predicted to double in the next 10 years. In achieving the imaginative and prescient of Malaysia to end up a high-profits in 2020, Malaysia capital market is predicted to further boom to RM 5.8 trillion (US$1.93 trillion) with an equity marketplace of RM 2.4 trillion (US$800 billion) via 2020 (Security Malaysia, 2013).

The Malaysia capital market however is not without issues. The Rating Agency Malaysia (RAM, 2015) noted that Malaysian firms are face severe issues of bonds default. Rating agency Malaysia noted on their report that 2.6 percent of issuances went defaulted only in 2005. The default rate continued within the range of one to four percent till 2009,

where the situation got worst with highest default rate after the capital market received a negative and severe economic shock of crisis. Hence, 2009 was the vital year of default. 5.1 percent, 1.2 percent and 2.6 percent defaults occurred from 2009 to 2011 respectively. After 2011 the defaults percentages were getting less than two percent, but market was not even now completely improved, as evidenced by the small volume of total issuances from 2011 to 2015 (MARC 2015). Khinfer (2011) had described 2009 as the "default year" for the global bonds market as the year ended with at least 15 cases, and rising to at least 31 defaults as officially reported in early 2012 with the defaulted value amounting RM 6.848 billion in Malaysia market

Bonds default is a dominant factor in the corporate financing transactions that leads bankruptcy. The basic reason for default is that firms are highly levered with and showing inefficient. Moreover, they do not generate enough cash flow to meet their debt obligations that cause them towards default.

In the case of corporations, defaults usually occur when deteriorating business conditions have led to a decline in revenues sufficient to make scheduled repayments impossible. Which lead to a mismatch between cash inflow and outflow.

Similarly, countries are typically forced to default when their tax revenues are no longer enough to cover the combination of their debt servicing costs and ongoing expenses. In Greece, yields on 10-year government bonds reached 29% in early 2012, right before the country defaulted. Due to the Greece government-debt crisis, Greece failed to make a €1.6bn payment to the International Monetary Fund (IMF, 2015). due to high debt cost and inability to generate enough cash flows for repayment of their debts. Many other factors can affect the corporate bonds for example leverage, taxes, liquidity etc.

Keeping the situation in view, dividend payout is an important factor, and it is considered a major concern by the shareholders; yet such payments could be detrimental to the interest of bondholders.

Most of the investors in the market are concerned with the dividend payments of the firms. A large dividend payout indicates the organization's confidence about future cash flows. However, a reduction in dividends causes a severe market reaction, and investors as well as bondholder's shown low confidence on the market. Bondholders perceive the firm that are paying high dividends as less risky and requires low rate of returns. This dividend payout impacts the investor's perception of firm's risk. In line with this theory, corporations that pay larger dividend, indicate a positive view of their future cash flows.

Bondholders identify the positive indicator, and they offer a higher price of the bond. Thus, the positive indication in form of dividend payouts results in lower bonds risk. Dhillon and Johnson (1994) noted that the signal of dividend payout creates the conflict between the bondholder and shareholder in the financial market and increase the firm's bonds risk. Normally, firms pay dividends when they earn profit, and they can meet their obligations in due time. In this way, they have less chances of default, and have more sustainability power that increases the shareholders wealth.

On the contrary, dividends decrease the cash accessible to meet the predetermined corporation's financial obligations with principal and interest on debt financing. Furthermore, due to an adverse reaction of market participants upon reduction of dividends payment, firm borrows concerns more to avoid reducing the dividends. This extra leverage will increases the corporations risk with a subsequent decrease in bond prices and rise in default of debt.

Evidences have been generated by Floyd et al. (2012) and Acharya et al. (2011) that the corporations pay the dividend to shareholder, even though, they take the extra burden of debts. Bondholders see dividends announcement negatively and call for high rate of returns from the corporations paying high dividends. This yields a (Fridson and Garma, 1998; Guntay and Hackbarth, 2010; Mansietal, 2011; positive relation among the dividend payout and default of debt (Nejadmalayeri & Singh, 2004).

Firms go for debt financing, and they issues bonds in the market to increase the shareholders wealth. Bond prices affect the range to which bondholders see the risk related to the bond payment that are expropriated by the shareholders. Borrowers fail to meet their obligations on the specific time period according to the credit contract. In this situation, the creditor will be exposed to the risk of default. The greater the perceived risk, the high return is expected by the bondholders on their investments to compensate the additional risk. Hence, this yields a high-quality relation among dividends payouts and default of debt. The firms must manage these investors, keeping in view their risk profiles.

Bond probably reflects the level to which bondholder perceive risk of expropriation through shareholder. Dividend payouts might create one such contrivance of expropriation by shareholder. The greater the observed expropriation risk, the higher is the return that the bondholders assume on their funding to reward for the additional risk (Handjinicolaou and Kalay, 1984; Woolridge, 1983; Jayaraman and Shastri, 1988; Maxwell and Stephens, 2003). The evidences to the results, generated by these conflicts, are mixed, and the argument still continues but the bond risk has not been discussed yet.

Thus, dividend payout can play a critical role in the default of corporate bonds. This is especially important for Malaysia, as Malaysian firms have been paying a large amount

of dividends. Malaysia is the second highest dividend payout country in Asia. The dividend payout is noted as 48.9% inside the Asia ex-Japan region.

This study explores the effect of dividend payouts on the bonds risk that reflected on the default of bonds. One approach is to inspect the bond market's reaction to dividend declaration. The study on the default of bonds is valuable under the specific context of the Malaysian corporate bonds market.

1.2 Background of the Study

1.2.1 Dividend Policy in Malaysia

Dividend policy is a crucial element in a business enterprise (Moradi et al., 2013). It increases the confidence of shareholder, particularly, of their payouts of capital receipt. The most efficient dividend policy is described as the policy that maximizes the stock prices of the corporation and is important determinants, which examine the shareholders 'wealth (Azhagaiah and Priyah, 2008). Dividend is usually used as gauging device financiers to point the future performance that increase the shareholders wealth (Malkawi et al., 2010). Shareholder capital is defined as the current worth of anticipated future profits (Brunzell et al., 2012).

There are no exact principles on the standard of profit strategy in Malaysia (Subramaniam and Devi, 2010). Based on the corporations Act 1965 (section 365), dividend ought to dispense with earnings, either taken the cutting-edge income, or amassed income. Further, in keeping with the corporations Act (1963), "Not anything in this phase will be taken to limit the charge of a dividend well declared with the aid of a company or the release of a liability lawfully incurred through it".

Corporation will decide a mark of dividend payout proportion and make modifications in line with the earning generated by the company (Lintner, 1956). Pandey (2003) noted that Malaysia's corporations, in all sectors, have proven a dividend balance, which they paid dividend as often as possible in any case how minor is the amount of dividend. He also argued that dividend payout ratios, by way of sectors, in Malaysia presented that plantation organizations are giving higher dividend than creation corporations, which giving minimal dividend in comparison to other areas. Moreover, buying and selling and services sectors also pay low dividend because of the low income got. In recent times, Malaysia is documented as the second major dividend payout inside the Asia ex-Japan location. The dividend payout is noted as 48.9% inside the Asia ex-Japan region. Essentially, Malaysian corporations have massive dividend payout because of the own family ownership business version, wherein minority investors act according to big investors (Yap, 2012).

The Bursa Malaysia Berhad has released last ten years data on the Malaysia dividend payouts of the Malaysian capital market. The data is shown in Table 1.1.

Table 0.1: Dividend Payouts in Malaysia capital market 2005 -2015

Years	Dividends per cent	Dividends	Dividend payouts %
2006	28	141543	96.3%
2007	85	443,668	184.38 %
2008	24.3	127,507	122.11 %
2009	19.1	100,650	56.68 %
2010	20	106,141	93.90 %
2011	26	138,187	94.55 %
2012	27	143,486	95.28 %
2013	52	276,919	160.00 %
2014	54	287,74	145.16 %
2015	34.5	184,197	92.74 %

Source: KLCI Bursa Malaysia (2016)

It is obvious from the data, offered in this table, that Malaysian capital market was paying dividend to shareholders each year. Since 2009 till 2011, the dividend payout ratios decreased because of the financial crisis.

Hence, 2009 was the vital year of payout. 56.6 percent, 93.90 percent and 94.55 percent payout happened from 2009 to 2011 respectively. After 2012, the dividend payout percentages increased, and the payout market completely improved, as evidenced by the lager volume of total payouts from 2011 to 2015 (KLCI Bursa Malaysia 2016). In short, the Malaysia capital market was lucrative with the number of dividend payouts touching hundred percent per year.

Conversely, some corporations no longer pay their shareholder dividend. These corporations are having similar features, which can be small profits, sturdy funding and comparatively small in length. As contrasted to year 1973, year 1977 had 0.33% of businesses paying dividend, while, year 1999 only have 3.7 percent corporations complete dividend payout. The motives of not paying dividend are low incomes made; keep high boom possibility, and additionally, presence of repurchase in year 1980. Similarly, corporation experiencing merger or delisting, additionally, prevent paying dividends. Aside from that, Distress Company, which produces negatively incomes, may also terminate dividend as well high growth. Organizations, generally, do not pay dividend to investor as they made decrease income, associated with dividend payer organizations.

Furthermore, corporations with high progress and funding possibility pay dividend at equal time will get worse income and investment made. Ultimately, dividend payer corporations are generally massive business enterprises. There is less proof of small corporation paying dividend (Fama and French, 2001). In line with tax preference theory,

tax is compulsory while organization distribute dividend to shareholders. In Malaysia, the tax obligatory on cash dividend is extra than tax obligatory on investment profits. Therefore, traders choose investment advantage as opposed to dividend (Zameer et al., 2013). Investors focus on after-tax profit, and it sooner, or later, increases the call for dividend. Furthermore, consequences of tax also disturb the dividend distribution, in which administration will increase retained profits to maximize investor capital (Malkawi et al., 2010).

Given the significance of dividend coverage, a top-rated dividend choice is vital. In addition to rival hypothetical stances on dividend coverage, earlier research have stated that dividend choice might be suffering from different issues, which includes profits, investment opportunities, firm size, cash flows and lagged dividend. Over time, academic examination has thoroughly tested the reasons influencing dividend payout policy. Regardless of the abundance of examination in this trouble, the proof mentioned remains inconclusive. Furthermore, the studies have in most cases been executed in the context of advanced countries (Charitou, 2000; Al-Malkawi, 2007; Ramli, 2010; Appannan and Sim, 2011; Hashemi and Zadeh, 2012).

Malaysia is an emerging country; however, its capital market place is greatly evolved than several other developing markets. Malaysia's capital market incorporates traditional and Islamic capital markets. Non-stop government guide and the usage of the Capital market end-all strategy from 2000 to 2010 have helped the capital market develop from a market length of RM 717.5 billion (US$239 billion) in 2000 to RM 2.0 trillion (US$667 billion) in 2010 (security Malaysia, 2013).Among 2000 and 2010, Malaysia's equity market developed by 11.1 according to cent each year, making it the fifth quickest developing business sector in Asia (security Malaysia, 2013). Malaysia's capital market

capitalization has tripled within 10 years, and is anticipated to twofold in the following 10 years. In accomplishing the imaginative and prescient of Malaysia to end up a high-profits in 2020, the capital market is anticipated to additionally boom to RM 5.8 trillion (US$1.93 trillion) with an equity marketplace of RM 2.4 trillion (US$800 billion) till 2020 (security Malaysia, 2013).

Dividend choice is a major corporate finance problem because of its large effect on funding and financing selections. If a corporation chooses not to pays smaller amount dividends, the company may have greater inside earnings, hence dropping its shareholders confidence on external income. However, if a company pays great dividends, it will bring about quite a lesser amount of internal incomes, and therefore, it will develop company's need on obligation or other outside financing. This means that the choice to elevate budget is straight linked to dividend policy. Ultimately, as dividend policy impacts the capital shape of a corporation, it will also have an effect at the funding choice and cost of capital of the organization (Lee et al., 2010).

1.2.2 Bonds Issuance and Default in Malaysia

Among a mixed income performance around the international sphere in 2015, Malaysian capital market unimpressively showed modest growth over the year 2015. The area grew by 2.1% in 2015, according to the Securities Commission Malaysia, the capital market controller, to reach USD 698 billion by the end of the year, (OBG, 2017). Almost 60% of this growth was due to the stock market of Bursa Malaysia, the Malaysian stock exchange. Stock market showed total market capitalization of USD 420.8 billion, while outstanding debt issuances made up the USD 277.2 billion (OBG, 2017). This follows on from more than a decade of steady evolution in many Malaysian capital market areas including fund management and sharia-compliant financing tools particularly. The