Corporate Governance and Dividend Policy: Evidence from Commercial Banking Sector in Nepal

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Abstract

We attempt to explain how dividend payment is influenced by corporate governance system in Nepal with a sample from the commercial banking sector by utilizing a regression model of panel data. Using board characteristic variables such as board size, board independence, regularity of board meeting, and size of audit board as the proxies of corporate governance along with profitability, capital gearing, and bank size as control variables, we explore that except audit committee size all explanatory variables are insignificant in determining the dividend payment. The size of audit committee members is positively and significantly affects dividend payout. This finding leads us to conclude that the outcome hypothesis is partially applicable and corporate governance is not an important and influencing factor to the dividend decisions in commercial banking sectors signifying that governance practice and dividend policy are not helpful in mitigating agency conflicts. It is also concluded that banking dividend payouts are not the result of the good or poor governance mechanism. Further, among other firm-specific determinants, profitability, leverage, and bank size significantly positively affect the dividend decision.

Keywords: dividend policy, corporate governance, board characteristics, banks, Nepal

1. Introduction

The goal of the corporate managers, especially financial managers is to enhance the wealth of shareholders along with satisfying the interest of all stakeholders on an equitable basis. Corporate governance is a system that includes explicit and implicit contracts between the firm and the stakeholders for the sharing of rights, responsibilities, rewards, and procedures for reconciling and integration. An effective and good corporate governance system helps in creating a harmonious relationship among the stakeholders by reducing the agency conflict. Chung, Elder and Kim (2010) asserted that companies with fragile governance structure have to encounter more agency problems which lead to more threat to shareholders caused by improper structures, the absence of appropriate system and mechanism that make certain a corporation is governed and operated in a manner that makes sure of significantly raise in shareholder wealth. Corporate governance is thus regarded as an integral mechanism for optimizing a company's performance through increasing commitment, openness, and accountability of management.

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Corporate governance is a mechanism to make sure that providers of funds to firms will entertain a fair rate of return on their venture (Shleifer & Vishny (1997). The dividend is a way of providing a return to shareholders from the earnings of the firm. Ross, Westerfield and Jaffe(2002) stated that dividend payout is a crucial decision for corporate managers and investors because it determines the rate of return to shareholders and the growth of the firm by reinvesting the corporate earnings. Gul, Sajid, Razzaq, Iqbal and khan (2012) evidenced that dividend payout policy is significant to attain corporate goals through efficient performance. Further, it is claimed that dividend pay outs could be treated as a device for reducing agency problem between owners and management. In the agency theory of dividend, Jensen (1986) demonstrated that dividends help to alleviate agency-related overheads by restricting the free cash flows available to managers that would be depleted on unwise and non-profitable ventures. Sheikh and Wang (2010) revealed that dividend policy turns out to be asignificant aspect of corporate governance because corporate governance aims to safeguard the welfare and interest of stockholders by reducing the agency problems.

The banking sector of any country occupies an extremely essential role in the transferring of financial resources from excess to deficit units thereby facilitates smooth functioning of the financial system. There are two reasons for selecting commercial banks in Nepal as a sample. First, in Nepal investor protection is weak and agency conflict is rampant. Second, Nepalese investors are more inclined toward investment in the shares of banking sectors especially, in the share of commercial banks. This is supported by the fact that the Nepal Stock Exchange (NEPSE), the one and only stock market in Nepal, is overwhelmingly dominated by commercial banking companies in terms of both the gross trading volume and the number of shares listed, as seen in Figure 1.

![Figure 1 Percentage of commercial bank in total market](http://www.modern-journals.com/)

Source: SEBON Annual Report -2020
Website: http://www.modern-journals.com/
Thus, any vulnerability and failure of banking firms as a result of unethical and immoral activities of banking executives can lead to significant losses to the shareholders along with reputational spoil. Despite the value of banking firms to the financial system, depositors, and shareholders, there exists a lack of practical evidence about the effect of corporate governance structures on dividend payment strategies of commercial banks. Meanwhile, the preceding empirical studies conducted by Al-Najjar and Hussainey (2009), Al-Matari, Al-swidi and Fadzil (2012), Hao, Hu, Liu, and Yao (2014), Ntim(2015 ), Khan, Mihret and Muttakin (2016), Elmagrhi et al. (2017), Atanassov and Mandell (2018) have supported that corporate governance mechanism may affect dividend payment behavior. Consequently, we aim to add to the dividend literature by assessing the relationship of corporate governance variables with dividend payout policy of NEPSE listed commercial banks through this paper. Particularly, we investigate the degree to which banking dividend payout is influenced by the board characteristics taking the sample from the commercial banks listed in NEPSE from 2009 to 2020.

The majority of the previous studies regarding corporate governance and dividend policy are conducted in highly developed and emerging economies, most of which are based on the sample drawn from non-banking firms. Particularly, in the Nepalese context, no studies focusing on this issue have been conducted yet. Brown, Beekes and Verhoeven (2011) and Claessens and Yurtoglu (2013) stated that further research is necessary in different market, organizational and legal circumstances to widen the understanding about the effects of corporate governance practices on corporate decisions. Accordingly, we aim to tackle the weakness of existing studies by extending and exploring new contributions in several ways. First, the paper aimed at adding to the literature by empirical study about the influence of board uniqueness or characteristics/composition on dividend policy in the milieu of commercial banks listed in NEPSE. This is important and essential since, by excluding the banking industry, previous studies are focused on certain company-specific and traditional dividend decision determinants. Second, we base our analysis on testing the outcome and substitution model in the banking sector and provide evidence from the least developed country like Nepal regarding the intentions of managers for paying a dividend. Third, the paper offers the most recent empirical proof of the effects of banking board composition features on dividend policy using the data from 2009 to 2020, just before the COVID-19 crisis. Thus, our findings will help make comparisons in dividend reform and corporate governance activities of banking firms before and post COVID-19 pandemic.

Inspired by the agency theory, we try to explore the role of board characteristics of the banking sector on dividend payment decisions by controlling for some company-specific factors like profitability, leverage, and bank size. La-Porta, Lopez-de-Silanes, Shleifer and Vishny (2000) and Sawicki (2009) showed that the dividend payment is the consequence of the corporate governance system as the managers of good governance firms tend to pay a larger cash
dividend to their shareholders. The intention of managers behind such a large dividend is that the management will retain earnings only when there are attractive investment projects are available that adds value to stockholders. Thus, they likely signal their dedication and commitment to fulfill the shareholders’ interest. Hence, hypothesizing dividend payout of commercial banks as an upshot of corporate governance, this research provides empirical proof of the association and interaction between the corporate governance quality and the payment of dividends.

2. Literature Review

2.1 Theoretical Review

The previous literature, for example, La Porta et al. (2000) suggests two theoretical perspectives on the association among corporate governance eminence with dividend policy: first is the outcome and second is substitution hypothesis. The outcome hypothesis conceives that dividend payment behavior is the ‘result’ or “outcome” of a successful corporate governance quality because shareholders demand cash distribution from management. Moreover, in a firm with good governance practices, it’s difficult to confiscate shareholders through unwise use of free cash flow and shareholders successfully pressure executives to dispense in temperance cash as larger dividends. Ntim (2016) posits that by paying a larger dividend, the managers of a good-governed organization perform to the best of shareholders’ interest. Hence, the main stem of the outcome hypothesis is that the dividend policy of a firm is related positively with quality of corporate governance.

The Substitution hypothesis, contrary to the outcome hypothesis, implies that firms with pathetic corporate governance mechanism likely to distribute bigger dividends to develop a favorable standing and relationship with stockholders (La Porta et al., 2000). Further, it is argued that firm pays dividends because managers who intend to raise external equity at some point have an opportunity to build a reputation for handling minority shareholders with decent. Hence in this situation, dividend payouts can be viewed as a form of substitute governance mechanism. Accordingly, firms having poor governance practices should use the dividends as an effective method for reducing possible conflicts of interest between management and owners (Sawicki, 2009). Accordingly, reverse to the outcome model, the substitution model envisages that corporate governance is adversely correlated with the dividend payment scheme.

2.2 Empirical Review and Hypotheses

i) Corporate governance and dividend Policy

Prior research has fetched mixed as well as inclusive results relating to the influence of corporate governance on dividend policy. The arguments and evidence are provided in support of both the outcome and the substitution hypothesis. It is well established in the literature that there is a significant and meaningful relationship between Jenson’s (1986) agency theory, corporate
Board Size and Dividend Policy

ii) Board Size and Dividend Policy

Board of directors (BODs) is the governing body of a business firm and the number of members in BODs is known as board size. It is essential to have a considerable number of members on board for bearing the challenges and operating the firm successfully. However, past studies have provided mixed results concerning the affect of board dimension on dividend payout. The outcome hypothesis predicts affirmative relationship between board size, firm performance, and dividend payout with lower agency conflict because larger boards have more
There is a positive relationship between board size and dividend payment.

iii) Board independence and Dividend Policy

Basheer (2014) stated that a firm’s board is important in scrutinizing and preserving the discipline of management, particularly if the board consists of a more independent or non-executive directors chosen based on their expertise and independence. It is argued that board independence assists in diminishing agency-related problems in the firm and improves the performance of the managers thereby able to pay a larger dividend (Jiraporn & Ning, 2006). Similarly, independent directors are supposed to have better inducement and power to control and monitor an opportunistic behavior of managers which results in a better image and reputation in the market (Borokhovich et al., 2005). Accordingly, consistent with outcome theory, Shehu (2015), Abor and Fiador (2013), Afzal and Sehrish (2011), Gugler (2003) Sumail (2018) reported the positive connection between the number of independent outside director in the board and the dividend payout. By contrast, La-Porta et al. (2000), Al-Najjar and Hussainey (2009), Mansourinia et al. (2013), Iqbal (2013), and Pahi and Yadav (2018) showed a strong negative relationship between board independence variables and the dividend payout. In Nepalese context, the Bank and Financial Institution Act (BAFIA)-2017 instructed all commercial banks to appoint at least one non-executive or independent director on the board to make certain that management is concentrated on maximization of value of the equity by mitigating agency conflict. Thus, the greater the fraction of independent or free directors, the lower will be the agency conflicts and consequently lower will be the dividend payment. Hence, our second hypothesis that is tested in the paper is:

H₂: There is a negative relationship between board independence and dividend payment.

iv) Board meetings and Dividend Policy

Board meetings are helpful to shareholders because an additional diligent board is concerned with paying closer attention to managing the actions of the manager to meet the expectations of the shareholders. Adnan (2011) asserts that when board meetings are held regularly, the members are well-informed and knowledgeable regarding the pertinent performance of the firm which directs the proper action to address the issue. However, past literature has provided the mixed results about the influence of the number of board meetings on dividend policy. Ntim (2013) argued that frequent and regular meetings of the board can trim
down agency problems and helps to improve firm performance, together with the dividend payment. Similarly, Dissanayake and Bandara (2018) also documented a positive correlation between board meeting frequency and dividend payout. On the contrary, Taghizadeh and Saremi (2013), Benjamin and Zain (2015), Elmagrhi et al. (2017) reveal a significant negative effect of the number of directors’ meetings and dividend policy. With consistent to outcome model and linking board meetings with good governance practice, we develop our third hypothesis as:

\( \text{H}_3: \text{There is a positive relationship between board meetings and dividend payment.} \)

v) Audit committee and dividend policy

The audit committee is among the most important corporate governance practices for enhancing a firm’s value by implementing the rules and policies. In Nepal BAFIA (2017) has made it mandatory for all the financial institutions to establish an internal audit committee under the headship of one non-executive director. There is a scarcity of empirical evidences regarding the size of audit committee and dividend payout practices. The outcome hypothesis suggests that audit committees with more members having additional skills, more experience, and added expertise, considered to be more effective in scrutinizing and controlling managers’ self-benefit behaviors and paying fewer dividends to investors (Kajol & Sunday, 2008). Ho (2005) reported affirmative connection of audit committee with dividend payout. However, in accordance with the substitution theory, in the firms having a weak governance system, dividend payout reduces agency conflict (Rouf, 2011). Based on the idea that an effective audit committee contributes better firm performance and accordingly larger dividend payout, our next hypothesis is:

\( \text{H}_4: \text{There is a positive relationship between audit committee and dividend payment.} \)

2.3 Conceptual Model

We establish the following conceptual model of study depending on the literature assessment and formulation of the aforementioned hypotheses, along with the predicted signs of the interaction ofpredictive and control variables with the predictor variables.

![Conceptual Model and the Hypothesized Relationship](http://www.modern-journals.com/)

Source: Authors’ Own Modeling (2020)

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3. Methodology

3.1 Sample and Data

The dataset is composed of nineteen commercial banks from the population of twenty-seven commercial banks listed in NEPSE, which cover more than 70 percent of the total population covering 12 years of data from 2009 to 2020 for an aggregate of 228 bank-year observations. The sample comprises both private domestic and foreign joint-venture banks. Sample with omitted data concerning governance and dividend are disqualified from the study to achieve balanced panel data. The banks’ financial statements acquired from the annual reports are considered for calculating variables for the study.

3.2 The Model

Assuming expected relationship among the variables is linear, we use panel data least square regression model to ascertain the relationship between corporate governance and dividend policy. Panel data model allows controlling for unobservable heterogeneity through individual (firm) effect unlike cross-section data(Pandey, 2002). In conjunction with the control variables, our estimation model is as follows:

\[ DPS_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 BM_{it} + \beta_4 AC_{it} + \beta_5 PR_{it} + \beta_6 LEV_{it} + \beta_7 SZ_{it} + \epsilon_{it} \]

The subscript ‘i’ and ‘t’ in the model point to bank and years correspondingly, \( DPS \) symbolizes the per share dividend, \( BS \) indicates board size, \( BI \) specifies board independence, \( BM \) signify number of board meetings, \( AC \) is the size of audit committee, \( PR \) is profitability, \( LEV \)stands for leverage, \( SZ \) indicates bank size, and \( \epsilon \) is the measure of error term.

3.3 Definition and Measurement of Variables

In order to analyze the fundamental research issue under the hypothesized relationship, we use three variables in the research as follows:

1) **Dependent Variable:** We use dividend per share (DPS) as a dependent variable for the proxy of dividend payout as it considered to the most reliable variable capturing the dividend policy (Jiraporn et al., 2011; Ullah et al., 2012; Elmaghrriet al., 2017). It is the ratio of total cash and stock dividend to the number of share outstanding.

2) **Independent Variable:** Corporate governance practices characterized by the board size, board independence, board meetings and audit committee are the main explanatory variables exploited in the study. These are summarized and presented in Table 1.
Table 1 Independent Variables definition and measurement

<table>
<thead>
<tr>
<th>Variables</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size (BS)</td>
<td>Total directors on a bank’s board at the year-end.</td>
</tr>
<tr>
<td>Board Independence (BI)</td>
<td>Fraction of independent or external directors to total directors on bank’s board at the year-end.</td>
</tr>
<tr>
<td>Board Meetings (BM)</td>
<td>Total meetings conduct by a bank’s board in a fiscal year (In numbers).</td>
</tr>
<tr>
<td>Audit Committee (AC)</td>
<td>Total directors appointed as the member of the audit committee</td>
</tr>
</tbody>
</table>

Source: Authors’ Compilation (2020)

3.4 Control Variables

A vast literature exists on the factors affecting dividend policy. For the sake of briefness, we are ignoring the detailed empirical and theoretical linkage of factors affecting dividend payout in this paper. Some prominent past studies such as La Porta et al. (2000) Amidu and Abor (2006), Gill et al. (2009), Goel (2014), Yusof and Ismail (2016), Al-Kayed (2017) showed that the payment of dividends is greatly impacted by the company's earnings, degree of debt financing and its size. Accordingly, we use these three determinants of dividend as control variables in the regression model. The quantification of control variables is presented in Table 2.

Table 2 Control Variables definition and measurement

<table>
<thead>
<tr>
<th>Variables</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability (PR)</td>
<td>ROA is used as a proxy of bank profitability calculated as dividing operating profits by total assets.</td>
</tr>
<tr>
<td>Leverage (LEV)</td>
<td>Fraction of total debt to total assets of bank</td>
</tr>
<tr>
<td>Bank Size (SZ)</td>
<td>A proxy firm life cycle and economies of scale computed as natural log of sum of assets.</td>
</tr>
</tbody>
</table>

Source: Authors’ Compilation (2020)

4. Result and discussion

4.1 Summary Statistics

Table 3 provides the summary statistics of the parameters used in the panel data regression model. Panel A depicts the descriptive of dividend payment, Panel B presents the summary statistics of corporate governance and Panel C portrays descriptive summary of control variables.
Table 3 Summary Statistics of the Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Min.</th>
<th>Max.</th>
<th>Mean</th>
<th>Median</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Panel A: Dividend payment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DPS</td>
<td>0.00</td>
<td>129.97</td>
<td>23.03</td>
<td>17.13</td>
<td>20.85</td>
</tr>
<tr>
<td><strong>Panel B: Corporate governance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BS</td>
<td>4.00</td>
<td>7.00</td>
<td>6.14</td>
<td>6.00</td>
<td>0.80</td>
</tr>
<tr>
<td>BI</td>
<td>0.14</td>
<td>0.25</td>
<td>0.17</td>
<td>0.17</td>
<td>0.02</td>
</tr>
<tr>
<td>BM</td>
<td>20.00</td>
<td>45.00</td>
<td>32.58</td>
<td>33.00</td>
<td>7.50</td>
</tr>
<tr>
<td>AC</td>
<td>1.00</td>
<td>3.00</td>
<td>2.05</td>
<td>2.00</td>
<td>0.79</td>
</tr>
<tr>
<td><strong>Panel C: Control Variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PR</td>
<td>-0.04</td>
<td>0.04</td>
<td>0.02</td>
<td>0.02</td>
<td>0.01</td>
</tr>
<tr>
<td>LEV</td>
<td>0.77</td>
<td>1.18</td>
<td>0.91</td>
<td>0.91</td>
<td>0.04</td>
</tr>
<tr>
<td>SZ</td>
<td>8.25</td>
<td>12.45</td>
<td>10.69</td>
<td>10.76</td>
<td>0.78</td>
</tr>
</tbody>
</table>

Remarks: DPS symbolizes the per share dividend, BS indicates board size, BI specifies board independence, BM signify number of board meetings, AC is the size of audit committee, PR is profitability, LEV stands for leverage, SZ indicates bank size.

Source: Authors’ Computation (2020)

The descriptive results reveal that the dividend per share ranges between nil to Rs.129.79 with the average payment of Rs.23.03 and fluctuation scaled by standard deviation is 20.85. This signifies that there is no evenness and uniformity in dividend payout by the banks. Similarly, the average value of board size (BS) is 6.14 members, varying from 4 to 7 members. The fraction of independent board directors i.e. board independence (BI) varies from 14 to 25 percent having the average of 17 percent. Additionally, the number of board meetings (BM) by sample banks in a year ranges between a least of 20 to a greatest of 45 representing the average of 32.58. The number of board meetings is quite satisfactory concerning the provisions of BAFIA (2017) which calls for at least 12 meetings in a year every 2 months. In commercial banking, the number of directors in an audit committee (AC) ranges from 1 to 3 with an average of 2.05 which symptomatic of complying with audit committee requirements according to BAFIA (2017). Among the control variables, the average profitability (PR) of commercial banking in Nepal is 2 percent measured by ROA with a smallest of -4 percent and a highest of 4 percent. Moreover, the banks are financed 91 percent by debt and the remaining 9 percent by shareholder’s equity as shown by the average leverage (LEV) score of 90.91 percent. The average size of Nepalese commercial banks is 10.69 captured by the natural log of total assets. The value ranges between 8.25 and 12.45 with smallest and largest bank respectively. Further, the result of summary statistics reveals enough variation in the variables and the mean and median values are roughly the same signifying that data is close to normal having an approximately linear relationship.
4.2 Pearson’s and Spearman’s bivariate correlation analyses

The Pearson’s and Spearman’s correlation coefficients of the research variables are presented in Table 4. The correlation coefficient is used for the purpose of determining the strength and direction of relationship as well as detecting the Multicolinearity of variables under study. Further, we account for both parametric (Pearson’s) and non-parametric (Spearman’s) correlation coefficients for ensuring robustness of the study. Since, all coefficients are relatively smaller; the Multicolinearity is not problematic for the regression analysis.

Table 4 Pearson’s and Spearman’s correlation coefficients

<table>
<thead>
<tr>
<th></th>
<th>DPS</th>
<th>BS</th>
<th>BI</th>
<th>BM</th>
<th>AC</th>
<th>PR</th>
<th>LEV</th>
<th>SZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPS</td>
<td>0.045</td>
<td>-0.102</td>
<td>-0.021</td>
<td>0.149*</td>
<td>0.544**</td>
<td>0.236**</td>
<td>0.500**</td>
<td></td>
</tr>
<tr>
<td>BS</td>
<td>0.019</td>
<td>-0.150*</td>
<td>0.037</td>
<td>-0.015</td>
<td>0.036</td>
<td>0.007</td>
<td>0.107</td>
<td></td>
</tr>
<tr>
<td>BI</td>
<td>-0.089</td>
<td>-0.187**</td>
<td>0.173**</td>
<td>-0.039</td>
<td>-0.176**</td>
<td>0.026</td>
<td>-0.11</td>
<td></td>
</tr>
<tr>
<td>BM</td>
<td>-0.022</td>
<td>0.019</td>
<td>0.177**</td>
<td>-0.104</td>
<td>0.009</td>
<td>-0.092</td>
<td>-0.048</td>
<td></td>
</tr>
<tr>
<td>AC</td>
<td>0.193**</td>
<td>-0.019</td>
<td>-0.013</td>
<td>-0.105</td>
<td>0.113</td>
<td>0.001</td>
<td>0.028</td>
<td></td>
</tr>
<tr>
<td>PR</td>
<td>0.519**</td>
<td>-0.005</td>
<td>-.144*</td>
<td>-0.01</td>
<td>.141*</td>
<td>-0.039</td>
<td>0.385**</td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>0.160*</td>
<td>0.025</td>
<td>0.100</td>
<td>-0.092</td>
<td>-0.019</td>
<td>-0.058</td>
<td>-0.203**</td>
<td></td>
</tr>
<tr>
<td>SZ</td>
<td>0.350**</td>
<td>0.103</td>
<td>-0.115</td>
<td>-0.059</td>
<td>0.039</td>
<td>0.346**</td>
<td>-0.141*</td>
<td></td>
</tr>
</tbody>
</table>

Remarks: DPS symbolizes the per share dividend, BS indicates board size, BI specifies board independence, BM signify number of board meetings, AC is the size of audit committee, PR is profitability, LEV stands for leverage, SZ indicates bank size. Moreover, ** and * denotes correlation is significant at the 0.01 and 0.05 level. Pearson's correlation is seen in the lower left half of the table, and the upper right half of the table shows the coefficients of Spearman's correlation.

Based on Pearson’s correlation coefficients, among the corporate governance variable, magnitude of audit committee is statistically significant positive correlation with dividend payment which is consistent as our hypothesis. This is consistent with Al-Swidi et al. (2012) and Elmagrhi et al. (2017) who evidenced that audit committees with more members are coupled with better monitoring of managerial actions resulting higher dividend payment reduced agency related problems. Board size and dividend payment are positively related in the line of our expectation but the link is not strong enough to be statistically significant. This implies that more members in audit committee and in board of directors results larger dividend payment accordingly supports to the findings of Ho (2005), Mansourinia et al. (2013), Elmagrhi et al. (2017), Pahi and Yadav (2018) and Sumail (2018). Similarly, dividend payment is inversely associated with board independence and board meetings signifying that board independence and dividend payment are substitutes in reducing cost of agency problem (Al-Najjar & Hussainey, 2009). Hence, companies having superior governance mechanism by frequent board meetings and appointing higher proportion of independent directors are tend to pay less dividends (La-Porta et al., 2000). Among the control variables, profitability, leverage and bank size are significantly positively related with dividend payment of commercial banks.

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4.3 Multivariate Analysis

Table 5 presents the outcome of a panel data regression model that is employed to examine and investigate the relationship between corporate governance quality and dividend policy.

<table>
<thead>
<tr>
<th>Variable</th>
<th>$\beta$</th>
<th>t</th>
<th>Sig.</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-177.17</td>
<td>-5.012</td>
<td>0.000</td>
<td>1.056</td>
</tr>
<tr>
<td>BS</td>
<td>0.295</td>
<td>0.206</td>
<td>0.837</td>
<td>1.114</td>
</tr>
<tr>
<td>BI</td>
<td>-25.45</td>
<td>-0.534</td>
<td>0.594</td>
<td>1.067</td>
</tr>
<tr>
<td>BM</td>
<td>-0.100</td>
<td>-0.647</td>
<td>0.518</td>
<td>1.067</td>
</tr>
<tr>
<td>AC</td>
<td>3.465*</td>
<td>2.404</td>
<td>0.017</td>
<td>1.033</td>
</tr>
<tr>
<td>PR</td>
<td>929.53**</td>
<td>7.400</td>
<td>0.000</td>
<td>1.179</td>
</tr>
<tr>
<td>LEV</td>
<td>123.04**</td>
<td>4.112</td>
<td>0.000</td>
<td>1.047</td>
</tr>
<tr>
<td>SZ</td>
<td>6.044**</td>
<td>3.896</td>
<td>0.000</td>
<td>1.178</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D-W stat.</td>
<td>1.741</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F value</td>
<td>18.173**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.366</td>
<td></td>
<td></td>
<td></td>
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<td>Adj. $R^2$</td>
<td>0.346</td>
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<td>No. of obs.</td>
<td>228</td>
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</table>

Remarks: DPS symbolizes the per share dividend, BS indicates board size, BI specifies board independence, BM signify number of board meetings, AC is the size of audit committee, PR is profitability, LEV stands for leverage, SZ indicates bank size. Moreover, ** and * denotes correlation is significant at the 0.01 and 0.05 level.

Source: Authors’ Computation (2020)

The analysis of regression reveals that the adjusted $R^2$ is around 0.346 meaning that the independent variables predict the affect on the dependent variables to the extent of 34.6 percent. F-Statistic is significant (p-value is 0.000) implying that results are quite explanatory and the model is fit. Further, VIF and D-W factors assure for the non-existence of Multicolinearity and autocorrelation problem in the model.

Among the corporate governance proxies, size of audit committee (AC) is statistically and positively affects dividend payout, signifying that our hypothesis stating there is a positive relationship between audit committee ($H_4$) and dividend payment is confirmed. In the light of insufficient previous evidences on the effects size if audit committee on dividend payment, our findings contributes to the literature that the audit committee formed with more members reduces agency related costs, improves banking performance and declare larger dividend to the shareholders. This finding is consistent with Al-Swidi et al. (2012) and Elmagrhi et al. (2017). Another explanatory variable, board size is positively associated with dividend payment but such association is not statistically significant. Hence, we do not find the statistical evidence in support of our hypothesis ($H_1$) stating board size is positively related with dividend payment and conclude that more or less number of members in board statistically does not influence the banking dividend payment behavior. This finding contradicts with *outcome hypothesis* and many of the previous studies such as Natim (2011), Van Pelt (2013), Natim et al. (2015), Elmagrhi et al. (2017), Pahi and Yadav (2018), Sumail (2018) who evidenced significant positive and
Ghasemi et al. (2013) and Kulathunga et al. (2017) who reveled significant negative influence of board size on dividend payout authenticating the substitution hypothesis.

Further, with board independence (BI) and board meetings (BM) negatively affect the dividend payment supporting the theoretical evidence that institutions encompassing with better quality governance practices with regular board meetings and appointing higher proportion of independent non-executives directors are likely to pay a lesser amount of dividends (La-Porta et al., 2000). However, such negative association of board independence (BI) and board meetings (BM) with dividend payout is not statistically significant, therefore we don’t find statistical evidence in favor of our 2nd and 3rd hypothesis.

Apart from the main explanatory variables, we make use of widely accepted firm-specific determinants of dividend payout such as profitability, leverage and bank size as control variables in regression model. Profitability affects dividend payout positively and significantly in line of our expected sign signifying that highly profitable firms likely to pay larger dividends Al-Kuwari (2009). Another control variable, contrary to our anticipated sign, leverage is significantly positively affecting dividend policy which supports Kania, and Bacon (2005), Jiraporn et al.(2011), Dada et al.(2015) and Elmagrhi et al. (2017) in the ground that debt capital can be used by the firms to pay dividends. The potential explanation for a positive relationship is that more profitable firms with superior performance be capable of employing additional debts to capture benefits of tax savings on debt at the expense of creditors. In addition, bank size significantly positively affect dividend payout which signifies that large-size firms likely to pay a more dividend in as argued by Fama& French (2001). He documented that larger firms have trouble-free admittance to the capital market and can raise external funds with lowest transaction cost. Moreover, the large-size firms are able construct well-diversified investment portfolio, maintain a strong financial record and develop a good standing in the market by paying a larger dividend.

5. Conclusion

The study ascertains the association between corporate governance practices and the dividend payout of commercial banks registered in the Nepal Stock Exchange. Specifically, based on the agency theory, this study examines the impact of board characteristics on dividend payout decisions on a sample of nineteen listed commercial banks in Nepalese over the period of 2009 to 2020 by using a panel data regression model. We examined the linkage between board characteristics such as board size, board independence, rate of board meetings, board and size of audit committee size, and dividend payout in one of the least-developed country. The empirical findings reveal that the audit committee size affects the bank’s dividend policies. The relationship between these two is positive and statistically significant. Similarly, board size and dividend payout have also a positive relationship. However, the board size has no significant effect on the dividend payout of banking firms. Moreover, board independence and board
meetings have an insignificant negative link with the dividend payment. Besides, the empirical result reveals that more profitable, large, and mature banks pay larger dividends. This result supports the view that the large enterprises are often more mature, have larger free cash flows and are therefore more willing to pay higher dividend than small firms.

The findings of the study lead us to conclude that corporate governance in terms of board characteristics has no significant function in shaping the dividend payout of the banking sector. This is because banking firms are the most regulated institutions through prudential and non-prudential regulations along with the strong supervision, monitoring, and directions of regulating agencies. The responsibility, accountability, and transparency of banking firms ensure good governance over other business firms. Accordingly, there is no vital issue of agency conflict in banks and therefore dividend is not related significantly with corporate governance and agency conflict. We further conclude that our findings partially support the outcome hypothesis as most of the proxies of board characteristics are positively associated with the dividend payment.

Our study contributes and elongates to the existing literature in a variety of ways. First, we present an up to date empirical understandings and insights concerning board characteristics and dividend payment. Second, we provided evidence from banking firms of the least developed country regarding the corporate governance and dividend policy whereas most prior studies focus on non-banking firms of the developed and emerging nations. Third, our results expand and enlarge the insights of managers and shareholders that the corporate governance issue is partially significant in banking firms in determining the dividend payout by evidencing well-governed banks pay larger dividends.

Finally, the study is based on a number of limitations. Firstly, we used only four board characteristics as a proxy of corporate governance of the banking sector; hence we acknowledge that the findings would be more compelling and persuasive if other measures of corporate governance were also used. Second, we emphasized only commercial banks however the study can be done by taking a large sample considering other financial institutions for a long period to obtain deeper analyses and more conclusive results. Third, we used only firm-specific control variables in the study. The dividend policy may also be influenced by some macroeconomic variables. Hence we leave a space for future research by addressing these limitations.

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