

Postgraduate Dissertation Cover Sheet

Name	Md. Safiullah	Student ID	12901106
Programme	MSc Corporate Governance & Ethics	Supervisor	Dr. Sue Konzelmann
Title of Dissertation	Corporate Governance Mechanisms and Financial Policy Decisions of SMEs in Developing Countries: Evidence from Bangladesh		
Word count	14,671 (excluding Cover page, Acknowledgement, Table of contents, List of tables, References and Appendices)		

Plagiarism - please read the statement overleaf on plagiarism, and sign the declaration below: *You are reminded that all work submitted as part of the requirements for any examination of the University of London must be expressed in your own words and incorporate your own ideas and judgements.*

Plagiarism — that is, the presentation of another person's thoughts or words as though they were your own — must be avoided, with particular care in coursework and essays and reports written in your own time.

Direct quotations from the published or unpublished work of others must always be clearly identified as such by being placed inside quotation marks, and a full reference to their source must be provided in the proper form.

Remember that a series of short quotations from several different sources, if not clearly identified as such, constitutes plagiarism just as much as does a single unacknowledged long quotation from a single source. Equally, if you summarise another person's ideas or judgements, you must refer to that person in your text, and include the work referred to in your bibliography.

Recourse to the services of 'ghost-writing' agencies (for example in the preparation of essays or reports) or of outside word-processing agencies which offer 'correction / improvement of English' is strictly forbidden, and students who make use of the services of such agencies render themselves liable for an academic penalty.

Penalties for plagiarism

Disciplinary proceedings will be initiated wherever there is evidence that plagiarism has been committed. Where plagiarism is confirmed, candidates will fail on the work concerned and may be liable for further disciplinary action, including permanent exclusion from study not only at Birkbeck, but also everywhere else in the University of London.

More information

For more information on plagiarism, please refer to section 3 of the postgraduate handbook. You can also find information online at: <http://www.bbk.ac.uk/reg/regs/plagiarism>

I confirm that I have read and understood the advice given with regard to plagiarism in assessed work. I agree to abide by these rules and I agree that the JISC plagiarism service can be used to detect plagiarism. I accept that I may be penalised if I fail to abide by them.

Signed: Md.Safiullah

Date: September 23, 2013

For Office Use Only

Received:



Acknowledgement

I would like to express heartfelt gratitude to my honourable supervisor Dr. Suzanne J. Konzelmann, for her sublime guidance, much support and friendliness throughout the program. I am also indebted particularly to Dr Ioanna Boulouta and Toby Webb for their intellectual help. Finally I sincerely owe the greatest debt to my parents, Mrs. Rahima Begum and Mr. Md. Ali Akbar for their love with immense love.

MSc Corporate Governance and Ethics Dissertation

Md.Safiullah

School of Business, Economics and Informatics
Department of Management
University of London- Birkbeck College

London, September 2013

[2]

Abstract

Purpose of this study: To examine how and which corporate governance provisions impact financial policies of SMEs in developing countries (Bangladesh).

Methodology: This research paper follows positivist paradigm and the deductive approach of research. It includes internal corporate governance mechanisms as independent variables and the financial policies of firms (capital structure and dividend payment) as dependent variables and control variables on the basis of existing literature. The study sample covers listed SMEs of the Dhaka Stock Exchange (DSE), Bangladesh for a 4 year-time period from 2009-2012. It examines the impact through cross sectional and panel data regression (pooled model) analysis. In order to validate the analysis this study also take account of factor analysis and also use the KMO test to measures sample adequacy and Bartlett's Test of Sphericity in order to determine underlying factors that represents a grouping of variables.

Findings: This research provides the evidence of the impact of corporate governance mechanisms on the financial policy decision of SMEs in developing countries. Examining the impacts through cross sectional and panel data regression (pooled model) analysis this paper finds the same line of results. This study finds that board independence, directors and institutional shareholding have a significant impact in explaining the capital structure decision. Results are statistically insignificant in the case of board size, board diversity, CEO-Chairman duality and audit committee. Furthermore, this study explores the impact of corporate governance on dividend payment and the empirical results show that board diversity, board size, the director's shareholding and CEO-Chairman separation is statistically significant. But the results are statistically insignificant in the case of board independence, institutional shareholdings and audit committee in explaining the dividend decision of SMEs in Bangladesh. The impacts of factor variables are also in the same line of cross sectional and panel data regression analysis. So, apparently it can be said that all governance provisions are not matter and impacts are case sensitive to dependent variables.

Conclusion: This research paper in particular, focuses on the evidence of Bangladeshi firms and therefore generalisation of empirical results may not be possible. However, it will provide an insight to policy makers of Bangladeshi regulators and other like structured developing market economies seeking to protect minority shareholder's right and quality corporate governance practice. For instance, to think more sincerely about the urgency of the institutional investor's engagement, independent functioning of the audit committee and moderation of majority shareholder's dominance in the board.

Key words: Corporate governance, Capital structure, Dividend pay-out, Capital market, Significant, Efficiency, Agency problem.

Table of Contents

Contents	Page
Abstract.....	ii
Chapter 1: Introduction.....	01-6
Chapter 2: Literature Review.....	07-23
2.0 Theoretical literature.....	07-15
2.1 Corporate governance mechanisms.....	07-11
2.11 Internal mechanisms	
2.12 External mechanisms	
2.2 Theories of capital structure.....	12-13
2.3 Theories of Dividend payment.....	13
2.4 Theories of corporate governance.....	14-15
2.5 Empirical literature.....	16-23
2.5.1 Corporate governance and capital structure.....	16-18
2.5.2 Corporate governance and dividend decision.....	19-21
2.6 Significant results of key empirical literature.....	22-23
Chapter 3: Research Methodology.....	24-29
3.1 Research paradigm ad approach.....	24
3.2 Research questions.....	25
3.3 Research hypothesis.....	25
3.4 Variables description.....	26-28
3.4.1 Dependent variables	
3.4.2 Independent variables	
3.4.3 Control variables	
3.5 Data and methods of analysis.....	28-29
3.5.1 Sample period and observation	
3.5.2 Data collection	
3.5.3 Data analysis	
Chapter 4: Results and Discussion.....	30-41
4.1 Impact of corporate governance on capital structure.....	30-35
4.2 Impact of corporate governance on dividend payments.....	36-41
Chapter 5: Conclusion and Limitations.....	42-43
References and Appendices.....	44-54

List of Tables (all in appendix)

- Table 1 Descriptive statistics of variables
- Table 2 Cross-sectional regression results: Capital structure decision
- Table 3 Panel data regression (Pooled model) predicting Capital structure
- Table 4 Cross-sectional regression results: Dividend decision
- Table 5 Panel data regression (Pooled model) predicting Dividend decision
- Table 6 Varimax Rotated component Matrix
- Table 7 Regression result of Factor variables

Chapter 1: Introduction

Corporate governance is vital for organizational sustainability and absence of it results financial instability and depression (Konzelmann, Wilkinson, Davies and Sankey, 2009). The key objective of corporate governance is to make sure accountability of related parties and transparency in both financial and non-financial transactions (OECD 1999, revised 2004). This is also means to maximize the best interest of the economy and to a greater extent for the society (Cadbury, 1992) by the diverse corporate governance provisions (Gillan, 2006; Shleifer and Wolfenzon, 2002).

Indeed, corporate governance develops to resolve the agency problem of the large corporation's results from the diverse shareholding system. The concept is getting more acceptances in every developed market even in developing markets in particular, after the scandals and the collapse of giant corporate houses in developed countries (e.g., Enron, WorldCom, Arthur Andersen, Parmalat etc.) and hence draws the attention of the international community regarding its importance more than before. But, theoretical and empirical corporate governance research mainly concentrates more on large companies since the inception (Daily, Dalton, & Cannella, 2003; Gabrielsson & Huse, 2004) and very limited in the case of medium enterprises and small enterprises (Dyer, 2003; Smith, 2007).

Notably, to ensure the sustainable development of world economy strong practice of corporate governance is urgently required in every shape of business organizations including SMEs. Small and Medium Enterprises (SMEs) is the lifeblood of the world economy which accounts for nearly ninety percent of businesses in the world. Its contribution in the employment generation is also tremendous in all over the world and accommodates around seventy percent of world employment (IFC, 2005). Additionally, it is a key device of earnings and economic prosperity predominantly in developing world because in the developing countries private economy is more or less exclusively comprised of SMEs. Moreover, the economic downturn of the recent past and earlier decades reminds that not only large corporations but also SMEs are effective vehicles which contribute significantly to rescue the economy.

Nonetheless, regardless of the creditable role in the world economy SMEs are encircled with diverse genera of shortcoming and challenges. This sector is in severe financial complexity and face huge obstacles in exploring the new market opportunity and of course lack of transparency is not beyond question. Importantly, sustainability of SMEs falls in severe criticism. Therefore, Abor and Adjasi (2007) state that strong practice of corporate governance may resolve the challenges of SMEs and will increase the level of confidence to investors and obviously increase sustainability of business.

However, research literature shows differences of opinion in regard to the existence of the agency problem in SMEs. One school states that as in most cases control of ownership seems to be stronger in SMEs and hence agency problems are expected to be less (Uhlener, Floren & Geerlings, 2007; Schulze, Lubatkin, & Dino, 2003). In addition to this, the other school thinks that because of concentrated (family or founding member dominated) ownership and higher bargaining power of directors, senior management are influenced to maximize the interest of majority shareholders at the expense of minority shareholders benefit, and thus raise agency conflict and the essence of corporate governance. Because of the higher operational risk, low transparency and firm specific characteristics of assets corporate governance is very important even in the financial policy determination of SMEs (Smith, 2007)

It is also extensively believed that agency conflict has a strong influence on financial policies of the firm. Financial policies of firms comprise both capital structure and dividend decision. According to Kajanathan, R., (2012) and Jiraporn, P. *et al.*, (2012) corporate governance quality has a strong influence on key financial policy such as capital structure decision as debt ratio in the capital structure and the risks of financial distress is closely associated. Increasing proportion of debts in the capital structure beyond optimal limit intensifies the risk of general equity holders and of course cost of new equity financing (Robert Hamada, 1969). It may also create underinvestment problem as senior managements are always reluctant to invest in profitable, but the risky project unless the investment is safe in their view (Lipson & Mortal, 2009; Erwan Morellec, 2000). Research literature states that senior management generally prefer to use debt less than the shareholders expect to avoid further

monitoring from the lender and their interest seeking behaviour tends to lead the financial decision against of shareholders interest (Hart and Moore, 1995; Donaldson's, 1969; Jensen, 1993). But lack of transparency and accountability of issuing and re-packaging debt security (see Enron case) in the capital structure generate higher cost and lower cash flow only. Effective corporate governance can make sure balanced capital structure decision and sustainable development of the firm protecting the rights of principals (Ahmad, A. *et al.*, 2012; Al-Najjar and Hussainey, 2011; Vaklifard *et al.*, 2011).

Furthermore, another critical financial policy of firms is the dividend payment decision. Dividend contributes significantly in resolving agency problems through distributing free cash flow of the firm. Because, the higher amount of free cash flow is an indirect incentive for management to spend for their personal benefit or to invest in less profitable projects (Jensen, 1986). In addition to this, dividend exposes firms to more close scrutiny of capital markets and its participant, which is also a very effective means of deterring management opportunistic behaviour. Again, shareholders in general prefer to have more dividends when agency problem is very high.

This proposition means that corporate governance quality has an apparent influence on dividend policy as well (Jiraporn, P. *et al.*, 2011). Literature also shows that firm with strong governance quality pay more dividends to minimize pressure from the shareholders (Outcome model) additionally firms with poor corporate governance also pay more dividend in order to retain goodwill with shareholders (substitution model) (O'Connor, T., 2012; Mutamimah and Hartono, S., 2010; Adjaoud, F., and Amar, W., 2010; Abdullah, N. *et al.*, 2012; Warrad, L., 2012). Empirical literature of the impacts of corporate governance provisions on the capital structure and dividend decision for large corporations is extensive, but for SMEs of developing countries is relatively scarce. But SMEs are now taking on corporate governance issues more and more even in developing countries because of its notable effect on sustainable development (Abor, 2007). Moreover, existing studies of corporate governance and financial policies with few exception deals with individual governance mechanism either board or ownership structure (e.g., Monks and Monow, 2004, Dailly and Dalton, 1993).

This research paper is an initiative to address the gaps in the literature by examining how and which corporate governance provisions impact the financial policies of SMEs in developing countries (Bangladesh). This study will explore the relationship of capital structure and financial policies in the context of Bangladesh. Dhaka Stock Exchange (DSE) is the prime exchange of Bangladesh and it is regulated by the Bangladesh Securities and Exchange Commission (BSEC) which forms the foundation of corporate governance of listed firms in Bangladesh. But for banks and financial institutions there are different corporate governance guidelines directed from the central bank (Bangladesh Bank) in addition to SEC guidelines. In order to ensure quality corporate governance, the SEC promulgated corporate governance compliance order in 2006. This order is primarily centered on the insider system of corporate governance. All of the listed companies are required to report their corporate governance compliance status annually according to order and they are also obligated to disclose their shareholding's pattern for the public. The listed companies of DSE are a mix of government and private firms which are also owned by family members, multinational companies and private institutions. The accounting system of Bangladesh is similar to those followed in developed economies. But the ownership structure differs from Anglo-Saxon countries (e.g., USA, UK) and directors and corporate have more controlling ownership and influence in policy decision. Minority shareholders have fewer legal protections from the expropriation of the corporate insider. Moreover, the market is less liquid, firm size is much smaller even the tax system is also different from other developed and developing countries. Studies show that differences in ownership structure and legal environment has a significant impact on financial policies of firms (Faccio M, et al., 2001; La Porta, et al., 2000). Therefore, it would be interesting to know how the corporate governance system of Bangladesh or which governance provisions related to the financial policy decision.

This balanced panel data study will add some new features to the existing literature in the following ways. In the first, this study focuses on SMEs and developing countries in contrast to the majority of previous studies which has focused on large corporations and developed economies. Secondly, this study considers SMEs as a single unit in addition, distinguishes SMEs into medium and small enterprises where the majority of previous studies consider

SMEs as a single unit or homogeneous group only. Thirdly, previous studies either consider capital structure or dividend payment as predicting variable but this study incorporates both capital structure and dividend pay-out together and examine the independent impact of corporate governance variables and finally this study also add a new feature by incorporating comprehensive provisions of corporate governance.

The study consists of variables which have rarely been undertaken for Bangladesh market before. This study shows an interesting outcome given the results of prior studies in the capital structure. Examining the impacts through cross sectional and panel data regression (pooled model) analysis this paper finds the same line of results. Considering SMEs as a homogeneous group, this study finds that board independence and directors shareholding have statistically significant impact (positive and negative) on the capital structure. Distinguishing SMEs into subgroups it is found that only board independence is statistically significant in the case of medium enterprises. But in the small enterprises directors' shareholding and institutional shareholding impacts are statistically significant. Results are statistically insignificant in the case of board size, board diversity, CEO-Chairman duality and audit committee in explaining the capital structure decision of SMEs in Bangladesh.

Furthermore, this study explores the impact of corporate governance on dividend payment and the empirical results show that board diversity and board size is statistically significant in explaining the dividend decision of SMEs. It is also apparent that only board diversity is statistically significant in the case of medium enterprises. But in the case of the small enterprises director's shareholdings, board size and CEO-Chairman separation has statistically significant impacts. The results are statistically insignificant in the case of board independence, institutional shareholdings and audit committee in explaining the dividend decision of SMEs in Bangladesh. The impacts of factor variables are also in the same line of cross sectional and panel data regression analysis.

The study also affirms that despite the weak regulatory regime and protection of shareholder rights firms of Bangladesh tends to use more debt in their capital structure particularly from banks as the bond market is almost ineffective. However, banks hardly

play an active role in mitigating the agency problem moreover banks allow expropriating the interest of minority shareholders and other stakeholders in the absence of the strong institutional investor's engagement. Additionally, controlling owner's personal and political affiliations also fuels in uprising agency problem. This finding confirms other studies of related nature (Kumar, 2005, Du and Dai, 2005). Higher dividend payments and governance provisions impact also validate the substitution hypothesis of good corporate governance.

The subsequent part of this paper structured as follows. Chapter 2 describes the theoretical and empirical literature review in regard to the impact of corporate governance mechanisms on capital structure and dividend decision. Chapter 3 explains sample and observations used, variables, research questions and hypothesis and methods of analysis. Chapter 4 details the results and discussion of empirical results. In the end chapter 5 discusses the concluding remarks and limitations of this study.

Chapter 2: Review of the Literature

The main purpose of this study is to examine how and which corporate governance provisions impact financial policies of SMEs in Bangladesh. With the intention of providing a background of the research subject this section reviews previous theoretical research literature on corporate governance and financial policies. This chapter also provides an empirical literature review of corporate governance and its impact on financial policies of firms.

Corporate governance aims to discipline management activities for the best interest of shareholder specifying the rights & responsibilities among different related parties in the corporation. Indeed, corporate governance literature has two stands: Firstly, it considers as the way of guiding and improving the firm's performance (Hart, 1995; Fama and Jensen, 1983) and the other consider as the ways that provide suppliers of finance with some protection in regard to their investment (Rahman, 2006; Shleifer and Vishny, 1997). The second thought has become the center of contemporary corporate governance studies since the collapse and scandals of the large corporation in developed economies. This research falls into this second school of corporate governance literature, and it examines the effect of corporate governance mechanisms on financial policies.

2.1 Corporate Governance Mechanisms

Luo (2007) categorizes corporate governance mechanisms on the basis of market, discipline and culture, but these classifications itself incorporates broad components which can also be characterized under internal and external mechanisms. Internal governance mechanisms govern the functioning of senior management and the board where board is seen as an independent institution and an apex body of the internal control system. The board of directors is appointed by the shareholder's to take care of their interest disciplining management activities.

External governance mechanisms embedded with the rules, laws, and factors that influence the operations of a firm from the perspective of capital providers i.e. shareholders and debt-holders. External mechanisms are used to evaluate all firms in the same jurisdiction while

internal mechanisms are firm specific and use to evaluate the individual firm and very useful for investment decision. However, both streams of governance mechanisms complements each other rather than substitute and network together in a system to stimulate the long-term returns and governance of firms (Cremers and Nair, 2005).

The characteristics of board (e.g., board size, composition of the board, chairman of the board and CEO duality), ownership concentration, institutional shareholding, corporate by-laws and charters, audit committee, management compensation and incentive plans consist of internal mechanisms of corporate governance (Cremers and Nair, 2005; Gillan , 2006). In addition to this, the market for corporate control, proxy fight, product market competition, the external managerial labor market, anti-director rights, legal rules and regulations of the capital market, the quality of enforcement of investor-protection rules are generally refers to as external provisions of corporate governance. These mechanisms are viewed as effective in resolving agency conflict or deterring corporate managers seeking self-interest on a macro-economic or market-wide level (Shleifer and Wolfenzon, 2002; Shleifer and Vishny, 1997)

2.1.1 Internal Mechanisms

Board of directors: Management theory elucidates that in the widely dispersed ownership of corporations, the owners require to delegating their authority and responsibility to the board to oversee the corporation and to protect the shareholders' interests. In this regard board of directors is seen as an apex of the internal control system (Fama and Jensen,1983; Hermalin and Weisbach, 2003). The board performs the role of overseeing the functioning of the corporation and its management. They play a vital role of the link point between the corporation and its external stakeholders and provide direction for the corporation for the future. Indeed, the corporate board is an authoritative institution to hire, fire and recompense senior management and also to re-confirm and scrutinize important decisions.

Empirical research on the board of directors revealed that board size, composition of the board, chairman of the board and CEO duality has significant effects on the monitoring of senior management activities. The board's size closely relates group dynamics, coordination

and efficiency in decision making. Evidence of research shows that smaller board size results the higher valuation of firms and promotes effective monitoring and decision making irrespective of firms size (Jensen,1993; Yermack, 1996). Board composition weights on the independence of the board (non-executive directors) to ensure board decision free from the influence of executives and chairman. The outsider dominated board performs better monitoring of management activities than the insider and generate lower costs for companies (Mayers et al.,1997; Weisback, 1988). Chairman of the board and CEO duality is concerned with the concentration and control of power in one person's hand (Booth, Cornett and Tehranian, 2002; Hart, 1995). It is empirically proven that the collapse and scandals of large corporations (Enron, WorldCom etc.) materializes because of over empowering CEO as chairman of the board. Even though there is an additional cost of monitoring the monitor (chairman) but potential benefits supersede the cost (Bebchuk and Fried, 2003). In this study board size, board composition, Chairman and CEO separation employs as an explanatory variable in the proposed model. The chairman and CEO separation is recorded based on a dummy variable whereby '0' denotes duality and '1' denotes separation.

In addition to this, the diversity of board has also acquired a higher strategic salience within organizations and generates wide-ranging interest (Erhardt et al., 2003). Moreover, it is evident that gender diverse board generates high quality solutions and lead to higher company performance (Nielsen and Huse, 2010). It also increases the competition within the firm's internal labour market and serves the best interest of both primary and secondary stakeholders improving its reputation (Rose, 2007). Therefore, this study incorporates gender diversity of board as an independent variable taking into account of the minimum one woman in the board.

Ownership structure/concentration

Concentration of ownership can range from substantial minority ownership to majority ownership even to diverse ownership. The ownership structure of large/majority shareholding is nearly a universal method of controlling management activities and help

investors to get their investment back. In the diverse ownership structure agency problem is severe than concentrated ownership (Shleifer and Vishny, 1997). But large minority shareholders by outsiders in both equity ownership and voting rights provide strong mechanisms of corporate governance in disciplining managerial activities and determining financial policies of the firm. In the sample firms of this study, a large proportion is sponsor/directors owned and controlled but also have diverse shareholders. This study examines whether ownership concentration (director's shareholding or managerial shareholding) have any effect on firms financial policy decisions (A number of studies consider board of directors ownership as a proxy of managerial ownership e.g., Mork, Shleifer and Vishny, 1988).

Institutional shareholding

Institutional shareholders (mutual funds, trust funds, pension funds, etc.) by owning a large proportion of ownership right influences the strategic policies of corporations both in domestic and international financial markets. Since twentieth century institutional share ownership has increased significantly instead of individual ownership even in the UK 65-80% share owned by institutions and this is 55-60% in the US (Mallin, C., 2006). Their dissatisfaction and voice against management play prominent role particularly where the management of the firm does not practice good governance (Cremers and Nair, 2005). Moreover, institutional investors are also playing a key role to promote stakeholders interest and engagement to their invested companies (Armour, Deakin, and Konzelmann, 2003). Though institutional block holder's ownership data are not reported, but the proportion of institutional shareholdings are available in stock exchange website and hence this research considers it as an explanatory variable.

Corporate by-laws and charters

Corporate by-laws and charter is a governance mechanism within a company or across an economy which is important for the proper functioning of the economy and expected to have an impact on the confidence of the related parties of organizations (OECD, Corporate governance Principles, 2004). Indeed, it specifies the rights and duties of all parties in the organizations e.g., voting rights, meeting rights, minority shareholder rights, compensation

package and so on (Cremers and Nair, 2005). By-laws and charters act as a first line of defense for investors from the expropriation of insider and majority shareholders' unequitable treatment. Due to unavailability of data in this study this variable is not considered as an explanatory variable.

Audit committee

The International Organization of the Securities Commission (IOSC 2002) explains audit committee as a proxy of shareholders. They are responsible to govern the functioning of the organizations in compliance with the code. In order to enhance corporate governance quality and a good monitoring system within the listed firms Bangladesh Securities Exchange Commission (BSEC) has also strongly recommend to setting up an audit committee with composite guidelines. Therefore, this study considers the presence of the audit committee as an explanatory variable and measures as a dummy variable.

Management compensation and incentive plans

Compensation of senior management and different incentive plans such as compensation policy, stock option, share ownership, performance related bonus (the threat of fire if targets are not met) impact significantly in resolving agency conflict. Compensation policy of senior management is an important governance variable, but this study does not incorporate it because of the non-availability of data.

In fact, internal corporate governance mechanisms minimize risk-sharing relationship between the shareholders and senior management. Different governance mechanisms are complementary with each other and ensure better accountability and transparency.

2.1.2 External Mechanisms

Both conventional and legal theorists argue that external corporate governance mechanisms are also a powerful deterrent in resolving agency conflict and providing protection to investors (shareholders and debt-holders) interest (Shleifer and Wolfenzon, 2002; Jensen and Ruback, 1983). For example, the market for corporate control assumes that the performance of sound management reflects on the price level of share and if the

market fails to hold the expected share price it conveys a signal that management performance is not up to the mark and thus works as a controlling mechanism of management self-interest behavior. This research study is mainly concerned with the internal governance mechanisms of the sample firms and assumed that because of developing and weak characteristics of market and economy, external governance mechanisms influence financial policy decisions of SMEs indiscriminately.

2.2 Theories on the rationale of Capital structure decision

There are widely differing theories of capital structure, but to make induction by means of previous studies this study takes into account the following theories.

Modigliani & Miller (MM) Theory

Modigliani & Miller (1958) viewed that capital structure decision is irrelevant and has no impact on firm's value. It has no effect on the weighted average cost of capital and all firms (irrespective of size and amount of debt) are exposed to the same level of the risk under certain conditions. That implies companies can or should possess debt capital as much as possible at risk free rate. However, in 1963 MM revisited the previous proposition and incorporating corporate taxation argued that debt increases the value of the firm and return on equity because of its tax deductible feature. Moreover, Ozkan (2001), Meyers (2001), Harris and Raviv (1991), Chang and Rhee (1990), Scott (1977) argue that debt covenants and the amount of debt varies on the basis of firm characteristics and hence debt financing, determine the value of the firm and exposes firms in different grade of risk level.

Signalling theory

According to the signalling theory level of debt in the capital structure is an important tool of signalling regarding the financial happening of the organization. This sign of signaling can be both positive and negative. Debt capital beyond optimal level provides negative signal as it increases the risk of financial distress. But when the company issue debt instrument, and borrow debt with a favourable rate having repayment capacity, it tends to provide a positive signal of management's performance and efficiency (Chang, R., and Rhee, S., 1990; Harris, M., and Raviv, A. 1991)

Pecking order theory

This theory is related to the financial arrangement of the corporations. It suggests that when the company is required external funding or when a company grows swiftly and falls in the deficiency of internal sources of fund, it is likely to offer debt instrument and thereafter to move on to equity financing. In contrast to this order Lipson & Mortal (2009) argue that firms prefer fund from equity if it holds more liquid equity, and it results in lower leverage. On the basis of this theory profitability tends to be negatively related with financial leverage and contributes in reducing free cash flow and conflict of interest among the funds provider(debt holders and shareholders), Suto, M. (2003). But it can also influence leverage positively since lenders like to finance more to the profitable firms. However, insiders and controlling shareholders play an important role in strategic and financial decisions.

Agency Theory

Agency theory is based on a conflict of interest between agents (management) and principals (debt holders). In the case of the capital structure choice the agency problem originates mainly from the asset substitution behaviour of management when they borrow to invest in a good project but change to invest in a comparatively low earnings project after getting the loan from the lender. In addition to this, risk shifting between balance sheet items also increases the agency cost of debt. However, disagreement of the objectives between agencies because of the difficulty of project funding as well as differences in risk attitudes may also create conflict between parties. The higher ratio of debt may also create underinvestment problem as senior managements are always reluctant to invest in profitable, but the risky project unless the investment is safe in their view (Lipson & Mortal, 2009; Erwan Morellec, 2000). Strong debt covenants and good governance influence firms to obtain optimal capital structure resolving agency problem.

2.3 Theories on the rationale of dividend payments

Miller and Modigliani (MM) (1961) states that it is the earning only which determines the share price and the value of the company not the dividend payment decision or amount of retained earnings. However, dividend payment is important for investors and plays a strategic role in the firm's operation and valuation. The following theories explain why firm

pay dividends. According to signaling theory dividend payments transmit a positive signal about the firm's internal operation and future performance. Additionally, free cash flow augments the conflict of interest between shareholders and management. Dividend payments decrease the availability of free cash flow and contribute to minimize agency conflict.

2.4 Theoretical framework of corporate governance

In the absence of a general consensus on what is corporate governance or what the system of corporate governance should do a number of complementing theories emerged over time. The problem of corporate governance originated with the development of limited liability ownership that separate owners from management of the corporation (Berle and Means, 1932). Additionally, Ross (1973) argue that because of the dispersed shareholding system and information asymmetry; monitoring of management activities may not be economically viable and hence the agency theory of corporate governance comes in the limelight:

Agency theory: In the limited liability corporation agents (management) are hired employee but authorized to work for the very best interest of principal (shareholders). The principals are risk bearer, and the residual claimant (Fama and Jensen, 1983) of firm assets and have the most at stake (Williamson, O., 1984) therefore shareholders risk preference attitudes are different from agents. Senior managements are most often opportunistic and concentrate more to increase their job status, personal image and employee's welfare. Opportunistic behavior of senior management may lead to activities against of the principal's benefit in the long run. Because of the large number of shareholder it is difficult to discipline senior management by shareholders directly and hence the agency problem arise along with different agency cost i.e., the cost of monitoring agent's activities, bonding cost and the residual loss of principals (Jensen and Meckling, 1976). In this regard, Solomon and Solomon (2004) argue that when firms become bigger in size, operation and production, risk and uncertainties also increases in the same course. In order to reduce this risk and uncertainties senior management have sorts of incentives to internalize transactions and these incentives maximize management's self-interest more than the

rationale. It is also assumed that the rationale of management activities in all times is not beyond question, rather they practice bounded rationality (limitedly intentional rational behavior). Moreover, as the contractual obligations between agents and principals are not written and documented so the agency problem is always persistent and hence increase the importance of corporate governance. Core corporate governance institutions of Anglo-Saxon countries strongly oriented to shareholder's primacy (Armour, Deakin and Konzelmann, 2003) and have developed different codes of corporate governance primarily to strengthening the agency relationship.

Stakeholder theory: Stakeholder model of corporate governance is also getting more popularity to institutional and responsible investors. Moreover, the European and Japanese model of corporate governance also supports stakeholder's primacy. It is already established that business and organizations have responsibility to both primary and secondary stakeholders other than shareholder only (Freeman and Read 1983). Because firm's decision influence stakeholders and hence incorporating stakeholder's point and engaging them in decision making are crucial for board of directors. Cadbury 1992 reports and OECD 2004 revised principles of corporate governance also emphasized on stakeholder theory of corporate governance.

This study focuses more on the agency theory framework to examine how corporate governance enhances shareholder value in financial policy decision (capita structure and dividend decisions) of firms because in every financial decision shareholders interest are affected and thus their interests are crucial to protect through good corporate governance . However, this study also point out the implications of multiple theories in the result analysis.

2.5 Empirical literature

2.5.1 Corporate Governance and capital structure

Evidence of literature suggest that firms characteristics e.g., liquidity, the size of the firm, growth, return to equity, and the tangibility has significant effects on the capital structure decision (Asteriou, D. and Hall, 2007; Chen and Zhao, 2006; Lipson and Mortal, 2009; Rajan and Zingales, 1995; Scott, J., 1977). Additionally, research literature has been focusing close attention to financial decisions and corporate governance for many years because corporate governance plays a strategic role and has important implications to optimal capital structure or financing decision (Kajanathan, R., 2012; Bartus, M. et al., 2010. It influences better management, monitoring of management activities and effective compliance and control system that results sound financial decisions (Ganiyu and Abiodum, 2012).

Existing research literature asserts that corporate governance and financial leverage has the following two types of interaction. Financial leverage itself plays a role as a corporate governance mechanism to resolve the shareholder-management conflict. The financial leverage increase engagement of the bond market, credit rating agencies, banks and financial institutions through covenants in overseeing the functioning of firms to discipline self-interest seeking managerial behavior. On the other hand, a strong corporate governance practice increase firm's value and therefore reduce the cost of debt financing, and hence the higher quality of governance lead to more debt(Jensen and Meckling, 1986). But this impact and relationship between capital structure and governance mechanisms depend on the structure of the financial market and of course on the extent of debt financing. The following part presents the key evidence of the effect of individual governance provisions on financial policies.

Abdoli, M. *et al.* (2012); Jensen (1986) conducts a study considering listed firms of Tehran Stock Exchange as samples and this panel data study infers that board member size is significantly and positively related to the capital structure decision. Yu Wen *et al.* (2002) examine the impact of the broad structure on the capital structure choices of Chinese listed firms. Their study suggests that higher corporate governance of boards influence managers

for lower capital structure, but an insignificant association reveals between the size of the board member and the capital structure. Their study also affirms that huge foreign investment in the capital markets of China does not make its listed firms governance to influence on capital structure like western markets.

However, Zong-jung(2006) affirms that board members size does not have a significant effect on the probability of the firm's financial distress while a higher debt ratio increases the risk of financial distress as well as the risk of shareholder. Kajanathan, R. (2012) study also confirms about no significant relationship between board size and capital structure. Magdalena, R. (2012) also investigate this proposition through the panel data of listed firms of the Indonesian Stock Exchange's excluding bank and financial institutions and states that size of boards of directors negatively influence capital structure decision. It is also evident in the literature that a significant positive association exists between institutional ownership and financial leverage (Abdoli, M. et al., 2012). Rehman, U.A. et al. (2010) conducts research in the different marketplace and also concludes the same result as former study. But Zong-Jung (2006) finds that institutional share ownership is inversely related to the financial distress and this result from sub-optimal capital structure. Hussainey, K. & Aljifri (2008) examine the same propositions on Dubai financial markets and discover the same findings of Zong-Jung. That indicates the higher proportion of institutional ownership influence lower debt and active monitoring and discipline of managerial activities. Magdalena, M.(2012) through the panel data study on Indonesian Stock Exchange's listed firm and conclude that institutional ownership, managerial ownership and family governance has no significant influence on the financial leverage decision.

Literature also suggests that independence of board members are inversely related with financial leverage (Abdoli, M. et al., 2012; Zong-Jung, 2006). Hsien-Chang Kuo et al. (2012) investigate this relationship using listed SMEs of the Taiwan Stock Exchange and affirms that director ownership and independent directors in SMEs and debt-ratio is negatively related. It means to reduce the risk of financial distress or bankruptcy they prefer the lower debt ratio. SMEs prefer short-term financing while large corporations are in favor of long-term financing. This finding provides the same result of Fosberg (2004) study, but contradicts with

Firth(1995) and Friend and Hasbrouck(1988) study. Kajanathan, R. (2012); Rehman, U. A. *et al.* (2010) assert that composition of board members with independent non-executive director influence capital structure decision significantly to Srilanka and Lahore stock exchanges listed firms respectively. Evidence of board composition's negative influences on debt-equity ratio also apparent in the study of Magdalena, M. (2012).

CEO duality influence financial leverage positively (Mokarami *et al.*, 2012). But Zong-Jung (2006) finds contrasting results and explore that CEO duality has no association with capital structure decision and hence on financial distress. Maryam *et al.* (2012) in their study particularly concludes that an insignificant association found between the tenure of CEO and capital structure decision. In contrast to Maryam *et al.* finding Yu Wen *et al.*(2002) finds the positive association of the capital structure with CEO tenure. Saad, N.M. (2010) investigates the effect of corporate governance compliance on financial leverage in Malaysia and this study also confirms that internal corporate governance mechanisms and capital structure is closely interrelated. Saad, also identified that listed firms with higher compliance of good governance can attract potential investors better than others that also helps in business expansion and development. It is important to note that Financial leverage reduces the agency conflict and agency cost because debt holders and other financial institutions play a monitoring role to discipline management activities. After Enron's collapse Sarbanes Oxley Act promulgated in 2002 to ensure optimal capital structure and more governance quality (ethics and accountability) of corporations. Bartus, M. *et al.* (2010) finds a causal relationship between Sarbanes Oxley Act and corporate governance and between corporate governance and capital structure. They conclude that Oxley act has developed for better governance and transparency of firms and it is working as a substitute of capital structure in resolving agency conflict. Florackis, C. and Ozkan, A. (2009) also suggests the strong evidence of a significant effect of corporate governance practices on capital structure in the United Kingdom, but it also depends on the structure of corporate governance.

The above findings convey a message to the insiders of the firm to take into consideration of corporate governance issues for better performance and financial policy decisions.

2.5.2 Corporate Governance and dividend payout

Corporate governance has significant effects in resolving the agency problem and the agency problem strongly influence dividend payment decision and thus it is believed that corporate governance has influence on dividend policy. Dividend payments to shareholder discipline management activities and deter expropriation of managers by reducing free cash flow available to managers that could be otherwise spend by managers for private benefit and thus reduce the agency problem (Jensen, 1986). But studies shows that higher dividend payments which reduce retained earnings and general reserves may also increases the cost of external financing (Rozeff, 1982). So, a proper dividend payment decision can maintain a balance between the agency problem and the external financing cost. Improvement in the corporate governance quality of the firm induces senior management for a balanced policy to protect shareholders interest and to reduce the information asymmetry between insiders and outside shareholders.

Gugler, K. (2001) examines the interrelation between internal governance mechanisms of corporate governance and dividend payments in Austrian firms through a panel data set and conjecture that corporate governance mechanism (in particular, the ownership structure of the firm) determines dividend pay-out ratios. Corporations with majority state ownership provides smooth dividends but the firm's with family controlled ownership provides significantly lower dividends. The family controlled firm tends to expropriate minority shareholders right cutting dividend payments and seeking constant investment opportunities. Hwang *et al.* (2004) documented a study on the Korean business group and examine whether good corporate governance pay higher dividends. Their research results were in line with the outcome model of corporate governance and dividend payments. Kim and Lee (2008) also explore the association of dividend payment to corporate governance holding external financing opportunity as an impacting variable of selected Korean firms. They conclude that when firms face constraints in external financing tends to pay lower dividends and again firms are likely to increase their pay-out ratio with an improvement in their corporate governance.

Hu, A. and Kumar, P. (2004) also concludes that internal governance mechanisms significantly (positively and negatively) impact the likelihood and the level of dividend payments. Kowalewski ,O. *et al.* (2008) study findings also support the outcome model of dividends. Their study particularly focuses on Poland where shareholder rights are highly protected and therefore firms are tending to pay higher dividends. This study also finds evidence of paying dividend generously by firms with weak shareholder rights.

Adjaoud, F. & Amar, W.(2010) look into the effects of corporate governance on dividend policy in Canada taking the sample from Toronto Stock Exchange's listed firms over four years time period. The firm level governance index incorporates different provisions of governance, including shareholder rights issues. They draw an interesting outcome which supports the outcome model of dividend that means good governance of firm lead to more dividend income for the shareholder. Their study result is also related to the research of La Porta *et al.*, (2000). Yordying Thanatawee (2013) conducts a study on dividend policy and ownership structure with a sample of 1927 observations for a time period of eight years long in Thailand and infer that dividend policy is heavily influenced by the ownership structure, particularly organizations with the higher percentage of institutional shareholding likely to pay the higher dividend.

Jiraporn, P. & Ning, Y. (2011) note that the dividend policy is positively related to corporate governance quality. The higher governance quality the higher is the propensity to pay higher dividends and thereby reducing conflict of interest between agents and management. In such a firm managers take on optimal dividend policy. Although this study opens a new window, but it contrasts with major previous findings and recommendations that good governance and dividend play a substitution role. However, the implication of this finding is subject to availability of finance and regulatory environment. Firms facing lower flexibility of finance and regulated properly pay lower dividends than firms do not have. This finding is more similar to the outcome hypothesis of governance. Abdullah, N. *et al.* (2012) in a study of the emerging market examines the effects of ownership structure on the dividend payment decision and concludes that dividend plays a monitoring role and also has important implications in resolving the agency problem.

Chang, B. & Dutta, S. (2012) examines the same proposition taking into account the listed Canadian firms as the sample for a period of 8 years. This study in general supports the substitution hypothesis of dividend. In accordance with this hypothesis weaker governance firms are inclined to pay higher dividends. In the literature, weaker corporate governance characteristics reflects larger board size, no or lesser proportion of independent director, CEO duality, dual class share ownership, lower board diversity etc.(Hu and Kammar, 2004). Their investigation covers different internal governance provisions (e.g., board size, independent director, CEO-chair, CEO voting, CEO ownership and option pay of CEO) as independent variables and concludes that firms with lower board member tends to pay lower dividends and vice versa. This paper clearly reveals that corporate governance has an important implication in determining dividend payment decision irrespective of the firm characteristics. O'Connor, T. (2012) also examines the issue of internal governance provisions taking the sample of 220 firms from twenty one emerging market economies. He infers that higher dividend payments are the outcome of quality corporate governance. He also draws an interesting point that in the emerging markets lack of accountability and transparency of transactions are likely to substitute with the higher dividend pay-out and through these mechanisms firms want to convey a positive signal to stakeholders to reduce financing constrains. Short et al.(2002) explore the association in the UK and concludes that institutional ownership is positively related but managerial ownership is negatively related with dividend pay-out. Trojanowski (2005) also examines the effect of governance provisions on the dividend decision of British firms listed on the LSE, and the results support the Short et al. (2002) findings.

2.6 Significant results of key empirical literature: Corporate governance and capital structure

Study	Independent variables	Empirical results
Florackis, C. & Ozkan, A.(2009)	Board size Board independence Managerial ownership Concentration of ownership	Positive Positive Positive Positive
Abdoli, M. et al.(2012)	Board independence CEO Duality	Negative Positive

	Institutional shareholding Internal Auditor	Positive Positive
Yu Wen, Kami and Bilderbeek(2002)	Board size Board composition Tenure of CEO	Positive Positive Negative
Jayesh Kumar(2006)	Foreign ownership Institutional ownership	Negative Positive
Renna Magdalina(2012)	Board size Board independence	Negative Negative
Vakilifar, R.H.(2011)	Board size CEO duality	Negative Negative
Bodaghi and Ahmadpour (2010)	Board size	Negative
Saad, M.N (2010)	Dual Leadership Board size Board meeting	Negative Negative Negative
Ganiyu, O, Y. & Abiodun, Y. B (2012)	Board size CEO Duality	Negative Negative
Rehman, U.A et al. (2010)	Board size Board independence Directors shareholdings Ownership Concentration	Positive Positive Positive Negative
Kajananthan, R.(2012)	Board meeting	Positive
Bartus, M. et al. (2010)	Board size Board independence	Positive Negative

Corporate governance and dividend payments

Study	Independent variables	Empirical results
Jiraporn, P. & Ning, Y. (2011)	Board size Board independence	Positive Positive
Chang, B. & Dutta, S. (2012)	Board size Board composition CEO duality CEO ownership CEO voting	Positive Negative Positive Positive Positive
Adjaoud, F. & Amar, W.(2010)	Board Composition Shareholder rights	Positive Positive
Mutamimah & Hartono, S.(2010)	Domestic Ownership Foreign Ownership	Positive Positive
Warrad, L.(2012)	Foreign ownership	Positive
Subramaniam, R. & Devi, S.(2011)	Board size Board composition	Negative Negative
Abdullah, N. <i>et al.</i> (2012)	Ownership concentration	Positive
Kowalewski ,O. <i>et al.</i> (2008)	Board structure CG disclosure	Positive Positive

	Shareholder rights	Positive
Jiraporn, P. et al. (2011)	Board Audit Ownership	Positive Negative Negative
Farinha, J.(2003)	Insider ownership	Negative
O' Connor, T.(2009)	Board independence Board accountability	Positive Positive
Short et al (2002)	Institutional ownership Managerial ownership	Positive Negative
Hu, A. and Kumar, P. (2004)	Board independence CEO ownership CEO tenure	Positive Negative Positive

Critical reviews of the existing literature suggest the following gaps. First, prior research studies mostly covers financial decisions and corporate governance of large corporations and shows that studies on SMEs are very rare. Secondly, previous studies either consider capital structure or dividend payment as financial policy and very few studies consider both. Thirdly, the majority of studies either consider boards characteristic or ownership structure as corporate governance variables and there is hardly any study incorporates comprehensive provisions of corporate governance including board diversity. Therefore, it is still interesting to examine this research subject. This distinct study will hope to address the aforementioned gaps and contribute in the several area of existing research literature.

Chapter 3: Research Methodology

3.1 Research paradigm and approach

The gaps identified in the existing research literature (see chapter 2) suggest the need for the study on SMEs of developing countries and the impacts of corporate governance on financial policies. This study is designed to explore this in the context of SMEs in Bangladesh. However, there is no general consensus in regards to the definition and criteria of defining SMEs and it varies in different countries on the basis of the asset's position, turnover and number of employees of the firm (Abor and Adjasi, 2007). Therefore, this paper considers OECD (2005) guidelines as a basis to select sample firms.

“SMEs are considered to be a non-subsidiary and independent with an annual turnover of less than EUR 50 million and total balance sheet not exceed EUR 43 million for medium size enterprise. An annual turnover of less than EUR 10 million and total balance sheet not exceed EUR 10 million for small size enterprise” (OECD (2005)).

In defining SMEs this study uses total balance sheet position and turnover and assumes that defining SMEs in terms of the number of employees may mislead in the context of Bangladesh as businesses are more or less labour intensive. In DSE there are 528 listed companies, including treasury bonds, corporate bonds and debenture and the number of listed non-financial companies is 122. This study includes 80 non-financial companies based on available data to determine the statistical sample for model estimation and hypothesis testing.

This study is a combination of both quantitative and qualitative research but the quantitative research methods and the framework of assumptions demonstrates that the research approaches or philosophy follows the positivist paradigm. Therefore, this research remains separate from subjectivity and deals with objectivity associated with quantitative data from secondary sources. The research in this approach is rigorous, linear and rigid based on hypothesis testing. The study follows the deductive approach or theory testing approach of research where developed theories and hypothesis are accepted or rejected on the basis of the empirical results which is the reverse of inductive approach.

3.2 Research questions

This study seeks to answer a key research question and some other sub- questions which are stated below:

Key research question:

Does corporate governance impact financial policy decisions (capital structure and dividend pay-out) of listed SMEs in Bangladesh?

Sub- questions:

- Does board structure (the size of the board, independence of the board, Chairman-CEO separation) impacts financial policy decisions (capital structure and dividend pay-out) of listed SMEs in Bangladesh?
- Does ownership structure (institutional ownership, directors/sponsors ownership) impacts financial policy decisions (capital structure and dividend pay-out) of listed SMEs in Bangladesh?
- Does audit committee and board diversity impacts financial policy decisions (capital structure and dividend pay-out) of listed SMEs in Bangladesh?

3.3 Research Hypothesis

On the basis of the above research questions and literature review this study considers the following testable hypotheses. Justification of these testable hypotheses is derived from previous studies discussed in details in the literature review sections.

Hypothesis 1(H₁): The provisions of board and ownership structure impacts financial policies positively

Hypothesis 2 (H₂): The CEO-Chairman separation impacts dividend pay-out ratio negatively but the debt ratio positively.

Hypothesis 3(H₃): The director's shareholding impacts the debt ratio negatively but the dividend ratio positively.

Corporate governance quality benefits in balancing capital structure and dividend decision and thus in sustainable development of firm (Konzelmann, Wilkinson, Davies and Sankey, 2009). Additionally, it increases financial flexibility, image and performance (operational and financial) of the firm and the better relationship with stakeholders and obviously minimizes

the investment risk (Claessens, 2006). Therefore, a statistically significant positive association is expected to exist between the corporate governance and financial policy decision variables in the aforementioned hypotheses.

This study tests the above hypotheses on the basis of the given regression model:

$$\text{Capstr} = \alpha + \beta_1 \text{Bind} + \beta_2 \text{Bsz} + \beta_3 \text{Insh} + \beta_4 \text{Ccs} + \beta_5 \text{Acom} + \beta_6 \text{Bdiv} + \beta_7 \text{Dsh} + \epsilon \text{ ----- (i)}$$

&

$$\text{Dpr} = \alpha + \beta_1 \text{Bind} + \beta_2 \text{Bsz} + \beta_3 \text{Insh} + \beta_4 \text{Ccs} + \beta_5 \text{Acom} + \beta_6 \text{Bdiv} + \beta_7 \text{Dsh} + \epsilon \text{ ---- (ii)}$$

Where, Capstr is the debt ratio; Bsz is the size of the board; Bind is the independence of the board; Insh is the institutional shareholdings, Ccs is the CEO-Chairman separation; Acom is the audit committee, Bdiv is the board diversity and Dpr is the dividend pay-out ratio, α denotes intercept, β for coefficients and ϵ for error terms.

3.4 Variables description

3.4.1 Dependent variables

Financial policy decision variables such as capital structure and dividend pay-out is considered as dependent variables. In order to draw the inference and to measure the firm's dividend payment, this study uses the ratio of cash dividends and yearly earnings which determines the firm's commitment to the interest of general shareholders. Even though dividend yield can be used as a proxy of the dividend payout ratio, but dividend yield is related to market perception which is indeed an indirect reflection of internal management governance in an efficient market only. This study includes another dependent variable capital structure which takes into account the ratio of total debt and total assets.

Definition of variables

Dependent variables	Definition of variables
Dividend pay-out ratio	Annual cash dividends divided by annual earnings
Total debt to total assets ratio	Total debt divided by total assets

3.4.2 Independent variables

Independent variables are particularly focuses on internal corporate governance characteristics (described in literature review section). In Bangladesh, the secondary market is not so strong and dominated by low paid-up listed companies and the market behaves as like a semi-strong form of the efficient market and therefore, external mechanisms, including the market for corporate control may not be applicable in this case. The construction of independent variables is given below:

Independent variables	Definition of variables
Board size	Natural logarithm of board size
Board independence	Number of non-executive director divided by the total number of directors
CEO-Chairman separation	CEO duality is measured based on a dummy variable whereby 0 denotes CEO is the chairman of the board and 1 otherwise
Institutional shareholding	Number of shares held by institutions divided by the total number of shares
Audit committee	It is a dummy variable whereby 1 denotes the presence of audit committee and 0 otherwise
Board diversity	It is a dummy variable whereby 1 denotes the diversity of boards and 0 otherwise.
Directors shareholding	Number of shares held by sponsors/directors divided by the total number of shares.

3.4.3 Control variables

Control variables help to know the behaviour of dependent variables under certain conditions (Francis, 1990). Previous studies have already established the relationship and their impacts on dependent variables and therefore these variables are secondary focus of this study. However, these explanatory variables are important to be considered in the study and exclusion of these variables may lead to a bias relationship even an unusual magnitude of the relationship. Previous studies (e.g. Chang and Dutta, 2012; Lipson and Mortal, 2009; Asteriou and Hall, 2007; Chen and Zhao, 2006) on this issue have recommended the use of control variables. Following the suggestions this research take up

firm size, liquidity, profitability (return to equity) and tangibility as control variables related to the firm's characteristics affecting dependent variables.

Control variables	Definition of variables
Firm size	Natural logarithm of total assets
Liquidity	Total current assets divided by the total current liabilities
Return to equity	Net income available to common stock holders divided by the total common stock equity
Tangibility	Total non-current assets divided by the total assets

3.5 Sample and methods of analysis

3.5.1 Sample period and observations

This is a balanced panel data study and sample firms are selected from 17 different economic segments for the period of 2009-2012. Dependent variables, independent variables and control variable data for each sample firm are collected for this 4-year period. As mentioned earlier SEC publicized corporate governance compliance order and made it obligatory for all listed companies in June 2006. In order to justify that firms have got the enough time period of practicing corporate governance, this study considers the sample period after 3 years of SEC order with the available latest data. The total no. of SMEs in the sample is 80 and the total number of observations for the 4 year-time period is 320. Due to unavailability of data this study incorporates 80 companies out of 122 as the sample. Even though the sample is small, but panel data study (the 4 year-time period and 17 economic segments) is in line with many previous studies. For instance, Al-Najjar, B. (2011) considers a 4-year study period, Yu Wen *et al.* (2002) consider a 3-year study period, Magdalena, R., (2012) also considers a 3-year study period in their research.

3.5.2 Data collection

This study consists of only secondary data. Intended data of corporate governance provisions and financial policy decisions are collected from the audited annual reports and stock exchange publications. Annual reports are available in the company website even in the website of stock exchange. More specifically, data for the corporate governance variables are collected from the introductory section (e.g., preview of company

management, audit report, the directors report) of the financial report. Data for defining SMEs and debt ratio source from the annual and semi-annual audited financial statements. Finally, dividend payment related data comes from the website and publications of the Dhaka Stock Exchange.

3.5.3 Data analysis

For this study data sets are analysed through SPSS 20 and Microsoft Excel 2007 on the basis of hypotheses. In order to ensure the perfect understanding of the impacts of corporate governance mechanisms on subgroups of SMEs, this study categorize total samples of SMEs into medium enterprises and small enterprises based on EC(2003) guidelines and Egle and Hirth (2011) study and analyse separately . Descriptive statistics are used to present the summary results of all selected variables. In order to analyze the effects of variables cross sectional regression and panel data regression (pooled model) are performed in line with the study of Farinha, J. (2003) and Crutchley & Hansen (1989). The study uses different statistical tests and associated P-Value in order to assess the hypotheses and to determine significant effects and goodness of fit model. In order to validate the findings this study also includes factor analysis using the principal component approach and also performs regression on factor variables. The KMO test measures the sample adequacy for satisfactory factor analysis and Bartlett's Test of Sphericity finds some correlations to each other in order to determine underlying factors that represents a grouping of variables.

Chapter 4: Results and Discussion

4.1 Impact of Corporate governance mechanisms on Capital structure decision

The table 1 is a summary of descriptive statistics of all thirteen variables which consists of seven independent, two dependent and four control variables. The result shows that on average the board of sample companies consist of seven members with a minimum size of four members and a maximum size of fourteen members but a large standard deviation of board members between the firms is noticeable. The mean proportion of independent directors to total directors of selected sample firms is quite high and it is about 79%. This proportion takes account of both non-executive board members who holds the minimum one share of the respective company and also independent directors without any ownership claim. It is also apparent that there are companies with all non-executive directors even though there are companies where the non-executive director's proportion should be increased significantly from the current level of only 33 percent.

The shareholding patterns of institutions demonstrate a significant discrepancy between firms. The average proportion is 16.42% even though there are firms with no institutional shareholders and also there are firms with the higher proportion (69%) of institutional shareholding. The institutional investor's equity ownership is much lower than other countries (see literature review, p.3). Chairman and CEO of selected firms are separate on an average in 37.81% cases, but in 62.91% cases Chairman and CEO is the same individual and hold control in both executive committee and in the board. This is happening because a large portion of listed firms of Bangladesh are family owned and controlled and hence a tremendous lacking is observed in authority and responsibility delegation to the hired CEO. The average proportion of the presence of the independent audit committee is 60.94%. Although there is huge scope to improvement but the compliance of governance guidelines is progressing with the passes of time. The board of directors of enterprises are moderately diverse. The diversity of the board is present in 60% cases, but higher standard deviation indicates the huge variation from the mean value that results from the perfect non-diverse board. The average shareholding patterns of directors/sponsors are 41.79% and the maximum proportion is 95%. A higher percentage of the director's shareholding indicates

the family or group controlled characteristics of listed companies. It also explains the essence of strong corporate governance to protect minority shareholder rights.

The results in the table 1 also demonstrate that the average capital structure (total debt to total asset ratio) of selected sample firms is 33.33% with a standard deviation of 18.54%. The minimum proportion of debt ratio is 1% and the maximum proportion of the debt ratio is 83%. It is apparently straightforward to state that on average selected firms maintain their capital structure in an optimal limit. In the existing theoretical and empirical literature of capital structure, it is established that 40:60 (40% debt and 60% equity) ratio is optimal or can be termed as the balanced capital structure (Brigham, 2009). However, in this case it is marked that there are firms with a huge debt ratio which ultimately increases the risk of shareholder again there are many firms with too low debt that inhibit firms in getting tax shield benefit. A significant variation in the capital structure decision is evident and the following section will be explaining which variables impact this important financial policy decision.

The dividend pay-out ratio statistics indicates that on average sample firms provide 37.49% of dividends. It is very interesting to note here that the maximum dividend pay-out ratio is 500% and there are also cases where firms pay no dividends to the shareholder. Therefore the extreme position might be the cause of inflated mean value, but from the data set it is also apparent that companies are consistent in paying minimum 10% of dividend in every year to the shareholders. The statistics above for capital structure and dividend payment validates the proposition that when firms tend to have more external financing pay more dividends to keep up the image to the stakeholders as higher dividend payment works as a substitute of the weaker legal environment and good governance.

Control variables are also an important observation of this study. The average size of the firm which represents the natural logarithm of total assets is 5.2968. These firms are selected based on a standard total asset's position. The average liquidity ratio is 1.7272 which is of course a good indicator. This liquidity ratio indicates that firms have 72.72% current assets over current liabilities which argue for financial soundness to accomplish the

structure of firm. In the year 2010 significant negative relationship ($b = -0.043$, $p < 0.05$) found only between institutional shareholding and debt ratio and supports the same outcome of the year 2011.

Moreover, 2009 shows relatively different results and significant relationship found between debt ratio and board size and CEO-Chairman separation along with board independence. The size of the board has significant but negative impacts on the debt ratio ($b = -0.016$, $p < 0.1$) which indicates that the presence of higher board size inhibit firms in quality decision making and decrease creditworthiness and hence provides less financial flexibility. But CEO-chairman separation is positively related ($b = .105$, $p < 0.01$) to the debt ratio. When CEO is the chairman of the board, then it implicitly means that the board can't play an active role as an independent institution. CEO duality is also an important cause of creating agency problem because a higher controlling power of CEO both in board and management influence management in opportunistic behaviour for private benefit and hence lowers its creditworthiness to investors. Separation of CEO and chairman reflects the better performing board and firm and facilitates more debt financing. The significant positive relationship supports the above discussion and stewardship theory (managers are keen to maximize shareholders benefit). Additionally, relatively board independence has also the greatest impact (the highest beta value) in the capital structure decision.

The effects of control variables on capital structure are also in line of existing literature. In 2012, 2011, 2010 and in 2009 it is evident that liquidity of the firm negatively impacts the debt ratio ($b = -0.036$, $p < 0.1$). That implies firms are likely to use less debt in their capital structure if they experience surplus liquidity. Surplus liquidity substitutes the need of external financing and cover-up short-term operational and financial obligation. This also supports the pecking order theory of financial arrangements and maintain the order of financing e.g., internal source (liquidity or retained earnings), debt and then equity financing. Additionally, higher liquidity of firms decreases the cost of issuing equity financing and decrease use of leverage. In the alternative speaking, it is also arguable that the higher long-term debt ratio creates more short term liabilities and decreases the level of liquidity (Erwan & William, 2000; Lipson et al., 2009).

A positive relationship found between capital structure and firm size for the entire sample period except 2010. It indicates higher the size of the firm the lower is the debt ratio. In the theoretical and practical literature it is also apparent that firm size matters significantly in the capital structure decision and follows pecking order theory of capital structure in many instances. That is small firms tend to finance more from internal source (retained earnings) and increase the debt ratio with the increasing of firms size. Kurshev and Strebulaev (2006), Asteriou, D. *et al.* (2007) also argue that in general the likelihood of default is less in the case of large size firms than small and medium size firms because of more diversified portfolio. It increases their acceptance and credit ratings to creditors and therefore gives easier access to finance at a lower rate. Their result states that the impact of size variable is also implacable for Small and Medium Enterprises. This finding is also consistent with the study of Hall, Hutchinson & Michaelas (2000), Watson and Wilson (2002) who also examines size impact on UK SMEs and infer that impact of size variables support for SMEs as well and follow pecking order model of financing. This research paper also finds the positive impacts of tangibility to the debt ratio in 2009 which state that a higher percentage of tangible assets increase the secured collateral and lead firms to have more debt capital. This result is also consistent to the study of Rajan R.G., and Zingales, L., (1995), Harris, M., and Raviv, A. (1991) but apparently no significant impact is visible in case of profitability and the debt ratio.

****Insert table 2 about here****

Table 3 in the appendix embody abstract of panel data regression (pooled model) predicting capital structure. Cross sectional regression analysis and panel data regression analysis provides almost the same results and thus increases the robustness of this study. In the case of SMEs a statistically significant positive relationship exists between capital structure and board independence, ($b = .133$, $p < 0.1$) but the negative relationship ($b = -.145$, $p < 0.01$) in the case of directors shareholding. Notably, relatively director's shareholding has the greatest impact (the highest beta) in the capital structure decision. In the case of medium enterprises, it is evident that the only board independence has a significant positive impact ($b = .140$, $p < 0.05$) on the capital structure decision. But in small enterprises, institutional shareholding effects positively ($b = .362$, $p < 0.01$) and director's shareholding effects negatively ($b = -.164$, $p < 0.01$) and relatively director's shareholding has the greatest impact

(the highest beta). Importantly, no statistically significant impact found between debt ratios and in the case of board size, board diversity, CEO-Chairman duality and audit committee in all cases.

As like previous studies of capital structure, this study finds the same outcome for control variables. Firm size, liquidity and tangibility impacts capital structure decision significantly. But for medium enterprises, it is visible that the proportion of non-current assets to total assets has no significant impact in determining debt ratio. Again in case of small enterprise it is difficult to conclude about significant association between liquidity and debt ratio. However, it is apparent that profitability of the firms has no effect on the capital structure decision. ****Insert table 3 about here**.**

In the above cross sectional and panel data regression, total variables are categorized in two models where model 1 represents the control variables and model 2 specifies the predictor variables including corporate governance mechanisms. Division of variables in two models aim to get more accurate and unbiased results. The absence of control variables in the model may inflate the regression outcome. From the regression results, it is evident that 9 % (R square .090) of capital structure decision can be explained by the control variables but model 2 possessing the best predictive function for explaining variance in the dependent variables. It is clear that 24.4 % (R square .244) of capital structure decision can be explained by new predictors. The change of R Square explains that a 15.3% variant in the dependent variable that can be explained by incorporating variation in the explanatory variables. The value of F-statistics (7.828 and 4.705 respectively) and the value of significance (0 .000* for model 1 and 0.000* for model 2) point out that independent variables used together in all models are significantly better in predicting the dependent variable and also is an evidence of goodness of fit model.

In the case of medium enterprises, it is also apparent that 6.67% of variation in the dependent variable that can be explained by control variables and explanatory power increases by 15.7% after including corporate governance variables. But statistically significant p-value (.014**, .089 *** respectively) implies that both the model is better in predicting capital structure compares with the mean. But for small enterprises, this study concludes that 9.1% of variation in the dependent variable that can be explained by control variables and the explanatory power increase by 12.3% after incorporating corporate governance variables. Again, statistically significant p-value (.002*, .000* respectively) implies that both the model is better in predicting capital structure. Notably, no collinearity exists between variables as VIF is less than 3 in every case.

4.2 Impact of Corporate governance mechanisms on Dividend Decision

Table 4 in the appendix represents a synopsis of cross sectional regression (Farinha, J., 2003 and Crutchley and Hansen, 1989) results explaining impacts of corporate governance provisions on dividend decision. The results illustrate that in year 2012 board size and board diversity significantly impacts the dividend pay-out decision of firms. Size of the board impacts dividend payment positively ($b = .108, p < 0.05$) that means smaller the size of the board the smaller amount of dividends for the shareholders and vice versa. But it is empirically proven that smaller the size of the board, the better is the corporate governance quality (Hu and Kumar, 2004) and in the alternative speaking the smaller size board tends to pay higher dividend and follows the outcome model. But the above findings apparently explain that dividend pay-out of the Bangladesh market follows substitution model. Additionally, it is also apparent that the diverse board also impacts dividend payment positively ($b = .026, p < 0.05$). In this regard evidence of the literature states that the diverse board contributes significantly towards maximizing shareholder's interest and to the firm's reputation, innovation and quality decision making (Joy, 2008; Miller & Triana, 2009). Presence of diversity in the board makes more transparency of financial transactions and accountability of management that leads to more benefit for the shareholders. However, it is apparent that relatively size of the board has the greatest impact (the highest beta) in the dividend decision of 2012.

In the year 2011 it is also apparent that board independence has significant positive impacts ($b = .49, p < 0.1$) on the dividend pay-out ratio which supports the outcome hypothesis of dividend payment. Higher board independence improves the internal control and monitoring and discipline activities of opportunistic senior management. It also decreases the level of free cash flow position of the firm paying more dividends to shareholders and contributes in reducing agency conflict. Board diversity has the same effect ($b = .361, p < 0.1$) as in 2012. But relatively diversity of board has the greatest impact (the highest beta) in 2011 in determining dividend payment.

Institutional shareholdings significantly and negatively impacts ($b = -.062, p < 0.05$) the dividend decision of 2010. Indeed, in the corporate governance literature it is evident that

higher institutional shareholders presence plays an active role to discipline management opportunistic behaviour and to minimize agency conflict. In the same reasoning it is expected that higher the percentage of institutional shareholders higher is the dividend for the shareholders. But the inverse relationship here concludes that institutional shareholders can't play an active role in Bangladesh and therefore dividend payment follows substitution model. In 2009 it is also evident that board independence has the same impact on dividend as in 2011, but the director's shareholding has a significant positive impact ($b = .331$, $p < 0.05$) on dividend payments which support the stewardship theory of corporate governance. According to the Bangladesh Company act, 1994 each of the directors of publicly listed companies should have minimum one share. This clause is to ensure the proper rights and interest of shareholders. As the directors of board are shareholders and therefore it is likely that board takes more care of shareholders interest. The higher shareholders representation in the board ensures the higher dividend for them. However, BSEC in 2006 has developed rule for the independent directors outside of the shareholding directors and this study also finds relatively the greatest impact of the board independence in 2009.

****Insert table 4 about here****

Control variables also impact the dividend decision significantly. In 2012, 2011 and in 2010, it is apparent that firm size has significant positive impacts on the dividend payment ratio. The positive relationship between variables specifies that the shareholders of larger size firms tend to enjoy more dividend than small size firms. The same finding also demonstrates in the empirical research of Holder et al, 1998; Farinha, 2003; and in Fama and French (2001). But this study doesn't find any impact of firm size in 2009. Again only in 2010 significant negative relationship found between dividend payment and liquidity. The negative relationship demonstrates that the higher dividend payment decreases the liquidity of the firm. In addition to this, the profitability (return to equity) impacts the dividend pay-out decision positively in all years that states that the higher profitability increases the dividend payment to shareholders. Previous studies also find the propensity of paying higher dividends by profitable firms (De Angelo and DeAngelo, 1990; Jiraporn *et al.*, 2011)

Table 5 (appendix) is a summary of panel data regression (pooled model) predicting the dividend decision. It is apparent that both board size ($b = .038, p < 0.1$) and board diversity ($b = .124, p < 0.1$) positively impacts the dividend decision of listed SMEs of the Dhaka Stock Exchange. But relatively board diversity has the greatest impact (the highest beta) in the dividend decision. Existing research literature also support that board diversity, particularly gender diversity in board influence profitability and shareholder value significantly but of course it depends on the specific circumstances of each company.

With the aim of understanding a more precise impact of governance variables in dividend decision, this study also look at the impacts on medium enterprises and small enterprises separately. The study explores that only board diversity positively ($b = .228, p < 0.1$) impacts the dividend decision of medium enterprises. In the case of small enterprises, it is also clear that board size, CEO-chairman separation and the director's shareholding has significant impacts on the dividend decision. But relatively board size (the highest beta) has the greatest impact in determining the dividend pay-out ratio. An important finding in the case of small enterprises is that CEO-chairman duality has significant but negative impacts in the dividend payment decision. From the theoretical literature of dividend decision, it is apparent that agency conflict between management and shareholders arise because of the CEO duality. Because, management in general don't want to invest in positive NPV, but the risky project and also don't want to declare dividend to shareholders from free cash flow. Independent CEO and chairman in this case play a key role to resolve agency conflict and to maximize shareholders benefit balancing between dividend payment and investment. Notably, this study does not find any statistically significant impact of institutional shareholding to the dividend decision in any case.

****Insert table 5 about here****

Findings of control variables in pooled model are also in the same line of cross sectional model. Dividend payment and firm's size is positively related and the impact of firm size is statistically significant in every case. However, liquidity impacts negatively to dividend only in medium enterprises. Profitability impacts dividend pay-out positively in the case of SMEs, medium enterprises and small enterprises separately.

In the cross sectional and panel data regression, model 1 represents the control variables and model 2 specifies the predictor variables including corporate governance mechanisms. From the regression results, it is evident that 12.6 % (R square .126) of dependent variable can be explained by the control variables but model 2 possessing the best predictive function for explaining variance in the dependent variables. It is apparent that 26.4 % (R square .264) of capital structure decision can be explained by new predictors. The change of R Square explains that 13.8% variation in the dependent variable that can be explained by variation in the new independent variables. The value of F-statistics and the value of significance (15.183; 0.000* for model 1 and 6.076; 0.000* for model 2) point out that independent variables used together in all models are significantly better in predicting the dependent payment and also states the evidence of goodness of fit model.

In the case of medium enterprises, it is also apparent that 13.9% of variation in the dependent variable can be explained by control variables and the explanatory power increase by 11.7% after including corporate governance variables. But statistically significant p-value (.000*, .000* respectively) implies that both the model is better in predicting dividend pay-out compare with the mean. Again, in the case of small enterprises, it is obvious that 20.1% of variation in the dependent variable can be explained by control variables and the explanatory power increase by 7.4% after incorporating corporate governance variables. Again, statistically significant p-value (.000*, .000* respectively) implies that both the model is better in predicting dividend payment. Notably, there is no existence of collinearity statistics between variables as VIF is less than 3 in every case.

In the end, it is arguable that relatively board diversity has the greatest impact on dividend payments followed by board independence, board size, the director's shareholding and audit committee. Therefore, this research paper infers that corporate governance mechanisms validate both substitution and outcome hypothesis of dividend payments in the case of listed small and medium enterprises of the Dhaka Stock Exchange, Bangladesh.

This study also includes factor analysis method in order to validate the analysis of financial policy decisions. Bhaduri (2002) explains that "Factor analysis is a statistical tool to

determine a minimum number of unobservable common factors (which are smaller in number than the number of variables) by studying the covariance among a set of observed variables". The factor analysis technique consists of two steps. Firstly, extracting the factors based on KMO MSA rule (the initial eigenvalue greater or equal to one) and then regress the extracted factors against dependent variables.

Table 6 (appendix) explains varimax rotated component matrix. From this table factor variables are determined following the rule of thumb where cut off point is 0.32 and the variables shows loadings more than 0.32 are acceptable for a suitable explanation of factors. In the varimax matrix table, the KMO Measures of sample adequacy (MSA) value 0.557 demonstrates that data samples are adequate and also suitable for factor analysis. In addition to this, it is also evident that Bartlett's Test of Sphericity is significant because it's associated p-value (0.000) less than .05. This states that variables do have some correlations to each other, which is very important to find an underlying factor that represents a grouping of variables. Both of these indicators apparently show satisfactory outcome and thus performing factor analysis to measure the validity of the study seems to be wise.

****Insert table 6 about here****

It is evident that factor 1 is highly loaded with board diversity, audit committee and CEO-Chairman duality. Diversity of board balances the power of the board and lessens the controlling power of chairman or CEO and ensures more transparency of transactions. Therefore this study considers board diversity as a factor. Factor 2 is highly loaded with board independence and board size. Board independence and size are positively related and importantly impacts the governance quality of the firm. Again, board size determines the independent functioning capability of the board. The higher board paves the way of more independent thinking and decision. Therefore this study considers both board size and board independence as a factor. Factor 3 is highly loaded with institutional shareholdings and the director's shareholdings. The higher director's shareholding position may attract fewer institutions to hold or purchase new shares of the company. Therefore this study considers the director's shareholding as a factor. The first factor accounts for 20.74% of the variance, the second 17.53% and the third 17.13%, a total of 55.40% of total variance.

Table 7 in the appendix explains regression results of factor variables. The regression model of factor variables also shows a good fit of model (P-value less than 10% in both cases). It is apparent that board independence has positive impact ($b = .134, p < 0.1$), the director's shareholding has negative impact ($b = -.159, p < 0.01$) on the capital structure decision and the results of regressing factor variables are found in the same line of previous analysis. The impact of factor variables on dividend decisions are also in the same line of previous analysis and shows that the board size has positive impact ($b = .031, p < 0.1$), and the diversity of board has negative effects ($b = .113, p = 0.1$), on the dividend payment decision. The results of factor analysis authenticate the outcome of this study. *Insert table 7 about here**

In the following the summary results of this research study are presented:

Corporate Governance and capital structure decision

Variables	Hypothesis	Empirical Results/ Impacts	Decision
Bind	Positive	Positive	Accepted
Bsz	Positive	No significant relationship	Rejected
Insh	Positive	No significant relationship	Rejected
Ccs	Positive	No significant relationship	Rejected
Acom	Positive	No significant relationship	Rejected
Bdiv	Positive	No significant relationship	Rejected
Dsh	Negative	Negative	Accepted

Corporate Governance and dividend decision

Variables	Hypothesis	Empirical Results/ Impacts	Decision
Bind	Positive	No significant relationship	Rejected
Bsz	Positive	Positive	Accepted
Insh	Positive	No significant relationship	Rejected
Ccs	Negative	Negative	Accepted
Acom	Positive	No significant relationship	Rejected
Bdiv	Positive	Positive	Accepted
Dsh	Positive	Positive	Accepted

From the above discussion and analysis apparently it can be said that corporate governance has statistically significant impacts on the financial policy decision of SMEs in Bangladesh, but all governance provisions are not matter and impacts are case sensitive to dependent variables.

Note: The direction of coefficient value explains the relationship between variables. This study admits that there are market and economy specific factors which are also very relevant in explaining the dependent variables over selected independent variables.

Chapter 5: Conclusion

5.1 Conclusion and Policy recommendations

With the growing importance of corporate governance to balance between the financial and social goal all over the world, Bangladesh has also developed corporate governance code for listed companies to ensure better transparency and accountability of transactions. However, the feeble regulatory system along with personal and political affiliation of corporate entrepreneurs and directors negate the essence of quality corporate governance in many times. The Bangladesh capital market collapsed in 1996 for the first time but after a slow recovery again in the 2010 market collapsed hugely that questioned about the firm's governance compliance status. Therefore, it becomes more interesting to know whether corporate governance provisions are a matter in determining a balanced and strong financial decision. This study attempts to answer the above question investigating the relationship between corporate governance provisions and financial policy decisions such as dividend and debt financing policy for a sample of Bangladeshi firms over the period 2009-2012. The study affirms that corporate governance is partly working in explaining important financial policies, but all governance provisions are not matter and impacts are case sensitive to policy variables.

The board independence and board diversity support outcome hypothesis of good governance, but it is very important to note that the higher proportion of the director's shareholding tends to avoid implicit monitoring and scrutiny of banks and other financial institutions. In addition to this, the inactive bond market also neutralizes implicit monitoring of the marketplace. Again, the absence of strong explicit monitoring mechanisms such as the market for corporate control, strong regulatory system and protection of shareholders right increases the likelihood of expropriation of outsiders by the majority ownership claim holders (insiders).

Additionally, the higher director's shareholding tends to pay more dividends (positive direction of the relationship between dividend payment and directors shareholding) which clearly support the substitution hypothesis of good corporate governance. It is also unforeseen that institutional investors hold a significant portion of shares in every sample

firm, but their influence in financial policies is unexpectedly insignificant. This may be either because of non engagement tendencies of institutional investors in decision making or lack of effective institutional investor's activism. Moreover, this study does not find any effect of the audit committee to financial policies which may question about the independence of the audit committee. These findings may be quite useful to policy makers of Bangladeshi regulators seeking to establish the rule of law to protect minority shareholders right, and to make sure an effective outcome of corporate governance practice in strategic and financial policy decisions.

5.2 Limitations

This paper is not certainly beyond limitations in particular, the number of sample firms and observations is low and therefore the results may not be representative. An extension of this paper would consider sample firms from other developing countries and more observations to strengthening the findings. These issues were difficult to address due to time constraint and unavailability of public data. This study also acknowledges that all viewpoints of both theoretical and empirical literature are not captured in this relatively small dataset. However, careful steps were taken in collecting and analyzing every single data to ensure an unbiased research study.

References

Abdoli, M. et al., 2012. Corporate Governance and Its Effects on the Corporate Financial Leverage. *Journal of Basic and Applied Scientific Research*, 2(9), pp. 8552-60.

Abdullah, N. et al., 2012. The Influence of Ownership Structure on the Firms Dividend Policy Based Lintner Model. *International review of business research papers*, 8(6), pp.71-88.

Adjaoud, F., & Amar, W., 2010. Corporate Governance and Dividend Policy: Shareholders' Protection or Expropriation. *Journal of Business Finance and Accounting*, 37(5& 6), pp.648-667.

Abor, A., and Adjasi, 2007. Corporate Governance and the Small and Medium Enterprises Sector: Theory and Implications. *Corporate Governance*, 7(2), pp. 111-122.

Ahmad, A. et al., 2012. Corporate Governance and Capital Structure: Evidence from Tehran Stock Exchange. *Middle-East Journal of Scientific Research*, 11(4), pp. 531-535.

Al-Najjar, B., 2011. Empirical Modelling of Capital Structure: Jordanian Evidence. *Journal of Emerging Market Finance*, 10(1), PP. 1-19.

Al-Najjar, B., and Hussainey, K., 2011. Revisiting the Capital-structure Puzzle: UK Evidence. *Journal of Risk finance*, 11(4,), pp. 329-338.

Armour, John, Deakin, Simon F. and Konzelmann, Suzanne J.,2003. Shareholder Primacy and the Trajectory of UK Corporate Governance. *Cambridge Centre for Business Research Working Paper*,No.266.Available at <http://dx.doi.org/10.2139/ssrn.1930885>

Asteriou, D., and Hall, S., 2007. Applied Econometrics: A Modern Approach Using Eviews and Microfit. Basingstoke, Palgrave Macmillan.

Bartus, M. et al., 2010. Capital Structure, Corporate Governance and the Effect of Sarbanes Oxley. *Discussion paper*, Auburn University, USA

Bebchuk, L. A., and Fried, J. M., 2003. Executive Compensation as an Agency Problem. *Journal of Economic Perspectives*, 17, (3), pp. 71-92.

Berle A.A., and Mean, G.C., 1932. The Modern Corporation and Private Property. New York: Macmillan, 1933

Bhaduri, S., 2002. Determinants of Corporate Borrowing: Some Evidence from the Indian Corporate Structure. *Journal of Economics and Finance*, 26(2), pp. 200–15.

Booth, J.R., Cornett, M.M. and Tehranian, H., 2002. Boards of Directors, Ownership, and Regulation. *Journal of Banking & Finance*, 26, pp. 1973-1996.

Bodaghi and Ahmadpour, 2010. The Effect of Corporate Governance and Ownership Structure on Capital Structure of Iranian listed companies. 7th ICESAI, Greece.

Brigham, E.F., and Ehrhardt, M.C., 2009. Financial Management:Theory and Practice, 13th edition

Cadbury Committee Report (1992) Report of the Committee on the Financial Aspects of Corporate Governance, (Chairman: Cadbury, S.A.), Gee Ltd (Professional Publishing Ltd), London.

Chang, B., and Dutta, S., 2012. Dividends and Corporate Governance: Canadian Evidence. *The IUP Journal of Applied Finance*, 18(4), pp. 1-30.

Chang, R., and Rhee, S., 1990. The Impact of Personal Taxes on Corporate Dividend Policy and Capital Structure Decisions. *Financial Management*, 19(2), pp.21-31.

Chen, L., and Zhao, X., 2006. On the Relation Between the Market-to-Book Ratio, Growth Opportunity, and Leverage Ratio. *Finance Research Letters*, 3, pp. 253-266.

Claessens, S., 2006. Corporate Governance and Development. *The World Bank Research Observer*, 21 (1), pp. 91-122.

Cremers, K. J. M., and Nair, V. B., 2005. Governance Mechanisms and Equity Prices. *The Journal of Finance*, 60, (6), pp. 2859-2894.

Crutchley, C., and Hansen, R., 1989. A Test of the Agency Theory of Managerial Ownership, Corporate Leverage and Corporate Dividends. *Financial Management*, 18, pp. 36-76.

Daily, C.M., Dalton, D.R. and Cannella, A.A., 2003. Corporate Governance : Decades of Dialogue and Data. *Academy of Management Review*, 28, pp.371–382.

Denis and Osobov, 2008., Why do Firms Pay Dividends? International Evidence on the Determinants of Dividend Policy. *Journal of Financial Economics*, 89, pp.62–82.

De Angelo, H., and DeAngelo, L., 1990. Dividend Policy and Financial Distress: An Empirical Investigation of Troubled NYSE firms. *Journal of Finance*, 45, pp.1415–1431.

Dhaka Stock Exchange, Available at: www.dsebd.org

Donaldson, Gordon, 1969. Strategy for Financial Mobility. *Harvard University Press, Mass.*

Dyer, W. G. J., 2003. The Family: The Missing Variable in Organizational Research. *Entrepreneurship Theory and Practice*, 27 (4): 401-416.

Egle and Hirth, 2011. Capital Structure of SMEs: Does Firm Size Matters. Working paper, Aarhus University, Business and Social Sciences.

Erhardt, L.N., Werbel, D. and Shrader, C.B., 2003. Board of Director Diversity and Firm Financial Performance. *Corporate Governance: An International Review*, 11, pp.102-110

Erwan M., 2001. Asset Liquidity, Capital structure, and Secured Debt. *Journal of Financial Economics*, 61, pp. 173–206.

Fama and French, 2001. Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay? *Journal of Financial Economics*, 60, pp.3–43.

Fama, E. F., and Jensen, M., 1983. Agency Costs and Residual Claims. *Journal of Law and Economics*, 26, pp.327–349.

Farinha, J., 2003. Dividend Policy, Corporate Governance and the Managerial Entrenchment Hypothesis: An Empirical Analysis. *Journal of Business Finance & Accounting*, 30(910), pp.1173–209.

Faccio, M., Lang, L. H. R. and Young, L., 2001. Dividends and Expropriation. *American Economic Review*, 91(1), pp. 54-78.

Firth, M., 1995. The Impact of Institutional Stockholders and Managerial Interests on the Capital Structure of Firms. *Managerial and Decision Economics*, 16(2), pp. 167-175.

Florackis, C., and Ozkan, A., 2009. Managerial Leverage and Corporate Incentives: Evidence From the United Kingdom. *Accounting and Finance*, 49, pp.531-553.

Fosberg, R. H., 2004. Agency Problems and Debt Financing: Leadership Structure Effects . *International Journal of Business in Society*, 4(1), pp. 31-38.

Friend, I., and Hasbrouck, J.,1988. Determinants of Capital Structure. *Research in Finance*, 7(1), pp. 1-19.

Freeman, R. E., and Reed, D. L., 1983. Stockholders and Stakeholders: A New Perspective on Corporate Governance. *California Management Review*, 25(3), pp. 88-106.

Francis, A., 1990. *Advanced Level Statistics*, 2nd edition, Stanley Thornes (Publishers) Ltd.

Gabrielsson, J., and Huse, M., 2004. Context, Behaviour, and Evolution. *International Studies of Management & Organization*, 34(2), pp.11–36.

Ganiyu, O. Y., and Abiodun, Y. B., 2012. The impact of Corporate Governance on Capital Structure Decision of Nigerian Firms. *Research Journal in Organizational Psychology and Educational Studies*, 1(2), pp. 121-128.

Gillan, S. L., 2006. Recent Developments in Corporate Governance: An Overview. *Journal of Corporate Finance*, 12, 381-402.

Gugler, K., 2001. Corporate Governance, Dividend Payout Policy and the Interrelation between Dividends, R&D and Capital Investment. *Journal of Banking and Finance*, 27, pp. 1297-1321.

Hall, G. C., Hutchinson, P. J. and Michaelas, N., 2000. Industry Effects on the Determinants on the Unquoted SMEs' Capital Structure. *International Journal of the Economics of Business*, 7(3), pp. 297-312.

Harris, M., and Raviv, A., 1991. The Theory of Capital Structure. *Journal of Finance*, 46, pp. 297- 355.

Hart, O., and Moore, J., 1995. Debt and Seniority: An Analysis of the Role of Hard Claims in Constraining Management. *American Economic Review*, 85, pp. 567-585.

Hart, O. D., 1995. Corporate Governance: Some Theory and Implications. *Economic Journal*, 105(May), pp. 678-680.

Hermalin, B., and Michael, S., 2003. Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature. *Economic Policy Review*, April.

Hermalin, B.E., and Weisbach, M. S., 2003. Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature. *Economic Policy Review*, 9 (1), pp.7 – 26.

Holder, M., Langrehr and Hexter, 1998. Dividend Policy Determinants: An Investigation of the Influences of Stakeholder Theory. *Financial Management*, 27(3), pp. 73–82.

Hsien-Chang Kuo et al., 2012. Corporate Governance and Capital Structure: Evidence from Taiwan SMEs. *Review of Economics and Finance*, ISSN: 1923-7529; 1923-8401, pp.43-58

Hu, A., and Kumar, P., 2004. Managerial Entrenchment and Payout Policy. *Journal of Financial and Quantitative Analysis*, 39(4), pp. 759-790.

Hussainey, K., and Aljifri, 2008. Corporate Governance Mechanisms and Capital Structure in UAE. *Journal of Applied Accounting Research*, pp. 1-30.

Hwang *et al.*, 2004. Do Firms with Good Corporate Governance Practices Pay More Dividends? Evidence from Korean Business Groups. Paper presented at Korean Finance Association 2004 annual meeting.

IFC(2005), Annual Review Small Business Activities, International Finance Corporation; World Bank Group. Accessed on www.ifc.org/sme

Jayesh, K., 2006. Capital Structure and Corporate governance. SSRN, Working paper series.

Jensen and Meckling, 1986. Agency Cost of Free Cash Flow, Corporate Finance, and Takeovers. *American Economic Review Papers and Proceedings*, 76, pp.323-329

Jensen, M.C., 1993. The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems. *The Journal of Finance*, 48, (3), pp. 831-880.

Jiraporn, P. et al., 2011. Dividend Payouts and Corporate Governance Quality: An Empirical investigation. *The Financial Review*, 46, pp.251-279.

Joy,L., 2008. Women Board Directors in the United States :An Eleven Year Retrospective. Northampton, MA : Edward Elgar.

Kajananthan, R., 2012. Effect of Corporate Governance on Capital Structure: Case of Srilankan Listed Manufacturing Companies. *Journal of Arts, Science and Commerce*,3(4), pp.63-71.

Kim and Lee, 2008. Corporate Governance and Dividend Policy Under External Financing Constraints and Agency Problems. *Asia-Pacific Journal of Financial Studies*, 37(5), pp. 949-981.

Konzelmann, et al., 2009. Governance, Regulation and Financial Market Instability: The Implications for Policy. *Cambridge Centre for Business Research*, Working Paper No. 392. Available at SSRN: <http://ssrn.com/abstract=1929629> or <http://dx.doi.org/10.2139/ssrn.1929629>

Kowalewski, et al., 2008. Does Corporate Governance Determine Dividend Payouts in Poland? *Post-communist Economics*, 20(2), pp. 203-218.

Kurshev, A., and Strebulaev, I., 2007. Firm Size and Capital Structure. Work. Pap., Stanford University.

La Porta, et al., 2000. Agency Problems and Dividend Policies Around the World. *Journal of Finance*, 55,pp.1–33.

Lau, C., and Keith, M., 1998. Demographic Diversity and Faultiness: The Compositional Dynamics of Organizational Groups. *Academy of Management Review* , 23(2), pp. 325–040.

Lipson, M. L., and Mortal, S., 2009. Liquidity and Capital Structure. *Journal of Financial Markets*, 12(4), pp. 611-644.

Luo, Y., 2007. Global Dimensions of Corporate Governance. Blackwell Publishing.

Magdalina, R., 2012. Influence of Corporate Governance on Capital Structure Decision. *World Review of Business Research*, 2(4), pp. 37-49.

Mallin, C., 2006. The Role of Institutional Investors in Corporate Governance. *Runall.text*, 6, pp.76-95.

Maryam M. et al., 2012. Corporate Governance and Financial Decision Making in the Firms Listed on Tehran Stock Exchange. *International research Journal of Finance and Economics*, 93,pp.165-193.

Mayers, D., Shivdasani, A. and Smith, C.W., 1997. Board Composition and Corporate Control: Evidence from the Insurance Industry. *Journal of Business*, 70, (1), pp. 33-62.

Miller,T., and Triana, M., 2009. Demographic Diversity in the Boardroom: Mediators of the Board Diversity-Firm Performance Relationship. *Journal of Management Studies*, 46(5), pp. 755-786.

Monks,R.A.G., and Minow, N., 2004. Corporate Governance, Oxford : Blackwell Business.

Mutamimah and Hartono, S., 2010. Dividend, Debt and Investment policies as Corporate Governance Mechanism. *Investment Management and Financial Innovations*, 7(2), pp. 209-216.

Myers, S. C., 2001. Capital Structure. *Journal of Economic Perspectives*, 15 (2), pp. 81-102.

Nielsen and Huse, 2010. The Contribution of Women on Boards of Directors: Going beyond the Surface. *Corporate Governance : An International Review*, 18(2), pp. :136–148

Norvaisiene, R., and Stankeviciene, 2012. The Relationship of Corporate Governance Decision on Capital Structure and Company's Performance: Evidence from Lithuanian Food and Beverage Industry Companies. *Economics and Management*, 17(2), pp. 480-486.

OECD, Available at www.oecd.org

O' Connor, T., 2009. Dividend Pay-outs and Corporate Governance in Emerging Markets: Which Governance Provisions Matter. SSRN.

Ozkan A., 2001. Determinants of Capital Structure and Adjustment to Long Run Target : Evidence from UK Company Panel Data. *Journal of Business Finance and Accounting*, 28(1 & 2).

Rajan R.G., and Zingales, L., 1995. What Do We Know about Capital Structure? Some Evidence from International Data. *Journal of Finance*, 50(5), pp. 1421–60.

Rahman, A. R., 2006. Discussion of Earnings Attributes and Investor Protection: International Evidence. *International Journal of Accounting*, 41, pp. 358-368.

Rehman, U.A. et al., 2010. Does Corporate Governance Lead to a Change in the Capital Structure? *American Journal of Social and Management Sciences*, 1(2), pp.191-195.

Rose, C., 2007. Does Female Board Representation Influence Firm Performance? The Danish Evidence. *Corporate Governance: An International Review*, 15(2), pp. 404-413

Ross, S.A., 1973. The Economic Theory of Agency: The Principal's Problem. *American Economic Review*, 63, (2), pp. 134-139.

Rozeff, M.S., 1982. Growth, Beta and Agency Cost as Determinants of Dividend Payout Ratios. *Journal of Financial Research*, 5, pp. 249-259.

Saad, M.N., 2010. Corporate Governance Compliance and the Effects to Capital Structure in Malaysia. *International Journal of Economics and Finance*, 2(1), pp.105-114.

Scott, J., 1977. Bankruptcy, Secured Debt and Optimal Capital Structure. *Journal of Finance*, 32, pp.1-19.

Schulze, W.S., Lubatkin, M.H. and Dino, R.N., 2003. Toward a Theory of Agency and Altruism in Family Firms'. *Journal of Business Venturing*, 18(4), pp.473–490.

Shleifer, A., and Vishny, R. W., 1997. A Survey of Corporate Governance. *The Journal of Finance*, 52(2), pp.737-783.

Shleifer, A. and Wolfenzon, D., 2002. Investor Protection and Equity Markets, *Journal of Financial Economics*, 66, 3-27.

Short, H., Zhang, H. and Keasey, K., 2002, The Link between Dividend Policy and Institutional Ownership. *Journal of Corporate Finance*, 8, pp.105–122. [http://dx.doi.org/10.1016/S0929-1199\(01\)00030-X](http://dx.doi.org/10.1016/S0929-1199(01)00030-X)

Smith, C. W., 2007. On Governance and Agency Issues in Small Firms. *Journal of Small Business Management*, 45(1), pp. 176-178.

Solomon, J., and Solomon, A., 2004. Corporate Governance and Accountability. John Wiley & Sons.

Subramaniam, R., and Devi, S., 2011. Corporate Governance and Dividend Policy in Malaysia. *International Conference on Business and Economic Research*, 1, pp. 200-207.

Suto, M., 2003. Capital Structure and Investment Behaviour of Malaysian Firms in the 1990s: A Study of Corporate Governance Before the Crisis. *Corporate Governance: An International Review*, 11(1), pp. 25-39.

Trojanowski, G., 2005. Patterns in Payout Policy and Payout Channel Choice of UK Firms in the 1990s. *European Corporate Governance Institute (ECGI) - Finance Research Paper Series*.

Uhlener, L., Floren, R.H. and Geerlings, J.R., 2007. Owner Commitment and Relational Governance in the Privately-held Firm: An Empirical Study. *Small Business Economics*, 29(3), pp.275–293.

Vakilifar, R.H., 2011. Effect of Corporate Governance on Capital Structure. *European Journal of Economics, Finance and Administrative Sciences*, 35, pp. 165-172.

Watson, R., and Wilson, N., 2002. Small and Medium Size Enterprise Financing: A Note On Some of the Empirical Implications of a Pecking Order. *Journal of Business Finance and Economics*, 29(3 & 4), pp. 557-578.

Warrad, L., 2012. The Effect of Ownership Structure on Dividend Pay-out Policy: Evidence from Jordanian Context. *International Journal of Economics and Finance*, 4(2), pp. 187-195.

Weisbach, M. S., 1988. Outside Directors and CEO Turnover. *Journal of Financial Economics*, 20, pp. 431-460.

Williamson, O., 1984. Corporate Governance. *The Yale Law Journal*, 93, p. 1197.

Yermack, D., 1996. Higher Market Valuation of Companies with a Small Board of Directors. *Journal of Financial Economics*, 40, (2), pp.185-211.

Yordying, T., 2013. Ownership Structure and Dividend Policy: Evidence from Thailand. *International Journal of Economics and Finance*, 5(1), pp. 121-132.

Yu Wen, Kami and Bilderbeek, 2002. Corporate Governance and Capital Structure Decisions of the Chinese Listed Firms. *Corporate Governance*, 10(2), pp.75-83. Blackwell Publishers Ltd.

Zong-J. W., and Xioa-L. D., 2006. Corporate Governance and Financial Distress. *The Chinese Economy*, 39(5), pp. 5–27.

Appendices

Table 1: Descriptive statistics of variables

	Mean	Std. Deviation	Minimum	Maximum
Capstr	.3333	.18544	.01	.83
Dpr	.3749	.65656	.00	5.00
Bind	.7837	.13346	.33	1.00
Bsz	7.3656	1.72772	4.00	14.00
Insh	.1642	.35716	.00	.69
Ccs	.3781	.48568	.00	1.00
Acom	.6094	.48865	.00	1.00
Bdiv	.5000	.50078	.00	1.00
Msh	.4179	.25423	.00	.95
Fsz	5.2968	1.50507	2.33	11.68
Liq	1.7272	.95719	.04	7.98
Profi	.1648	.14544	-.58	.75
Tang	.4989	.17913	.06	.91

Table 2: Summary of cross-sectional regression results: Capital structure decision

	2012	2011	2010	2009
Constant	.267* (.000)	.482** (.022)	.474* (.008)	.227 (.100)
Bind	.236 *** (.086) [.167]	.070 (.716) [.045]	.043 (.778) [.033]	.432* (.002) [.359]
Bsz	.008 (.599) [.063]	.008 (.596) [.064]	-.008 (.486) [-.084]	-.016*** (.075) [-.202]
Insh	.129 (.523) [.076]	-.054*** (.071) [-.046]	-.043** (.0211) [-.157]	-.002 (.789) [-.02]
Ccs	.017 (.719) [.042]	-.005 (.916) [-.012]	.004 (.291) [.090]	.105* (.003) [.31]
Acom	.031 (.524) [.077]	-.007 (.819) [-.017]	.000 (.912) [-.004]	-.016 (.263) [-.053]
Bdiv	.001 (.980) [.003]	.007 (.307) [.134]	.041 (.389) [.128]	.031 (.321) [.110]
Dsh	-.134*** (.064) [-.171]	-.231** (.021) [-.294]	-.218 (.020) [-.382]	-.015 (.795) [-.027]
Fsz	.14** (.019)	.131** (.043)	-.020 (.042)	.022*** (.069)
Liq	-.036*** (.076)	-.034*** (.100)	-.023 (.008)	-.028 (.313)
Profi	.160 (.314)	.129 (.422)	-.017 (.901)	-.172 (.128)

Tang	.065 (.618)	.055 (.661)	.082 (.477)	.181*** (.094)
------	----------------	----------------	----------------	-------------------

Table 3: Summary of Panel data regression (Pooled model) predicting Capital structure

	SMEs	MEs	SEs
Constant	.432* (.000)	.388* (.000)	.434* (.001)
Bind	.133*** (.086) [.095]	.140** (.045) [.109]	.004 (.272) [.003]
Bsz	-.004 (.523) [-.035]	-.009 (.192) [-.098]	.002 (.802) [.018]
Insh	-.021 (.460) [-.041]	-.017 (.560) [-.044]	.362* (.007) [.196]
Ccs	.024 (.253) [.062]	.009 (.727) [.026]	.035 (.209) [.096]
Acom	.008 (.696) [.022]	.017 (.527) [.047]	-.030 (.290) [-.082]
Bdiv	.019 (.360) [.052]	.024 (.353) [.070]	.019 (.522) [.052]
Dsh	-.145* (.000) [-.199]	.014 (.796) [.020]	-.164* (.002) [-.236]
Fsz	.029 (.000)	.014*** (.076)	.022** (.014)
Liq	-.028** (.011)	-.037* (.005)	-.014 (.263)
Profi	.054 (.440)	-.006 (.199)	-.003 (.978)
Tang	.099*** (.088)	-.080 (.305)	.217* (.004)

Table 4: Summary of cross-sectional regression results: Dividend decision

	2012	2011	2010	2009
Constant	.198*** (.063)	.536** (.039)	.467* (.008)	-.090*** (.065)
Bind	.137 (.808) [.029]	.49*** (.086) [.161]	-.338 (.538) [-.071]	.904*** (.073) [.211]
Bsz	.108** (.038) [.242]	.039 (.455) [.087]	.036 (.386) [.103]	.018 (.578) [.065]
Insh	-.302 (.614)	-.115 (.870)	-.062** (.036)	.231 (.618)

	[-.055]	[-.018]	[-.051]	[.055]
Ccs	-.110 (.474) [-.080]	-.033 (.851) [-.022]	.019 (.903) [.014]	.013 (.196) [.012]
Acom	.20 (.197) [.149]	-.057 (.752) [-.037]	.072 (.696) [.051]	.096 (.418) [.091]
Bdiv	.026** (.029) [.020]	.361*** (.064) [.241]	.133 (.433) [.097]	.070 (.547) [.070]
Dsh	.161 (.601) [.062]	.033 (.291) [.011]	-.06 (.298) [-.02]	.331** (.012) [.169]
Fsz	.087*** (.059)	.139** (.014)	.098** (.068)	.004 (.292)
Liq	-.047 (.454)	-.096** (.020)	-.024 (.802)	-.064 (.520)
Profi	.324* (.009)	.217** (.038)	.447* (.009)	.144* (.008)

Table 5: Summary of Panel data regression (Pooled model) predicting Dividend decision

	SMEs	MEs	SEs
Constant	.896* (.002)	.469*** (.084)	.245* (.001)
Bind	.299 (.266) [.061]	.407 (.344) [.066]	.277 (.393) [.060]
Bsz	.038*** (.064) [.10]	.040 (.214) [.088]	.063** (.025) [.158]
Insh	-.031 (.834) [-.011]	-.005 (.970) [-.003]	.028 (.945) [.005]
Ccs	-.032 (.656) [-.024]	-.018 (.878) [-.011]	-.177** (.038) [-.150]
Acom	.082 (.279) [.060]	.128 (.289) [.075]	-.010 (.193) [-.008]
Bdiv	.124*** (.093) [.095]	.228*** (.053) [.138]	.084 (.355) [.072]
Dsh	.168 (.230) [.065]	.216 (.388) [.063]	.303*** (.058) [.136]
Fsz	.093* (.000)	.074** (.041)	.145* (.000)
Liq	-.056 (.124)	-.097*** (.094)	-.035 (.347)

Profi	.281* (.000)	.704* (.000)	.298* (0.001)
-------	-----------------	-----------------	------------------

Note: In all tables values in parenthesis and [] indicates p-value and beta value respectively. Coefficients (b) are marked * to indicate significant at 1% level, ** indicates significant at 5% level and *** indicates significant at 10% level.

Table 6: Varimax Rotated component Matrix

Variables	1	2	3
Bsz	.119	.798	.076
Bind	-.213	.728	-.075
Ccs	-.503	.224	.169
Bdiv	.769	-.016	.111
Msh	.153	-.046	.743
Insh	.099	-.055	-.768
Acom	.717	.072	.080
% of Variance	20.74%	17.53%	17.13
Eigenvalues	1.545	1.267	1.066
KMO MSA test	.557		
Bartlett's Test of Sphericity (Sig.)	.000		

Note: variables are same as before. Rule of thumb: KMO test value should be greater than 0.5 and Bartlett's test of Sphericity(Sig.) less than 0.05

Table 7: Regression result of Factor variables

	Capital structure	Dividend
Constant	.326* (.000)	-.105*** (.085)
Bind	.134*** (.088)	.059 (.836)
Bsz	-.005 .374	.031*** (.071)
Bdiv	.016 .449	.113*** (.100)
Dsh	-.159* (.000)	.212 (.145)
Observations	321	
R square	24.5%	
Sig.(p-value)	.001*	.060***