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Effect Of Dividend Policy On The Share Price: A Case Of Non-Financial Firms

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Abstract

The Purpose of this study is to observe the relationship between dividend policy and stock return (share price). In this study 40 non-financial firms listed on Pakistan Stock Exchange have been selected for analysis who have paid cash dividends. The period for analysis is ten years from 2012 to 2021. For adopting sample, the random sampling technique has been used in the study. Due to panel data Ordinary Least Square regression was used to obtain the relationship between the variables. The results show significant relation of dividend yield and dividend per share-to-share price. And dividend payout ratio has insignificant relation with share price. So, findings suggest that sample firms should offer cash dividends regularly because it will lead upward movement in market price of shares. While the profit retention of firms will cause the downward movement in value of market price of shares.

Key Words: Dividend Policy (DP), Stock Return (SR), Dividend Yield, Dividend Payout Ratio (DPR), Dividend Per Share (DPS), Share Price (SP).

1. INTRODUCTION

Conventionally it has been observed that firms have ability to influence their share prices by manipulating the dividend policy (Asquith & Mullins Jr, 1983) and having significant relation (Koleosho, Akintoye, & Ajibade, 2021) .The most supporting view is that organizations have capability to increase share prices with the help of increasing payout ratio. Similarly, the dividend decisions have remained much debated among various stakeholders e.g., the shareholders, management and academicians(Sajid, Razzaq, Iqbal, & Khan, 2012). The dividend decisions are changed on the basis of investors' demand for dividend (Li & Lie, 2006). Usually, investors give priority to cash dividends rather than capital gains (H. K. Baker & Jabbouri, 2017). Dividends not only play the role of information circulation but dividends also gave indication of market trust to the firms' outlook. Dividend payout possesses information content that it delivers positive indications to investors regarding the organizations' future performance of earnings (Merton H Miller & Kevin Rock, 1985). According to the dividend signaling theory dividends fulfil two purposes. First it proposes that to what level the financial managers adopt dividends to influence the stock prices whether they impact them positively or negatively. Second it observes that to what level the investors perceive the dividend payout as part of their return, on their invested amount in the market(Eldomiaty, Atia, & Hafez, 2014). In addition, investors expect increment in dividends. As firms have trend for regularly issuing dividends due to continues increment in the profits of firms and favorable financial ratios (Harada & Nguyen, 2005).

Various theories have evolved regarding the dividends e.g., bird in hand theory, agency cost theory, tax preference theory and clientele effect theory which tells that in what way dividends should be distributed and how much of the firm profit should be allocated to the dividends (Bakri, Abd Jalil, & Hassan, 2021; Pahi & Yadav, 2021) . Some theories (Damodaran, 2010) which are commonly quoted by researchers for dividend and share price relation. Dividend irrelevance theory, describes zero effect of dividend on the stock returns ought to perfect competition in the market so it would not impact the value of firm (Olarinde, Abdullahi, & Yaro, 2020). Second school of thought tax preference theory suggests that for average investors the dividends are not good due the tax disadvantage associated with dividends which lowers firm value (Brennan, 1970). The contribution of financial research regarding the dividend policy and their impact on the value of stock and firm performance. So, the final school of thought bird in hand argues that dividends are considered good and have the potential to increase shareholders' wealth through stock prices(Ball, Brown, Finn, & Officer, 1979). In addition, other dividend theory "signaling theory" supports dividend distribution because dividends give favorable indications to the market regarding the firms' future outlook(M. H. Miller & K. Rock, 1985). They believe that asymmetric information brings consistency in investment decision. Agency theory, in Supporting of Signaling Theory, refers that dividend distribution can reduce the agency costs between management and shareholders. It describes that dividend payments are commitment by management to increase the wealth of shareholders and avoid to invest in more risky and unprofitable projects (Moh'd, Perry, & Rimbey, 1995).

Dividend payments are commitment by management to increase the wealth of shareholders and avoid to invest in more risky and unprofitable projects. Many investors become motivated to different investment opportunities based on the characteristics of investment and nature of investment. Some investors are inclined to investment in stocks by considering return opportunities in the form of periodic return and capital gains by bearing some risk (Musallam, 2018). Investors usually invest on the basis of their familiarity with some stocks. Investment decision also depends on the information analysis of other entities

2. RESEARCH QUESTIONS

1. Is there any significant relationship between dividend yield and share prices?

2. Is there any significant relationship between dividend payout ratio and share prices?

3. How significantly dividend per share affect the share prices?

3. LITERATURE REVIEW

3.1 Dividend Policy

Dividend policy had got much attention in the world of financial research (Al-Najjar & Kilincarslan, 2017; Pinto, Rastogi, Kadam, & Sharma, 2019). As the dividend signaling theory suggested that it would fulfil two objectives in terms of dividend contribution. Firstly, it showed that how much the finance managers manipulate the dividends to affect the prices of stock either positively or negatively (Nie & Yin, 2021) . Secondly it determined how investors made perception regarding the dividend payout as their investment return (Eldomiaty, Atia, Badawy, & Hafez, 2014). As corporations' dividend policies have attracted a large number of retirees and institutional investors. (Black & Scholes, 1974) suggested that if corporations would have capability to influence share prices by increasing or decreasing the dividend payout ratios. They would push and pull the demand payout ratio and it would to create equilibrium to make immaterial changes in policy. The firms used to significantly focus on the consistency and stability of dividends. The capital markets gave incentives to managers for keeping consideration of investor demand for dividends while they would make decisions regarding the level of dividends (M. Baker & Wurgler, 2004). Cash dividends would deliver indications about future growth of firm and investors gave preference to the cash dividends for three reasons. First the retiree investors and investment firms like mutual funds would require consistent cash flows to meet their expenditure budget. Second the investors would believe that the risk of corporations which had paid cash dividends was lower because mostly these companies were stable and mature. Third investors trusted that by paying high dividends companies would show their giant cash flow possession and it would also give signals that managers had possessed financial capability to pursue the self-discipline (Hsu & Lin, 2010).

3.2 Dividend Yield and Share Price

Dividend yield has been defined that how much portion of stock price is paid as dividend by an individual firm. Share price is also considered as one of the major factors which maximizes the value of firm in the form of capital gains in long run (Bustani, 2020; Nguyen, Bui, & Do, 2019) . According to the studies of Asquith et al. (1983) that variation in dividends would give significant implications on share price, performance of firm and stock returns. (Rigar & Mansouri, 2003) indicated that there was affiliation between the firm performance and dividend policy. They discovered a positive relation between the company performance and dividend. (Chiang & Hughen, 2017) studied the oil industry sector to find the relation between stock return and oil prices. Some empirical evidence suggests that the dividend yield and share price have positive relation. (Nishat & Irfan,

2003) had observed major effect among dividend payout and dividend yield, and volatility of stock price in the emerging economy of Pakistan. (Rashid & Rahman, 2008) concluded that stock price and dividend yield were positively affiliated with each other. (Hussainey, Mgbame, & Chijoke-Mgbame, 2011) investigated the relationship of dividend yield and stock market price. They concluded that dividend payout and stock price were negatively associated while there was positive relationship between stock price and dividend yield. (Asghar, Shah, Hamid, & Suleman, 2011) found that stock price and firm size were impacted by dividend yield by studying five non-financial sectors. They explored that there was positive connection between share price and dividend while negative relationship was found among other variables like return on equity and retention ratio.

3.3 Dividend Payout Ratio and Share price

Dividend payout ratio is defined that it is the ratio of amount paid as dividend to shareholders from the net income of company. It is also expressed as percentage of profit paid to stockholders; the remaining amount is treated as retained earnings to invest in a profitable project. Dividend was also defined that the ratio of cash dividend which had been paid as dividend from the total net profits of firm (Ramadan, 2013). Total dividend announced divided by the total net income is the calculation of dividend payout ratio. (Nissim & Ziv, 2001) dividend payout policy was described that it was the regulation and procedure which companies used to make decision to pay dividends to stockholders. The major philosophy of dividend payout ratio is the trade-off between dividend payout and retained earnings. Dividends are frequently delivered from the company's ongoing profits and occasionally they are paid out of common reserves. Most of the time dividend payments are in the form of cash dividend. Dividend payout was considered as a significant form of common stock return to shareholders (Arsyad, Haeruddin, Muslim, & Pelu, 2021; Odum, Odum, Omeziri, & Egbunike, 2019). Dividend payment impact on share price was surveyed by (Khan, Aamir, Qayyum, Nasir, & Khan, 2011) and had concluded that dividend yield was positively correlated with share price while retention ratio was negatively associated with share price.

3.4 Dividend per share and Share price

Dividends have been frequently used to uncover its impacts on the share price of firm. To know that how the investors react to larger dividends. (Friend & Puckett, 1964) suggested that there was relationship between dividend per share and stock price. (Black & Scholes, 1974) also checked the effects of dividends on stock prices (stock return) by using time serious method to avoid some variances on the estimation of previous cross-sectional regressions of share prices on the dividends. (Nissim & Ziv, 2001) concluded that there is strong association between dividend changes and profitability. (Mokaya, Nyangara, & James, 2013) studied the relation dividend and shareholder's wealth (share price). They found positive combination between variables; it meant when the dividends increased it would also lead in the increment of firm's stock price. The dividend variables like dividend yield, dividend per share and dividend payout ratio had significant association with wealth maximization of shareholders (Ozuomba, Anichebe, & Okoye, 2016). (Swarnalatha & Babu, 2017) concluded that the association among variables were positive. Moreover (Sharif, Adnan, & Jan, 2015) studied that dividend positively affected the stock price. They concluded that in Pakistan their results supported dividend theory of bird in hand while ignored the dividend irrelevancy theory. (Dixon, Palmer, Stradling, & Woodhead, 2008) suggested that stable dividend per share (total dividend divide by issued shares) could be adjusted by decreasing the numerator and cash amount that would be paid as dividend. It shows that when companies decide to cut dividends so either they reduce the share price or reduce the cash amount which concludes the importance of the dividend per share and stock price.

3.5 Theoretical Framework

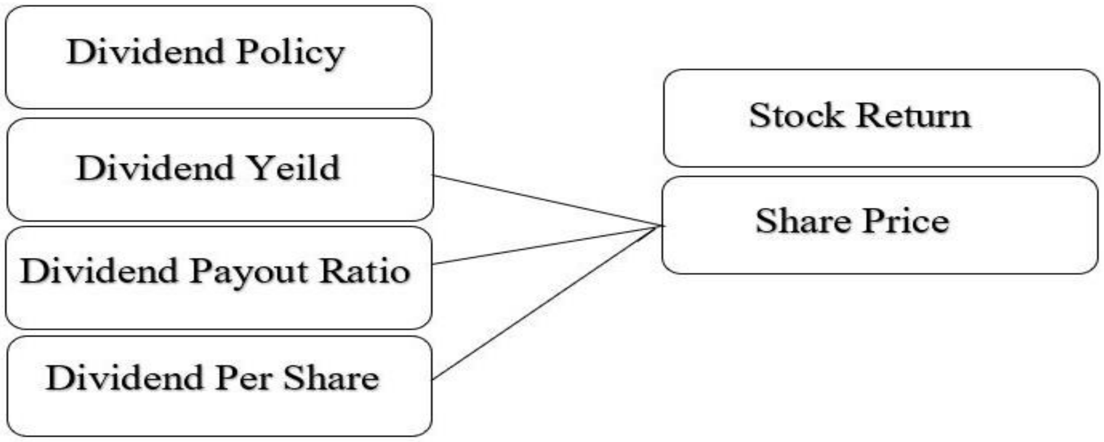

Figure 1: Model of the Study

3.6 Hypothesis Development

3.6.1 Dividend Yield and Share Price

(Nishat & Irfan, 2003)had observed significant effect of dividend payout and dividend yield on the stock price in emerging economy of Pakistan. (Nazir, Nawaz, Anwar, & Ahmed, 2010) had investigated non-financial firms of listed Pakistani firms. They had concluded by applying panel data and regression analysis that there was a positive relationship between dividend yield, payout ratio and stock prices. Hence it supports the hypothesis that:

H1: There is relation between dividend yield and share price

3.6.2 Dividend Payout Ratio and Share Price

(Baah, Tawiah, & Opoku, 2014) conducted study on the dividend payout policy in Ghana the variables they had used were return on equity, profit after tax, size of firm and dividend payout ratio on the share price. (Nazir, Abdullah, & Nawaz, 2012) surveyed the firm payout policy on share price They found payout ratio had strong effect on share price. Hence it supports the hypothesis that:

H2: There is relationship between dividend payout ratio and share price

2.12.3 Dividend Per Share and share price

(Friend & Puckett, 1964) suggested that there was relationship between dividend per share and stock price. (Sharif et al., 2015) showed that dividends positively affected the stock price. (Oyinlola & Ajeigbe, 2014) investigated the dividend policy variables and concluded that there was significant relationship between dividends and share price. Hence it proves the hypothesis that:

H3: There is relationship between dividend per share and share prices.

4. METHODOLOGY

The data had been collected from secondary sources including State Bank of Pakistan and companies' websites. Total 40 firms, from listed 14 non-financial sectors, were selected for study analysis for the period of ten years from 2012 to 2021. There was total 1600 observations in the study because of three independent variables and one dependent variable. To analyze the data IBM SPSS statistics software and polled ordinary least square (OLS) regression analysis had been used (NTUI, Yuda, Prosper, & Samwel, 2015; Zakaria, Muhammad, & Zulkifli, 2012). The panel data had been used due different units and for specific time period (Nazir et al., 2012)

4.1 Equation Model

$$SP= \alpha + \beta_1 DY + \beta_2 DPR + \beta_3 DPS + \varepsilon$$

4.2 Model Specifications

DY=Dividend Yield

DPR=Dividend Payout Ratio

DPS=Dividend per Share

SP=Share Price

5. DATA ANALYSIS AND RESULTS

5.1 Descriptive Statistics

Table 5.1 presents the descriptive statistic of this research. The table contain details about the firms' share price, dividend yield, dividend payout ratio and dividend per share. The details include average values of the variables. The average values describe the deviation of variable to point mean position that how much they are deviated either positively or negatively. Smallest and extreme value of the factors have also been mentioned in the table. Each variables' standard deviation was incorporated in the table. So standard deviation helps to tell the deviation in data. Higher standard deviation would tell that particular variable's data is scattered.

Table 5.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Dividend Yield	400	.00	146.63	8.3287	19.36619
Dividend Payout Ratio	400	-1562.50	45250.00	2.2374E2	2291.24925
Dividend Per Share	400	.00	550.00	20.9203	56.34578
Share Price	400	4.95	11499.99	6.4154E2	1726.27831
Valid N (list wise)	400				

The DY's standard deviation is 19.367 that tells data has followed normal distribution. The mean of DY consists of 8.329. However, the least and extreme value of DY is 00 and 146.63 respectively. Average value of DPR is 2.2. And the minimum and maximum values of DPR is -1562.50 and 45250 correspondingly. Std. Deviation of DPS and SP is 56.345 and 1726.27 respectively. These values show that both in values deviate from their mean values.

5.2 Regression Analysis

Table 5.2 shows the results of correlation between all variables i.e., independent and dependent variables. For checking multicollinearity, correlation matrix was used in this study, results are in Table 5.2 for equation 1. Results from the above table show that DY is correlated 15.2% and 10.8% with DPR and DPS respectively. Whereas DPR is 2.7% correlated with DPS vice versa. SP is negatively correlated by 9.7% with DY and 0.09% with DPR. SP is highly correlated with DPS by 79.7%.

Table 5.2

Correlations

		DY	DPR	DPS	SP
DY	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	400			
DPR	Pearson Correlation	.152**	1		
	Sig. (2-tailed)	.002			
	N	400	400		
DPS	Pearson Correlation	.108*	.027	1	
	Sig. (2-tailed)	.031	.597		
	N	400	400	400	
SP	Pearson Correlation	-.097	.009	.797**	1
	Sig. (2-tailed)	.051	.855	.000	
	N	400	400	400	400

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Model Summary

$SP = \alpha + \beta_1 DY + \beta_2 DPR + \beta_3 DPS + \varepsilon$

Table 5.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.818[a]	.669	.667	996.68199

a. Predictors: (Constant), DPS, DPR, DY

5.3 Hypothesis Testing

Firstly, in this study regression was conducted through OLS on the below model;

$SP = \alpha + \beta_1 DY + \beta_2 DPR + \beta_3 DPS + \varepsilon$

The formation of above model is through intuitive and previous research studies. It is expected that each of variables have an impact on the share price. To test the relationship and their significance regression test was run.

Table 5.4: Coefficient Statistics

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	255.160	56.672		4.502	.000
	DY	-16.784	2.622	-.188	-6.402	.000
	DPR	.012	.022	.016	.555	.579
	DPS	25.020	.891	.817	28.087	.000

Dependent Variable: **SP**

6. FINDINGS AND DISCUSSIONS

Dividend yield: Negative sign of the coefficient shows the inverse relationship. But it is significant in its parameter and proves the acceptance of hypotheses. (Zakaria et al., 2012) also found such relation in their study and claiming DY as a good indicator to predict the share price. And found the negative relationship existed between dividend yield and stock prices.

Dividend payout ratio (DPR): The relation between dividend payout ratio and share prices is positive but not significant and proves rejection of hypothesis. The study of (Schooley & Barney Jr, 1994) found such relationship between DPR and Share price. (Baah et al., 2014) examined six various sectors and found statistically insignificant and weak relation between dividend payout and share price. It concludes that payout ratio is driven by the income which is based on accrual basis so that's there is insignificant relationship between payout ratio and share prices.

Dividend per share (DPS): It has positive sign and statistically it has significant relationship with share prices. Statistically it is highly significant and accepting hypothesis. The dividend policy variables like dividend yield, dividend per share and dividend payout ratio had significant association with wealth maximization of shareholders (Ozuomba et al., 2016; Swarnalatha & Babu, 2017).

7. CONCLUSION

This study examined the impact of dividend policy (dividend yield, dividend payout ratio and dividend per share) on the share prices of non-financial firms (share price) listed on the Pakistan Stock Exchange. Two hypotheses were accepted that dividend yield and dividend per share have significant influence on share price while other hypothesis that there is significant relationship between dividend payout ratio and share prices was not accepted. However significant relationship between dividend policy and share prices concludes that dividend policy is good predictor of share prices(Koleosho et al., 2022; Zainudin, Mahdzan, & Yet, 2017). This study has developed the base for further studies because it has provided the results of firms which offer cash dividends. It suggests the management to offer cash dividend periodically to shareholders because it conveys positive signal to the market (Widyasti & Putri, 2021) . Investors can also get benefit from this study findings that they should make portfolios as well as trading strategies based on the dividend yield and dividend per share of the company because it talks about growth of the company.

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