

Review of Dividend Policy and its Impact on Shareholders Wealth

Rimza Sarwar and Nadia Naseem

Author(s) Biography

Rimza Sarwar is MS Scholar at National University of Modern Languages Islamabad (Fsd. Campus).

Nadia Naseem is MS Scholar at National University of Modern Languages Islamabad (Fsd. Campus).

ABSTRACT: *This paper reviews the literature for studying the impact of dividend policy on shareholder's wealth. For the measurement of the impact of dividend policy on shareholders wealth researchers have used different, methodologies like regression method, stepwise regression model, least square regression analysis, coefficient of determination, R square, descriptive statistics, multiple regression, and correlation. Data collected in these papers was secondary nature in general. In most papers dividend per share (DPS) and retained earnings (RE) are used as independent variables and market price per share (MPS) is taken as dependent variable. Relationship of dividend policy and firm's profitability has significant impact on value of shareholder, according to the findings of most of the studies. Some researchers find dividend policy relevant, while some find irrelevant to shareholder's wealth. Most of the firms depend upon dividend policy to show their positive performance. Some firms don't rely on single dividend policy.*

Keywords: *Dividend policy, Shareholder's wealth, Share price, Birds in the hand theory, Signaling theory, Agency theory, Relevance and Irrelevance.*

Focusing at dividend policy and its impact on shareholder's wealth with broader sense, very difficult for companies to make competition in a stunning nature of market, that managers of each company want to maximize the shareholders' value, by the reinvestment of common stock the earning per share also increases (M. Salman 2008), (Azhagaia and Sabari 2008) In 1956 Linter has searched about policy of dividend and ask what is important in this field of study?, after that (Miller & Modigliani 1961) searched that decisions of dividend policy showed irrelevance theory of dividend which represent that it does not affect the stock prices. So many researchers also support the theory of dividend; they said dividend policy affect the market price of shares, Gordon (1963). M. Salman, et al (2008) studied the relationship of dividend policy and shareholders wealth in sugar industries of Pakistan. For this study 33 listed companies of sugar were selected out of 36 at Karachi stock exchange, multiple regression model used, EPS taking as independent variable and MPS market price per share and PER price earnings ratio retained earnings ratio RER taken as dependent variables which shows PER and RER did not affect the shareholder's wealth.

Azhagaiah and Sbari (2008) studied the same relation of dividend policy and shareholders wealth, study used only the secondary data to measure the impact of dividend policy multiple and stepwise regression model was used by taking RE retained earnings per share and MPS lagged market price per share as independent variables and MPS as dependent variable, for which 28 listed companies of chemical industry from 114 listed companies in Bombay stock exchange. It has a significant impact of dividend policy on shareholder's wealth in organic companies but the shareholders wealth not influenced by dividend payouts. The relationship of dividend policy and value of shareholders and to analyze whether the dividend payments affects the shareholders . The primary objective of organic and inorganic companies is to analyze the fluctuations of shareholder's wealth by dividend paying and non-paying companies also studied the impact of retained earnings on past and present performance of dividend payouts. Secondary data has been used, analytical method used for data interpretation. A company paying dividend for 3 or more years treated as dividend paying. They have studied that dividend payouts maximizes the value of those shareholders who are the salaried person, retired pensioners, and who have limited source of income. Dividend can be enhanced by improvement in profit, investment of capital, maximum sale volume etc.

Ozumba&Okoye plus (2013) focused on that dividend may be managed or residual that payment made at fix ratio or according to the earnings generated from possible investments, it may be sometime zero also. The general purpose of this study is to analyze it through

empirical methods; main objective is to show the impact of dividend on shareholder's wealth of public companies in Nigeria. It covers 10 companies listed in Nigeria stock exchange, methodology of least square regression analysis used, also showed the relevance of value of shareholder's with dividend policy. Dividend payments made from reserves or sometime from current profit. Sometime distribute to shareholders or sometimes ploughing back to business to maximize the share price, investors used this information for their future expectations from company, increment in the share price will automatically increases the value of shareholders. Some scholar's belief that shareholders are risk adverse people they prefer cash dividends like "a bird in the hand is worth more than two in bush."

Naveed et al. secondary data got from annual reports. Multiple regression analysis used for this research, results based between +1 and -1. MPS and EPS impact very high on DPS dividend per share, sample used for 10 listed companies from the year 2001 to 2011, these ratios show positive impact on dividend policy, these results again follow the bird in the hand theory, its mean Nigerian firms retain a portion of earnings for reinvestment purposes, when we apply these findings the growth of firm depends upon the level of dividend policy.

A.Ajanthan (2013) searched that the main goal of this study to find relationship between dividend payouts and profitability of hotel and restaurant companies in Colombo Stock Exchange. The dividend policy considered as primary element of firm's policy, risk and investment of shareholders can be determined by different factors. Dividend policy affects the value of firm and wealth of shareholders Baker &powell (2001) dividend decisions important with respect to flow of investment or retained by firm to reinvest(Ross, S.A Westerfield). Dividend policy is one of the most important decisions of financial nature (Baker & Powell 1999).

Pani (2008) focuses on dividend policy and behavior of the stock prices in India. Showing the relation of dividend and stock return volatility, using 500 listed companies for the period of 10 years. Results that the dividend paying companies show large profitability ratio of financial performance. Dividend and retention ratio between textile and mining industries remains same.

M.Hashemijoo&Nejat focuses on 84 companies of consumer product out of 142 total listed companies in market of Bursa Malaysia. The 6 years data used from 2005 to 2010. That show significant -ve relation with dividend policy and share price volatility. What portion used by shareholders and which one reused in firm. More than 50 years dealt with critical corporate issues but they have some conflicting results. (Miller &modigliani, 1961) searched that shareholder's wealth

not affected by policy of dividend; it is based on firm's earnings.

Nazir, et al (2010) studied the determinants of stock price volatility in KSE Karachi stock exchange, by determining the stock prices using dividend policy. Taking sample of 73 firms from different sectors of KSE 100 index companies. Using data of 5 years . Data taken from the state bank of Pakistan, dividend payouts taken as independent variable and price volatility as dependent variable . Resulted that dividend has impact on stock prices volatility.

(SajidGul& M. Bilal, 2012) studied that wealth of shareholders influenced by the dividend policy. To examine the 75 companies listed in KSE Pakistan. A significant influence of dividend policy on value of shareholders . Management should have to give a fair return on their investment to enhance the value of shareholders.

(Afzal and Mirza 2010) found positive association of cash flows of day to day business and profitability with policy of dividend whereas -ve relationship with ownership cash flow sensitivity and leverage.

Relevance with Shareholder's Wealth

There is the positive relation that some researchers have found like same or +ve relation of dividend policy with shareholder's wealth is found by (Azhagaiah&Sabari 2008), (SajidGul& Bilal Khan), (Afzal and Mirza 2010), they show that dividend policy has positive influence on share price. Using same variables like DPS dividend per share, RE retained earnings as independent variables and MPS market price of share as dependent variable.

Irrelevance with Shareholder's wealth

There is some negativity between the two variables, some researchers find it negative according to their own perceptions like dividend policy having negative relationship with shareholders wealth (M.Hashemijoo&Nejat), Miller & mortigliani, 1961) searched that shareholder's wealth not affected by policy of dividend, it is based on firm's earnings, Capital structures (working and fixed), and profitability.

It can be shown in the form of table as below:

Table

Authors	Country	Negative Relation	Positive Relation
<u>Azhagaiah & Sabari</u> (2008)	India	Dividend payouts	Sales growth, capital investment
<u>Ozumba & Okoye</u> plus (2013)	Nigeria	Retained earnings	Dividend and shareholder's wealth
<u>A.Ajanthan</u> (2013)	Sri Lanka	Tax policy	Dividend payouts and profitability
<u>M.Hashemijoo & Nejat</u> (2012)	Malaysia	Share price volatility	Dividend yield
<u>M. Salman Sarwar</u> (2013)	Pakistan	Dividend payouts	Sales growth, capital investment
<u>Sajid Gul & M. Bilal</u> , (2012)	Pakistan	Market price	Dividend policy

Theoretical Background

Bird in hand Theory

Dividends have a positive correlation with firm's value. In a term that a bird in a hand having more worth than two in a bush. A theory of (Gordon 1956) focuses that outside shareholders prefer high dividend, they determine high and uncertain returns from their investments. But in perfect market this phenomenon fails due to rational behavior (Miller & mortigliani, 1961). This theory was criticized by Modigliani & Miller claimed that policy of dividend does not affect the cost of capital as those investors are indifferent if they receive more dividend or capital gains. Its mean "having something is better than nothing".

Agency Theory

Dividend reduced the overinvestment problems (Easterbrook 1984), dividend payments influence the equity markets to enhance capital, and lowers agency cost.(La Porta et al. 2000 and Bhattacharyya) predicts that in the absence of governance managers would expropriate cash and would not invest extra cash in business and distribute to shareholders. Because managers mostly risk adverse type people as compare to shareholders. Agency cost can be reduced by paying dividend to shareholders (Easterbrook 1984),

Signaling Theory

Changes in dividend policy convey the message of future cash flows. It has a positive or negative impact on outside investors according to dividend policy fluctuations. A manager who has good investment can increase the announcements of dividend which is a good signal for future. The price of company's stock changes when dividend payments changes Linter's (1956) . Many researchers used signaling theory as most influential theory.

Nature of Study

Study of dividend policy just an empirical nature in which we have to analyze secondary data using statistical tools. Researchers have different views about dividend that effects long term MPS market prices of shares.(Dhanani, 2005) who used a survey to capture managerial views and attitudes, dividend policy serves to enhance the MPS market value. (Velnapy.T,2013) in his research of corporate governance, a sample of 28 companies using the period of 2007 to 2011 finds that corporate governance are not correlated to the performance of the firm and does not affect the return on

investment ROI and return on assets ROA. (Amidu, 2007) found that profitability measured by return on assets, showing positive relationship b/w return on equity, ROE, return on assets ROA, sales growth and dividend.

Designing Hypothesis

- Relationship between dividend payouts and shareholder's value.
- Influence of EPS on shareholder's wealth
- The impact of retained earnings on profitability of company
- There is no relationship between dividend policy and shareholder's wealth

Type of Methodology

There are generally two methods used like qualitative and quantitative research methods. In quantitative research method there is numbers, facts and figures used and how we analyze and interpret the data. In case of qualitative research a particular subject related investigation doing externally. In this study pattern **archival strateg** used to select data because all data based on official data and annual reports (a product of day to day activities). In research perspective the **ontology** of this research topic is objective in nature because whole data relevant to real facts and figures can be analyzed by an external observer. **Epistemologically** it is called positivism in that sense the policy of dividend based on reality (the real annual reports of business). This topic based upon **deductive approach** in which theory testing technique must be used. To find data we mostly have used Thomson Reuters data stream but most of all we manually processes.

Sample Size

They have considered the companies listed in stock exchange in India i.e. 21 companies organic and inorganic (Azhagaiah&Sabari 2008), but choosing 28 companies "19 organic and 9 inorganic" In Nigerian stock exchange used as a sample of 10 companies for 12 years period (Ozumba&Okoye plus 2013), 33 companies out of total 36 of listed sugar industry data collected for six years(M. Salman Sarwar 2013), 16 hotel and restaurant companies listed in Colombo stock exchange (A.Ajanthan 2013) , , a sample of 75 listed companies in KSE for six years period (SajidGul& Bilal Khan), 84 companies from total of 142 listed in Kuala Lumpur stock exchange for six years period,(M.Hashemijoo&Nejat 2012).

Collection of Data

A reliable source of data used that sure the data reliability, sources like KSE Karachi stock exchange and State Bank of Pakistan to provide balance sheet and income statement etc

Analysis of Data

Due to empirical nature of study statistical tools like regression analysis, multiple regressions and correlation, stepwise regression, methods used to analyze data (Azhagaiah&Sabari 2008),(SajidGul& Bilal Khan), (M. Hashemijoo 2012), (M. Salman Sarwar 2013), techniques like ANOVA and MANOVA used in regression analysis. Variables like DPS dividend per share, RE retained earning used as independent variables and MPS market price taken as dependent variable, like analysis of a sample of 75 listed companies in KSE for six years period.

Results and Conclusion

So dividend is important factor to maximize the shareholder's wealth. DPS dividend per share, EPS earning per share and MPS market price per share are very important factors that impact on shareholder's wealth, the increase in these factors leads to increase in dividend per share that have positive impact on shareholder's wealth. Some companies paying dividend some not to pay. The dividend paying companies have positive impact on their internal shareholders and outsiders called investors to invest in bulk due to the strong economic condition of company. So it has proved that dividend paying companies show strong economic condition. Further it's concluded that investors prefer bird in hand type of dividend policy. The accounting standard bodies like international chartered accountants enforce standards on dividend policies, and suggest that companies responsible for dividend decisions.

Limitations and Further Research Implications

To define the quantities research we have to use secondary data. Which can be taken from a source like in above examples we use the data of some limited companies their financial position related data taken from stock exchange . To find the most accurate results sample size should be large enough in further research. Also we can determine the relationship of dividend policy and profitability be affected by tax policy, past dividends, growth rate and capital structure, and shareholder's expectations. Companies can change the

fluctuations in their share price. Point to be noted that accuracy of results depends upon the reliability of secondary data, if data is accurate the results will definitely correct. These researches based upon the sample choosing from one sector or within the same country a further need of work on this topic is that to use out of country and out of sector data to find some further studies. Investors can create any dividend policy they sell shares when dividend payout is low and buy shares when dividend payouts are too high. There should be a need of mixed method approach in which we have to compare the quantitative as well as qualitative data in research method to find some different results.

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