THE RECONSTRUCTION OF CORPORATE STRUCTURE. A HOLISTIC VIEW OF AGENCY PROBLEM

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ABSTRACT: *This paper provides an approach to reconstruct the corporate structure. The empirical research was conducted in the investigation of the dividend policy and related agency problem which arises between Management and Owners of the firm. The data was collected from eleven companies of Oil & Gas Industry of Pakistan for the four years starting from 2010 to 2013. The regression was estimated and it was found that most of the firms in the industry have consistent dividend history so fewer chances of agency cost. On the basis of the result, it is confirmed that positive relationship exists in dividend policy and agency problem. The conflict remains in most of the firms due to this decision. Majority and minority shareholders are always in favor of dividends whereas management is in favor of reinvestment in business so that they get the benefits. But in case agency problem arises then both the parties can view the problem and take a holistic approach where both are vital for the existence of the system. For existence the coexistence must be accepted.*

Keywords: Dividend Policy, Managerial Share Ownership, Institutional Share Ownership, Agency Problem, KSE

1-INTRODUCTION

In the corporate policies, dividend policy has considered the most important one. The question of importance has long been investigated by the researchers-why firms pay dividends. Researchers [1] investigated that shareholders who are owners of the firms are interested in receiving of dividends whereas managers who are acting as agents are more interested in retaining the earnings for control over the firms. This situation creates a conflict between the shareholders and the management which is referred as agency problem that lies at the heart of corporate governance. In this paper, a holistic approach is applied to investigate the impact of dividend policy on corporate structure. Corporate structure is a complex phenomenon, agency cost remains a bone of conflict between shareholders and management. A holistic framework which can provide the solution to complex can help both parties. It was viewed by [3] that in a holistic view, where a system is viewed in the context of another system. Where systems are connected with each other and have an impact. Where one system has its sub system and supra system. Basically, this concept helps us in our understanding and perspective. If we look the matter in broader view we can have a more long lasting solution to the problem. Although the systems and sub systems are becoming more complex so the answers are also complex. But a broader view can help us in the understanding of a complex system and finally, we can find a solution.

Objective of the study

This thought paper develops the relationship between cybernetics approach and dividend policy which is the core of any corporate structure. The solution of agency problem is possible if the both parties i.e. management and shareholder agree on the suggested solution. The possible solution of cybernetic approach to solving the agency problem between management and shareholder is first if management offers a continuous stream of cash flow in the form of cash dividend. Normally dividends are paid in two forms of cash dividends and bonus share dividends. But if a firm focuses on the bone of contention which is a cash dividend. Infect what is suggested here is a possible solution that if company binds the shareholder to reinvest seventy percent of that cash to buy the shares of the company. By this way, at one side the intensity of agency problem would be reduced and secondly more shares would be with the previous shareholders.

Significance of the Study

This thought paper is first of its nature who suggests a possible solution of agency problem between management and shareholders. If both parties agree this would a solution of long dispute that will be in the benefit of both parties. This paper is divided into four sections. The first section covers the introduction and significance of this study. The second section covers literature review, studies have been done in the past. The third section covers the methodology of the study with sample size data collection model and variables. The third section covers the analysis of the descriptive statistics and regression test. In the fifth section limitations, conclusion and recommendations are given.

2- LITERATURE REVIEW

This theory refers the when the managers send information to the shareholders for a worthy relationship. Managers who act as an agent on the behalf of the shareholders. Managers that have inside information are reluctant to provide information to the shareholders and always have benefits of this information. But the managers can use dividend policy for information purpose which acts as a signal that the management has the concern of shareholders. Signal theory also helps for the future projections of the firms and proves proficiency of the management. It was analyzed by [3] that dividend policy covey positive signal to the shareholders that managers are working for their interest. According to the researchers [6] who examined that self-interest utility model suggests that work-life policies affect organizational affection because employee use of these policies enables attachment. It was explored by [5] that the important circumstances for consistent signaling of condition-dependent qualities may be in many social domains. It looks that signaling theory has substantial potential for producing original and powerful visions into the ethnographic dominion. Researchers like [5] investigate the impact of outside investors who have flawed information about firms' profitability and that cash dividend are taxed which is higher than capital gains. It is shown that under these circumstances, such dividends purpose as a signal of expected cash flows. By constructing the model so that finite-lived investors turn over ongoing projects to following generations of investors, we derive a relative static result that relates the equilibrium level of dividend payout to the span of investors' planning horizons.

It was investigated by [9] that agency problem arises when shareholders who are principles engage the mangers who work as agents. The basic concept is a conflict of interest because both parties work to protect their interest. And this rift creates agency problem. It was viewed by [13] that the dividend policy as a device which can help in reducing the cost of the agency problem. He argued that dividend payment is a device which can help in reducing the agency cost. It was found by [9] that managers are more willing to retain the earnings of the firm which can give them more control over the firm but the unpaying of dividend can create a problem between the both parties. The researchers like [4] established the improvement that self-interest is restricted by standards of reciprocity and equality. The subsequent logic is that insights of fairness arbitrate the relationships resulting from standard agency theory through positively and negatively reciprocal behaviors. This mediating variable delivers a stingy new way to help explain risky results found in prior studies. It was proposed in a model of [12] that economic man based on bounded rationality and the assumptions are about risk preferences, but including new assumptions about time ignoring, inequity aversion and the trade-off between inherent and extrinsic incentive. They argue that behavioral agency theory provides an improved framework for conceiving about executive compensation, an enhanced theory of agent behavior and an improved platform for making references about the design of executive return plans. In China, there is an increasing sum of state-owned firms have gone public, which proposes a dual-principal phenomenon such that firms are owned by both parties, the government, and non-state shareholders. Non-state shareholders tend to focus on the firm’s market direction and recital, while state shareholders seek political goals over profit-maximization. This document attempts to examine the problem of agency theory with both qualitative and quantitative studies. Our findings suggest that state owned public firms certainly display a lower degree of market orientation than privately controlled public firms. Managerial ownership is the sum of the proportion of executives, managers, and directors divided by the total capital shares. It was investigated by [9] that managers are interested to retain the dividend for the growth of the company and their personal benefits. It was showed empirically the dividend policy and managerial ownership. This refers to the sum of the percentage of investment banks, insurance companies, banks and other financial institutions out of the total shares of the firm. It was found by [8] found a significant relationship between the dividend policy and institutional ownership. Researchers like [13] investigated that a firm can overcome on agency problem by paying dividends to its shareholders. He argued that if dividends are not paid the managers start using the resources of the firm for their personal benefits. Thus the dividends help in resolving the agency problem. It was found by [11] which is a pioneer work on dividend policy said according to them taxes are irrelevant and the value of the firm is independent. He discussed that investors are not interested in dividend policy but investors are more interested in buying of shares so the dividend policy is irrelevant. It was investigated by [8] that the impact of dividend policy in different countries. They found that firms of US, Germany, and France pay higher dividends. And in other countries normally low dividends are paid found that Dutch firm pays lower dividend as compared to other European countries because of they more inclined towards power in the organization. The impact of symmetric information was traced by [10] and they found that managers take the advantage of inside information and they concluded that higher the dividend lower will be insight gain. The reserchers like [2] investigate the correlation between institutional shareholder and dividend policy they collected the data from 120 countries from the period of 2002 to 2007. They found the positive impact of Return on Equity (ROE) and institutional ownership. Jensen (1992) found that dividends help in reducing the managerial control. He suggested a firm can control its over investment problem by paying proper dividends. A consistent dividend policy not only gives information to the shareholders about the Valuation of a firm but also assist in reducing the agency cost. The ownership structure is influenced by the dividend payout. In determining the efficiency corporate structure is very important it will explain the risk diversification and will provide information on agency problem of corporations. The control and influence of majority shareholders like institutional shareholders and managerial shareholders and they fight for their private benefits in the corporations. This situation creates dissatisfaction for minority shareholders. This paper emphasis on the econometric evidence on the ownership structure of firms in Pakistan. The purpose is to explore the impact of institutional ownership and managerial ownership on the dividend policy with the help of cybernetics.

Hypothesis Development

H1: There are a positive relationship in Dividend Policy and Agency Problem

3-RESEARCH METHODOLOGY

Sample Selection and Data Collection

This research investigates the impact of main factors on dividend policy on the nonfinancial firms listed in Karachi Stock Exchange. The sample covers 11 companies of Oil & Gas sector of Pakistan and these companies have consistent dividend history. The time period is selected for four years 2010 to 2013.

Variables

The independent variable is dividend policy and dependent variables are Managerial Ownership and Institutional Ownership.

Research Instrument

The Regression test was applied in MS-Excel to calculate the impact of dividend policy on managerial Ownership and Institutional Ownership was estimated.

Table 1 Regression Test of Dividend Policy and Managerial Share Ownership (MSO) and Institutional Share Ownership (IN)

MSO

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.984414779
R Square	0.969072457
Adjusted R Square	0.965636063
Standard Error	180.6867032
Observations	11

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*	
Regression	1	9206736.686	9206736.686	282.0027444	4.22E-08	
Residual	9	293829.1623	32647.6847			
Total	10	9500565.848				
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	-62.80750183	62.4006532	-1.006519942	0.340458294	-203.968	78.35258
(In million)	0.73686423	0.043879413	16.79293734	4.21602E-08	0.637602	0.836126

Institutional

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.748168
R Square	0.559755
Adjusted R Square	0.510839
Standard Error	179.6862
Observations	11

ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*		
Regression	1	369467.2	369467.2	11.44318	0.008091258		
Residual	9	290584.1	32287.12				
Total	10	660051.3					
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Upper 95.0%*
Intercept	88.81883	62.05511	1.431289	0.186141	-51.55959057	229.1972522	229.1972522
Total Shares	0.147612	0.043636	3.382777	0.008091	0.048899839	0.246324782	0.246324782

ANALYSIS AND DISCUSSION

The above given regression test indicates a positive relationship. Oil & Gas sector has a positive stream of cash flows and a consistent dividend history. So the agency cost is very low whereas the managerial Ownership and Institutional Ownership doe not disturb in the consistency of dividend payout and there is no such dispute in management and shareholders.

Limitations of the Study

This paper is first of its kind which has The present on Oil & Gas sector of Pakistan which do not represent the Economy of Pakistan but a fraction of it. Oil & Gas sector which is already well-known because of its divident payout history so we can not generlized the results.

CONCLUSION

This thought paper provides a cybernatic approch of corporate structure. The emipirical reserch was conducted in the investigation of the dividend policy and related agency problem which arises bdtween Mnagement and Ownwer of the firm. The data was collected from elevan companies of Oil & Gas Industry of Pakistan for the four years strated from 2010 to 2013. The regression was estimated and it was found that most of the firms of the indusry has consistant divedend history so less chances of agenvy cost. On the basis of result it is confirmed that positive relationship exists in dividend policy and agency problem. The confilict remains in most of firms due to this decision. Majority and mnority shareholders are always in favor of dividends, wheras managemnt is in favor of reinvestment in business so that they get the benfit. In case agency problem arisis then both the parties can veiw the problem in a cybernatics context and take a holistic approach where both are vital for the existance of the system. For existance the coexistance must be accepted.

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