

PalArch's Journal of Archaeology of Egypt / Egyptology

RE-EXAMINING DIVIDEND PAYOUT, PROPORTION OF OWNERSHIP AND FIRM'S VALUE IN INDONESIA

Yosman Bustaman¹, Agustini Hamid², Anita Juwita³

¹Accounting Department, Faculty of Economic, Swiss German University

²Finance Program, Accounting Department,
Faculty of Economics & Communication,

Bina Nusantara University, Jakarta, Indonesia 11480.

³Accounting Department, Faculty of Economics & Communication,
Bina Nusantara University, Jakarta, Indonesia 11480

yosman.bustaman@sgu.ac.id; agustini.hamid@binus.ac.id; anita.juwita@binus.ac.id

Yosman Bustaman, Agustini Hamid, Anita Juwita: Re-examining Dividend Payout, Proportion of Ownership and Firm's Value in Indonesia-- Palarch's Journal Of Archaeology Of Egypt/Egyptology 18(1), ISSN 1567-214x

Keywords: Dividend Payout, Concentrated Ownership, Corporate Governance and Firm Value, the Indonesian Capital Market

Abstract

We re-examine the impact of dividend policy and proportion of ownership on firm value in the Indonesian Capital Market, which includes 2,712 firm-year observations over the period of 2005-2016. Tobin's Q measures firm value, and dividend payout over net income is a measure of dividend policy. We also include proportion ownership for the insider of the company, foreign owner, and government owner. A panel data regression model is used in our analysis. After controlling for firm-specific variables – size of company, liquidity, profitability, and leverage – we find that dividend policy is irrelevant in driving firm value in the Indonesian capital market. This phenomenon might occur in Indonesia because the market is characterized by investors' short-term investment perspective. They are less concern about the dividend payment and more focused on capital gains. Additionally, it seems that insiders expropriate the firm cash flows for their benefits at the cost of minority shareholders with their control power, and consequently values are lowered within the market. However, the greater the foreigner ownership, the higher the value in the market; this positive reaction emerges possibly because the firm perceives the application of good corporate governance. Concentrated ownership from the government does not have a significant relationship with the value of the firm.

Keywords: Dividend Payout, Concentrated Ownership, Corporate Governance and Firm Value, the Indonesian Capital Market

INTRODUCTION

The seminal paper of Miller & Modigliani (1961; hereafter MM) answered part of the puzzle regarding the relationship between dividend policy and a firm's value. These authors advocate that a firm's dividend policy does not create additional value for its investors in a frictionless market; only investment policy matters in determining the value beyond the

normal return created through investment policy in a frictionless market. Nevertheless, when there are imperfections in the market such as tax differentials and trading costs, asymmetric information results in different magnitudes and policies of dividends, which influence the value of the firm. In contrast to with MM, who assume that 100 percent of cash flow is distributed to shareholders every year, DeAngelo and DeAngelo (2006) examine retention of free cash flow and find that dividends at the same level of appreciation of investment policy become determinant factors of firm value.

The latest empirical study using the cross-section data analysis conducted by Kim, Park, and Suh (2017) suggest a non-monotonic (A-J shaped) relationship between dividend policy and the value of the firm. High payer dividend payment results in a higher firm value; however, firms that do not pay dividends are not valued lower than firms that pay lower dividends. Additionally, the authors also find that this J-shaped relationship does not mirror market mispricing. Fama and French (1998) find that dividends positively affect firm value and argue that there is no effect of tax on pricing dividends, so this dividend sends valuable information to the market about a firm's prospect profitability and cash flow, which can be missed by other controlled variables (Pettit, 1972).

Aligned with those findings, Asquith and Mullins Jr. (1983) reveal that an increase in dividend payment results in an upsurge in shareholder wealth. Moreover, Pinkowitz, Stulz & Williamson (2006) also provide evidence that dividends positively impact firm value in countries with poor investor protection. Conversely, contrary to previous findings, Baker & Wugler (2004) use catering dividend theory to find that the size of dividend payments contributes to firm value in different directions and could be positive or negative at different times. Therefore, managers tend to pay the dividend when investors value high for dividend payers and do not distribute dividends when shareholders choose not to have dividend payments.

The main purpose of this paper is to re-examine the relationship between dividend and firm value. We also test the impact of ownership concentration and firm value. As proposed by Claessens, Djankov, Fan & Lang (2002), there are two different effects of concentration ownership on firm value. Firstly, the positive effect appears when increasing cash flow rights or when large shareholder ownership causes a rise in the firm's value. Larger shareholders have strong incentive to improve firm value, because they can collect more information and control their appointed managers well, and this multi-coverage could result in lower agency problem between the principal and manager. Conversely, the entrenchment effect occurs with the right to control and to vote among larger shareholders outstrips the cash flow rights. When the external control from minority shareholders is weak, extreme managerial agency problems often arise (Lins, 2003). Managers and majority shareholders that have a large amount of control expropriate the firm cash flow for their private benefit. Consequently, this entrenchment effect negatively affects firm value. Additionally, this over control due to concentrated ownership and expropriation of company cash flow mostly occurs in countries with poor shareholder protection (La Porta, De Silanes, Shleifer, & Vishny, 2002).

Large shareholders play an active role in managing better corporate governance (Shleifer & Vishny, 1997). Recently empirical researchers have studied the effect of large shareholder ownership with different types of owners such as managers, institutions, and family on a firm's value. Lin and Fu (2017), Elyasiani & Jia (2010), and Jafarinejad, Jory & Ngo (2015) find a positive association with institutional ownership and firm value.

Some scholars say that the majority of firms around the world are owned by families (Claessens et al., 2002; Faccio & Lang, 2002; Mock, Wolfenzon, & Yeung, 2005). Earlier studies argue that family ownership could eliminate agency problems and improve the value of the firm (Morck, Shleifer, & Vishny, 1988). Meanwhile, Villalonga & Amit (2006) confirm that the value of a firm increases when the founder of the family firm serves as a CEO or as a chairman with an outsider CEO. Additionally, Lozano, Martinez, and Pindado (2016) find that the relationship between family ownership is non-monotonic and varies with their own range of control.

The relationship between managerial ownership and firm value is still debatable, as a general theory of agency states that a higher proportion of managerial ownership acts as an internal control to alleviate conflict of interest between the manager and shareholder. In line with this theory, Core & Larcker (2002) confirm a positive relationship between manager ownership and firm performance. Other scholars find a positive relationship, but after reaching some level of proportion, higher-level ownership negatively affects the firm performance (McConnell, Servaes, & Lins, 2008, Benson & Davidson III, 2009). However, Demsetz, (1983) finds no association between managerial ownership and performance of the company.

The Indonesian capital market is one of the most important capital markets in an emerging economy. During the decade of 2006-2016, it posted the highest market growth index among leading bourses. Comparing with S&P 500 that grew 59% during this period, the Jakarta composite index showed 159% growth; meanwhile, Kuala Lumpur (KLCI) only grew at 49%. The ownership of the firms is mostly concentrated either through a family, individual, or government, and these owners are active in controlling the firm (La Porta, Lopez-de-Silanes, & Shleifer, 1999). Additionally, in this type of market, the corporate governance practice is weak and demonstrates lower protection of shareholders and creditors. Therefore, this market is very relevant to our topic of examination.

LITERATURE REVIEW

This section will explain the relationship between dividend pay out policy and firm value and the impact of ownership concentration on the value of a firm.

Dividend Policy and Firm Value

Investment policy, not dividend payout, is the only determinant factor of a firm's value in a frictionless market; meanwhile, the dividend policy does not increase shareholder wealth when all of the firm's profits are distributed to shareholders (Miller & Modigliani, 1961). DeAngelo and DeAngelo (2006) relax this assumption by allowing retention of profit, resulting in a decrease in the free cash flows available to the shareholder, and then dividend policy matters when determining the value. This finding supports Jensen's theory (1986) of free cash flows related to the positive relationship between

dividend policy and the value of the firm. Meanwhile, when managers use their discretion by disgorging a firm's free cash flows, it will thus destroy the value (for example, Jensen, 1986, Easterbrook, 1984).

Fama & French (1998) analyze the effect of a dividend and debt on firm value according to US data; contrary to the tax hypothesis, the authors record that dividend payout is positively associated with firm value, while debt is negatively associated with firm value. Additionally, the authors suggest that those two variables bring information to the market about firm prospect future cash flows that are missed by other control variables. Applying the regression method by Fama & French (1998), Pinkowitz et al. (2006) use data from 35 countries and find a strong positive relationship between firm value and dividend in countries with poorer shareholder protection; however, this relationship weakens in the countries which have better protection of shareholders.

Hull (2015) expands signaling theory of dividends on prospect firm value and theoretically analyses the timing of reduction dividends and of managers' application of such strategy and its impact on the firm value. The timing of dividend reduction depends on the availability of external financing and investment opportunity. When a firm has relatively expensive external financing and a great investment opportunity, earlier reduction of dividend results in a higher firm value, and the opposite is true when external financing is less costly than earlier reduction of dividends, which causes lower firm value. Time varying of shareholders' demands on dividends impacts the share price or catering theory of dividends as proposed by Baker & Wugler (2004). The company caters dividends to investors who price the stock higher when the issuer pays dividends, meanwhile, the firms do not pay dividends to those investors who prefer not to receive dividends. Dividend policy depends on the market demand, firms that do not pay dividends will tend to distribute dividends when there is a higher demand, while on the other hand, the company will not pay dividends when the demand is low. Thus, the association between dividends and firm value is not linear.

The recent empirical study by Kim et al. (2017) identifies the non-monotonic relationship between dividend and firm value. The authors apply clientele dividend hypothesis in which a group of investors or clientele prefer to have dividends and other clients choose not to the received dividend (anti-dividend), probably because of higher taxes on dividends (Miller & Modigliani, 1961). This behavior and demand from both groups create value premium for the stocks, and pro-dividend clients create higher value for stocks that pay high dividends. Similarly, anti-dividend clients create premium value for the firms that do not pay the dividends. The study examines data from US firms and 13 other countries from the period of 1962-2010. In general, the literature finds that the market value of firms is higher for the higher dividends payer; meanwhile, non-dividend payer firms are valued higher than low dividend payers, thus the relationship between dividends and firm value is non-linear and J-shaped.

Concentration Ownership and Firm Value

Increased firm value is the ultimate goal of the corporate finance managers, and achievement of these goal managers should align their interests and serve in the best interest of shareholders. However, dispersion

of ownership in the company could give managers huge control over the company cash flows to their own advantage. Thus, the probable conflict of interest between managers and owners regarding agency problems will arise (Jensen, 1986). Corporate governance as a separation of ownership and control is used as a mechanism to control the managers. This can ensure that the investors receive good returns on their investment and that the managers invest the investors' money in the good projects and do not expropriate it (Shleifer & Vishny, 1997).

Villalonga & Amit (2006) explain that the classic agency problem which arises between managers and the shareholder can be mitigated by concentrated ownership that has the power to control managers. Similarly, the concept of corporate governance by Shleifer and Vishny (1997) suggests that investors are given power through two means: firstly legal protection from managers' discretion and secondly by increasing the ownership through large concentration of shareholders. Thus, investors will match their control rights and cash-flow rights. With such control, investors can then oversee managers as well as control firm assets in alignment with the interest of managers and shareholders to maximize firm profit and value (incentive effect). However, the largest concentrated ownership could impact the value of firm negatively in which the majority owners without significant control over others might use firm cash flows for their owned benefit at the cost of minority shareholders. This is referred to as type-II conflict of interest by Villalonga & Amit (2006) or the entrenchment effect by Lins (2003).

Empirical studies of the impact of concentrated ownership on firm value in eight East-Asian countries by Claessens et al. (2002) reveals that concentrated ownership increases the value of firms (incentive effect). However, when the controlled rights exceed the cash flow rights of the largest shareholder, the value of the firm decreases (entrenchment effect). Dispersed institutional ownership among several independent institutions could reduce the expropriate behavior of major owners and ultimately increase the value of a firm. Elyasiani & Jia (2010) correlate the stability of institutional ownership and firm value, using US firm data; the authors provide evidence that the more stable the institutional ownership, the better the company performance. Following Elyasiani & Jia (2010), Lin & Fu (2017) use a sample of Chinese firms and show a positive association between firm value and institutional ownership, even though not all institutions are active in monitoring the firms. The effect of institutional ownership on diversified firm value was analyzed by Jafarnejad et al. (2015); they find that increasing institutional ownership results in a higher firm value.

Family owners have more emotional connection with their firms, and sometimes they consider the continuity of company to be a family legacy, so it might less probable for them to expropriate firm cash flow (Lozano, Martinez, & Pindado, 2016). However, problems such as succession decisions among family members might create disgorged cash flow from the company, which destroys the value of the firm (James, Jennings, & Breitzkreuz, 2012). Exploring public-listed firms from 16 European entities, Lozano, Martinez, and Pindado (2016) confirm the non-linear relationship between family ownership and firm value. Meanwhile, Morck, Shleifer, and

Vishny (1988) and Villalonga & Amit (2006) record the positive linear relationship between family ownership and company value.

MATERIALS AND METHODS

Data

We use data from 226 publically listed companies from the Indonesian Capital Market that distributed dividends during the period of 2005 to 2016, thus in total we have 2712 instances of firm-year data. Banking and finance firms are excluded from the data, because they have differently structured balance sheets. We also exclude companies that are missing main variables data (dividends, firm value) for three consecutive years.

Firm value is measured by Tobin's Q, as used in several studies such as Kim et al. (2017) and Claessens et al. (2002). Ownership of firms is divided into manager ownership, state ownership, and foreign ownership. The dividend payment is proxied from dividend payment over net income.

Methodology

Static panel data regression is used to analyze the relationship between dividend payment, the proportion of ownership, and firm value. To overcome part of the endogeneity problem that arises from neglected firm-specific and time-invariant factors which simultaneously determine explanatory variables and firm value, we apply firm-effect regression in our analysis.

The model is

$$TQ_{it} = \alpha + \beta_1 Div_{i,t} + \beta_2 INS_{i,t} + \beta_3 STATE_{it} + \beta_4 FORG_{it} + \beta_5 LIQ_{it} + \beta_6 DER_{it} + \beta_7 Profit_{it} + \beta_8 SIZE_{it} + \varepsilon_{it} \dots (1)$$

Index i and t represent the individual company and the time

TQ_{it} = Value of each company measured by Tobin's Q

Div_{it} = Proportion of dividend payment by each company every year

INS_{it} = Proportion of insider ownership or manager ownership

$STATE_{it}$ = Proportion of state ownership

$FORG_{it}$ = Proportion of foreign ownership

LIQ_{it} = Measurement of firm liquidity proxied by current ratio

DER_{it} = Firm leverage ratio measured by debt to equity ratio

$Profit_{it}$ = Firm profit measured by Return on Asset (ROA)

$Size_{it}$ = Size of firm measured by ln Assets

RESULTS AND DISCUSSIONS

Descriptive Statistics

Table 1. *Descriptive Statistics*

Variables	Mean	Min	Max	Std Deviation
Tobin's Q	4,339	2,486	6,193	2,621
Dividend Payout	0,161	0,000	0,323	0,228
Proportion of Ownership				
- Insider (INS)	0,848	0,797	0,898	0,072
- Stated Owned (STATE)	0,002	0,000	0,510	0,001
- Foreign (FORG)	0,405	0,000	0,810	0,573

Liquidity (LIQ)	1,329	0,974	1,685	0,503
Leverage (DER)	0,413	0,023	0,803	0,551
Profit (ROA)	0,104	-0,039	0,248	0,203
Size of Assets (SIZE)	13,760	12,543	14,976	1,720

Descriptive statistics reveal that the average payout ratio is 16.1%, while the maximum number of this profit distribution is quite moderate at only 32.3%. Data also shows that the Indonesian publically listed firms have more value than their book value, as reflected from the Tobin's Q, which has average number of 4.339 and a minimum of 2.486. Proportion ownership by an insider is quite high at 84.8%, while the proportion of foreign ownership is only 40.5% with a maximum of 81%. Few firms are state-owned enterprises; maximum ownership is 51%.

Results Analysis

Table 2. *Regression results, Tobin's Q as dependent variable.*

	1		2	
Dividend Payout	-0,569		-0.013	
	(0,456)		(0,684)	
INS	-225.601 **		-259.084 ***	
	(0,076)		(0.007)	
FORG	107.519 **		122.756 ***	
	(0,073)		(0.007)	
STATE	134.086		306.326	
	(0,633)		(0,512)	
Profitability (ROA)	614.579		-103.776	
	(0,270)		(0,566)	
Size ASSET	-355.799 ***		-515.597 ***	
	0.000		0.000	
Liquidity (CR)	-216.539 ***		-103.540 ***	
	0.000		(0.005)	
Leverage (DER)	-0.139		-0.125	
	(0,340)		(0,229)	
Constant	746.290 ***		946.935 ***	
	0.000		0.000	
R²	0.196		0.338	

Numbers in parentheses () show probability (p); *, **, and *** indicate significance level at 10%, 5%, and 1%, respectively.

Table 2 shows the result of our panel data regression using the random effect model. We use the random effect model to capture the different characteristics of the firm in making dividend policy. We divide the results into two columns to distinguish the time of independent variables; the first column has the same level of the year between the dependent variable and independent variables. Meanwhile, the second column investigates the effect of the one-year lag value of the dependent variables on the firm value.

Our regression result indicates a negative relationship between dividend policy and the firm value in The Indonesian Capital Market. However, it is not significant, and this conclusion is in contrast to DeAngelo and DeAngelo (2006); thus our result supports the theory by Miller and Modigliani (1961), wherein a frictionless market is irrelevant to the dividend, even though there are costs or taxes involved in conducting the transaction in the Indonesian market. This outcome might occur, because the investors do not value the firm on the dividend basis, and probably more investors in this market invest their funds in a short-term period, creating less concern for the dividend payment.

Management ownership or insiders (INS) negatively affect the value of the firm, as Indonesian firms are predominantly owned by families and insiders of the company, so it seems that their control rights outstrip their cash flow rights. Thus there is an early indication of expropriation of firm cash flows for their benefits. An earlier study by Core & Larcker (2002) confirms the positive relationship between manager ownership and firm performance. Other scholars find an inverted U-shaped relationship; a positive relationship occurs at some proportion of ownership but after reaching some level of proportion, the higher-level ownership negatively affects firm performance (McConnell et al., 2008).

An increased proportion of foreign ownership consistently has a positive relationship with firm value. Investors might perceive good corporate governance on foreign ownership so that the minority ownership can be protected from expropriation by majority owners. Meanwhile, government ownership does not significantly affect the value of the firm. This outcome is different from the results presented by Wang (2017), who found that the central government in China has quality of control on company produce premium value, meanwhile the local government owners have the opposite results on firm value. We have limited firms in the sample that are owned by the government, so we suspect that this result could occur because of limited data.

This study also includes four control variables: the size of the company (Assets), liquidity (LIQ), profitability (ROA), and leverage (DER). Out of these four variables, there are only two specific firm control variables that impact the value of the firm: size of company and liquidity. Both of these variables negatively impact the value of the firm. The larger the company, the lower the firm value, as a larger company tends to take higher risks, and the ownership is generally concentrated on the larger owner. The minority investors fear losing their money, and consequently a larger-sized firm might be valued lower in the market. The more liquid the company asset is, the less the value of the firm is, and idle money in the current assets grow more slowly than investments in the riskier project involving fixed assets. Additionally, investors perceive that the liquid asset can be used by majority owners for their benefit on the cost of the minority shareholder. Thus the probability disgorges of free cash flow could be higher, subsequently lowering the market value.

CONCLUSIONS

Great controversy has arisen in the corporate finance field since Miller & Modigliani (1961) postulated the irrelevance of dividend policy on firm value. When the frictionless market is relaxed, not all firm profits are distributed to shareholders, then some scholars find the positive relationship between dividend payment and value of the firm (DeAngelo & DeAngelo, 2006; Fama & French, 1998; Pinkowitz et al., 2006). A non-linear relationship between dividend payments then emerges with clientele dividend theory and catering dividend theory by Baker & Wugler (2004). Applying this theory, Kim et al. (2017) suggest that the relationship between the proportion of dividend payment and firm value form a J-shape. The value of firms is higher when shareholders have higher dividends; however, the value of non-payer dividends is not lower than the value of fewer payer dividends.

Corporate governance is one of the control mechanisms of the conflict between shareholder and manager. As a common approach to corporate governance when there is dispersed ownership and to reduce the power of managers, control is given to the investors through legal protection and increased proportion of ownership. Thus concentrated ownership gives the owner significant control rights that could be matched with cash flow rights. Theoretically, higher concentrated ownership is valuable for investors, in which they can control managers by using their discretion, and they could align the interests of the managers with their own interests.

In this paper, we re-examine the impact of dividend policy and proportion of ownership on dividend payment. Our findings suggest no relationship between the proportion of dividend payments and firm value, as postulated by Miller & Modigliani (1961), even though the Indonesian Capital Market is far from a frictionless market and not all profits are distributed to investors. We suspect that investors in this market are characterized by the short-term investment horizon, and subsequently, they have less concern regarding dividend payment. Consequently, the dividend is not a determinant of firm value.

As insider management or families predominantly own Indonesian companies, the association between the increased ownership of insiders impacts firm value negatively. It seems that owners have more power to disgorge firm cash flows that are perceived negatively by the market. Meanwhile, foreign firms are valued higher by the market, probably because of the good perception of corporate governance; thus it follows the incentive value effect (Claessens et al., 2002).

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