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Impact of Dividend Policy on Shareholder's Wealth

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Abstract

The purpose of this study is to examine the relationship between shareholders wealth and dividend policy. Sample of 30 companies from Karachi stock exchange was selected which includes companies from textile, cement and chemical sector. Shareholders wealth is measured with the market price of shares. Dividend per share, retained earnings, lagged price and return on equity was used as independent variables. The estimation based on multiple regression model shows that there is strong relationship between shareholders wealth and dividend policy. The shareholders wealth is increase by dividend policy in case of Pakistan.

Keywords: *Market Price Per Share, Dividend Per Share, Return on Equity.*

Introduction

By dividend policy we mean that the amount of earnings distributed to the shareholders and the amount of retained earnings. So in this policy the amount of earnings of the firm are divided into two parts, dividend paid and the amount kept for future projects. Dividend policy is considered an important tool for investors to assess the company's financial position as they require return on their investment and dividend paying company will certainly attract them.

In the world of corporate finance the question that whether the earnings of the firm should be distributed to shareholders or it must be reinvested in future profitable projects has great importance. To answer this question finance mangers must consider which dividend policy will increase the shareholders wealth. Share holders like the cash dividends but on the other hand they also want the growth of the company by reinvesting the funds.

In ever increasing economies every company is in stress. Finance manager's prime objective is to maximize the share holder's wealth as they are principle agents of them. Share holders wealth is represented in the market price of the share which is the result of company's financing, investment and dividend policy decisions. The optimal dividend policy is that which increases the share prices of the company which in return increase the shareholder's wealth.

Researchers had tried to explain that why firms pay dividends (Green 1983). Although Miller and Modigliani (1961) argued that the dividend policy has no effect on the share holder's wealth. Dividend irrelevancy is also supported by the work of (Scholes, 1974). Many researches had shown that there is dependency of dividend policy on the shareholders wealth. Linter (1956), Gordon (1963) and Richardson (1986) had stated that there is a relevancy between the dividend policy and the firm's value and the dividend policy has the positive relationship with the firm's value. Researchers also found the positive impact of dividend policy on shareholders wealth. (Fama, 1969; Petit, 1972 & Travlos, 2001)

In this study the relationship between dividend policy and the share holder's wealth has been discussed in the reference of Pakistani companies that whether the dividend payouts have the impact on the shareholder's wealth, as market price of shares is used a proxy to determine the shareholders wealth.

Objectives

- The objective is to determine the relationship between shareholders wealth and dividend policy.
- To determine the impact of retained earnings on the wealth of the share holders.
- To analyze the impact of dividend per share on market price per share.
- The objective is to find that whether retained earnings or dividends increase shareholders wealth.
- To examine the impact of return of equity on shareholders wealth.

Literature Review

The theory presented by Miller and Modigliani suggested that the shareholders wealth is not increased by the dividend policy of the firm. Shareholders wealth depends upon solely on the earning capacity of the firm. By giving dividends to shareholders the company is adding more risk as they increase the amounts of debt so the gain for shareholders is offset by the added amount of risk. (Miller & Modigliani 1961).

The research indicated that the subsequent increase in the dividend payments to the shareholders has a positive effect on the shareholders wealth. This study does not include other earnings announcements. The other studies on this area reveal that there is a negative relationship between initial dividend and subsequent dividend. The results suggest that the increase in dividend payments have a unique impact on the shareholders wealth. (Asquith & D. W. Mullins 1983).

This study suggested that there is a strong relevance of dividend policy with the firm's value. The results suggested that dividend announcements and stock dividend both elicit abnormal returns for the investors. The Cyprus market reveals the results which are consistent with the theories of relevance of the dividend policy with the value of firms. (Travlos, N & Vafeas 2001).

They studied the relationship between share prices and the dividend announcements by considering a sample of 137 companies from Dhaka stock exchange. The results reveled that the dividend does not provide gain for the share holder's wealth and they found a 20% loss in the value of the first 30 days before the announcements to the 30 days after the announcements. (Uddin & Chowdhury, 2003).

The results of this study remain consistent with the theory of relevance of the dividend policy. Sampled companies from Ghana stock exchange has been taken for consideration. Results suggested that there exist an impact of dividend policy on firm's value. Dividend policy has positive effect on ROA and growth in sales. A negative relationship exists between ROA, leverage and dividend policy. (Amidu, 2007).

Selecting a sample of 73 firms from Karachi stock exchange (Nazir, S 2010) tried to find the determinants of dividend policy in Pakistan for the firms. Results suggested that market prices of shares are greatly influenced by the dividend announcements and dividend payouts. Dividend policy has a strong positive impact on the share prices of the firms. The study suggested that there is a positive relationship between dividend yield and stock prices volatility and there is e negative relationship between share price volatility and growth f the firm.

The result was based on the sample data extracted from Karachi stock exchange. (Asghare. M, 2011). The study examined that there is a negative relationship between stock prices volatility and dividend yield and also with dividend payout. Results suggested that there exists a strong positive relationship between these variables. The sampled data was used from London stock exchange. (Hussainey 2011).

To find out the determinants of stock prices volatility (Mehr-un-Nisa, 2011) selected the Karachi stock exchange. By including both micro and macro factors she concluded that earning per share, previous stock prices are most important factors to change the market prices of the shares. Results also described some macro factors which are responsible of the change in the prices of shares.

Pani (2011) tried to find the relationship between stock price movements and the dividend policy of the firm. By taking the sample of 500 firm s from Bombay stock exchange he found that there debt-to-equity, size of the firm and dividend retentions has significant impact on the stock prices movements.

In this study the different factors (determinants) of dividend policy has been tried to examine. By taking the sample of engineering sector from Karachi for the time period of 1996 to 2008. Results suggested that earning per share, dividend per share, firm's growth are the main indicators of the dividend policy for the coming period. (Imran, K, 2011).

(Okafor, 2011) examined the relationship between dividend policy and share prices volatility by taking samples from Nigerian firms. He found that dividend payouts and dividend yield both have significant impact on share price movements. Results also suggested that dividend yield has a negative relationship with share prices. On the other hand dividend payout ratio has positive and also has negative relationship with share prices in some years.

(Akbar, M, 2010) conducted a research in which he instituted the relationship among dividends and stock prices. He concluded that there is a strong positive relationship between dividends and stock prices of the firms.

Hypothesis

H0: There is no relationship between dividend policy and shareholders wealth.
H1: There is a relationship between dividend policy and shareholders wealth.
H1 (a): There is a positive relationship between dividend per share and market price per share.
H1 (b): There is a positive relationship between retained earnings per share and market price per share.
H1 (c): There is a positive relationship between return on equity and market price per share.
H1 (d): There is a positive relationship between lagged price of share and market price per share.

Data Collection

Population: The population of this study is the companies listed at Karachi stock exchange of Pakistan.

Sampling: For this study sample was decided to choose from Karachi stock exchange and cement, textile sector has been chosen on the basis of availability of the data. The data has been collected from annual reports of the companies from 2007 to 2011.

Regression Model

To measure the impact of dividend policy on shareholders wealth following regression model has been used:

MPSit = a + b DPSit + c REit + d ROEit + (MPS)it-1 + eit

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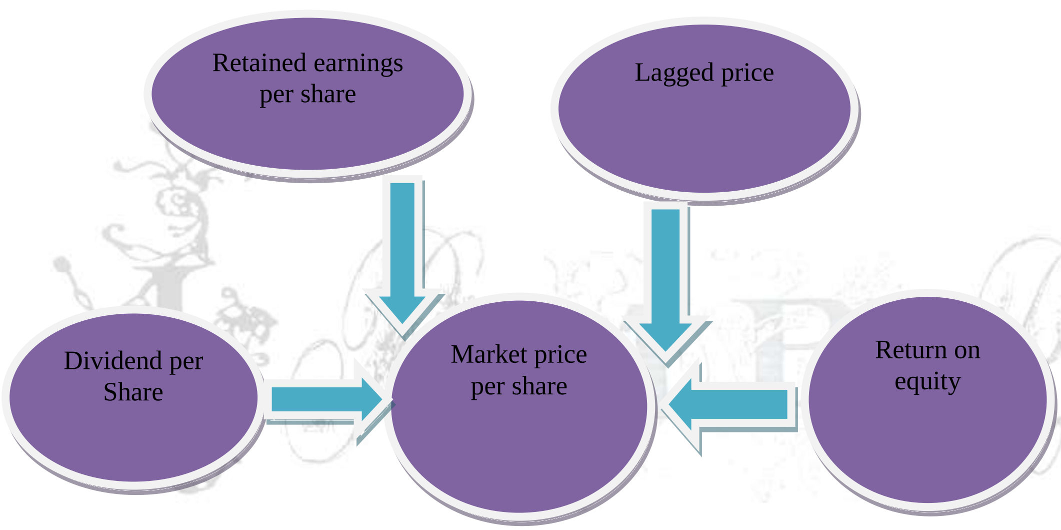
Where,

MPS= Market price per share
DPS=Dividend per share
RE=Retained Earnings per share
ROE=return on equity
MPSit-1= Lagged Market Price (MVit-1)

Market price has been used a proxy for the shareholders wealth. Dividend per share and retained earnings per share is used to measure the dividend policy of the firm.

Theoretical Framework:

In this study market price per share is a dependent variable and independent variables include dividend per share, retained earnings per share, return on equity and lagged market price.



Results and Analysis

Table 1 shows the descriptive statistics which includes mean, maximum, minimum, median and standard deviation. As we know that standard deviations show the variation in the data, the highest value of standard deviation is of market prices i.e 98.64520 of the sample which has been selected from Karachi stock exchange. The minimum variation is seen in dividend per share i.e 6.385524, which shows that dividend per share, is not so much changed among the selected sample. As we can also see that the highest mean value is of market price per share i.e 82.98375. The minimum mean value is of dividend per share i.e 3.053460.

Table 1

DPS	LAGPRI	PRI		RE	ROE
Mean	3.0535	-6.5159	82.9838	3.8045	9.9916
Median	1.25	-0.16	35.975	0.7622	8.69
Maximum	50	254.26	473.12	124.882	160.58
Minimum	0	-221.68	2.79	-14.995	-510.95
Std. Dev.	6.3855	43.6828	98.6452	14.1847	55.1838

Correlation Analysis

Table 2 shows the correlation among the explanatory variables. This table shows that there is no multi co-linearity among all the independent variables. As we know that there is assumption of multi co-linearity while using the regression model. So as there is no multi co-linearity so we can use all the independent variables in one model.

Table 2

Variables	DPS	LAGPRI	RE	ROE
DPS	1	-0.059	0.4017	0.1862
LAGPRI	-0.059	1	0.1274	0.0934
RE	0.4017	0.1274	1	0.3061
ROE	0.1862	0.0934	0.3061	1

Regression Analysis

Following table shows the regression model results

Table 3

VARIABLE	Coefficient	Std. Error	t-statistics	Prob
C	51.05928	6.14757	8.3056	0.0000
DPS	7.45991	0.94858	7.86431	0.0000
LAGPRI	0.27797	0.1279	2.17329	0.0314
RE	2.10192	0.44176	4.758	0.0000
ROE	0.29629	0.10498	2.82232	0.0054

Table 3 shows the regression results. According to the results H1 (a) is accepted as the p values shows that there is a positive significant relationship between the dividend per share and market price per share. It is shown from the table that there is a significant relationship between retained earnings and market price per share. On the basis of above information we accept the H2 (b). We also accept the H3 (c) that there is strong significant and positive relationship between return on equity and market price per share as p value < significance level. From the p value of lagged price in the above table we can conclude that the there is a significant relationship between lagged price and market price of the shares. So we can accept the H4 (d) that there is a positive relationship between the lagged price and market price of the shares. The co-efficient values show that if company pays dividends the prices are more increase as compared to retained earnings.

Table 4

R-squared	Adjusted R-squared	F-statistic	Pro (F-statistic)
0.551167	0.538785	44.51497	0

Table 1.4 shows that the value of R-square is .55116, which means that the regression model is explaining the 55% variation in the dependent variable which is significant.

Findings and Discussion

Results indicate that dividend policy positively affect the shareholders wealth. Dividend share per share, retained earnings per share, lagged price and return on equity has a positive relationship with market price per share which is used as a proxy to measure the shareholders wealth. Moreover, all the sub hypothesis of H1 is accepted. If a company pays cash dividends to the shareholders then positive results will be found because dividends has a signaling effect which tells about the financial condition of the firm and attracts the investors. These results are consistent with the findings of Azhagaiah (2008) and Muhammad Akbar

(2010). Retained earnings have a positive impact on shareholders wealth. Shareholders always consider the dividends as a source of income but they consider the growth options or growth projects beneficial for themselves. These findings are same as for pani (2008). Return on equity has also a positive impact on shareholders wealth as this shows that the management is making good use of shareholders investment. These Results are same as Raballe & Hedensted (2008) and Liu & Hu (2005).

Conclusion

The aim of this study is to determine that whether dividend policy increases the shareholders wealth. A sample of 30 companies from Karachi stock exchange from 2006 to 2011 was taken for study. The results of regression model suggest that there is positive relationship between shareholders wealth and dividend per share, retained earnings and return on equity. Moreover the theories of irrelevancy of dividends do not hold in the case of Pakistan.

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