Direct Agency Cost of Equity, Cash Flow Volatility and Dividend Pay-out: Evidence from Pakistan

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ABSTRACT

This study aims to examine the impact of direct agency cost of equity and cash flow volatility on the Pakistani firms’ dividend pay-out behaviour. Besides, this study also examines the interaction of direct agency cost of equity and cash flow volatility on the firms’ dividend pay-out behaviour. For analysis, a logistic regression model was employed and the data of 188 non-financial firms listed at the Pakistan stock exchange over the period 2011 to 2015 was used. The findings revealed that in an emerging country like Pakistan, cash flow volatility negatively affects the pay-out behaviour and agency cost of equity positively affects the pay-out behaviour. Moreover, interactions of cash flow volatility and asset turnover as proxy of direct agency cost of equity negatively affect the pay-out behaviour. However, the interaction of cash flow volatility and SGA expense as an alternative proxy of direct agency cost of equity is insignificant. This study contributes to the existing body of knowledge by providing an empirical evidence of the interaction effect of agency cost of equity and cash flow volatility on firm’s dividend pay-out behaviour which is yet to be examined in other developed and developing countries. It also provides several implications for multiple parties such as firm’s managers who determine their abilities to pay dividend and investors while making their investment decisions.

Keywords: Agency cost of equity, cash flow volatility, dividends, Pakistan