

IMPACT OF DIVIDEND POLICY ON SHAREHOLDER WEALTH: A CASE OF TOP PERFORMING COMPANIES OF PSX

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ABSTRACT

This is a quantitative research conducted out to find the Shareholder value maximization. What are the factors that contribute to increase the shareholder wealth, their satisfaction and intentions to invest in a particular share? To study this further we analyzed the impact of dividend policy on shareholder wealth, considering the dividend policy as the most important factor in increasing shareholder wealth. To study this relationship the top performing companies of Pakistan Stock Exchange were chosen in our sample that PSX announces every year. The independent variable were Dividend per share, Retained earnings per share, Return on equity and Lagged market price per share. Whereas the dependent variable, to measure the shareholder wealth is Market price per share. To analyze the relationship, the correlation and regression analysis were applied on E-views. After the analysis a positive relation is found between the independent and dependent variables and the overall variables with the model are found to be statistically significant. In doing this research an intensive amount of literature has been reviewed that helped in further explanation of theories and the variable analyzed in this research.

Keywords: Dividends per share, retained earnings per share, return on equity, market price per share and lagged market price per share

INTRODUCTION

Share prices are considered too be the foremost concern for the companies, whenever the shares prices goes up, board of directors and management are satisfied. Share prices indicates complete strength of any particular organization, if share prices of company continue to show upward trends, it is considered to be a signal for good managerial performance. Management of any company with higher share prices are is likely to spot increment and also have lesser amount of chances to go for layouts. In situations where management cannot bring suitable profit for investors, then they face the risk of replacement. Lower share prices also make companies vulnerable towards probable takeovers. Managers thus make attempts to prevent companies with such circumstances and protect their own interest. Leading further, dividend policies are also important component of corporate financial management policies. Corporate financial management policy of a company is concerned about the amount of cash that should be retained and the amount of cash that should be given to the shareholders in the forms of dividends (Hunjra, Ijaz, Chani, Irfan, & Mustafa, 2014).

A decline in stock prices also act as a major concern, as stock prices of most firms in capital market do not actually reflect their intrinsic value and investors provide more focus on their return on investment. Extensive amount of care is being given on the decision of finance policy practiced by management of firms at the time of decisions related to investments. Throughout the globe investors do

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not provide concern for the payment of dividend by organizations but they are also considering the amount of undistributed profit that businesses retain for further investments. It means that they are also concerned about the profits that businesses retain (Yemi & Seriki, 2018).

In past finance literature was widely concerned on dividend payouts and the way it affects the stock prices (Harkavy, 1953; Hackbarth, & Johnson 2011; Chughtai, Azeem & Ali, 2014; Wright, 2014; Kanwal, 2012). Yet, the impact of retained earnings on various other factors, such as; per share cash dividend, gain or loss of capital, return on stock etc, are unused, hence required to be further researched. Recently, scholarly attention is placed on distinct role that can be played by retained earnings at the time of predicting future cash flows through investing and major reason for this attention lies within the notion that retained earnings carries ability predict future cash flows. Yusof & Ismail, (2016), says that dividend has a positive role in investment and financing decision. It is very vital to realize the factors of dividend policy that have an effect on the shareholder wealth.

In past there is a lot of research conducted in industrial countries on the policy of dividends and its implication on prices of stock but there is a very less amount of works available within developing marketplaces. Hunjra et al., (2014) have stated that there is a substantial need to study impact of the policy of dividend and various other variables such as ROE on stock price, due to the fact that Pakistani economy is relatively unstable. Hence, a gap arises in the financial literature that provides focus on the outcome of dividends being paid on the prices of stock particularly in the selected sector.

REVIEW OF LITERATURE

Ofori-Sasu, Abor, and Osei, (2017) discussed that the dividend policies have an impact on the shareholder/value of the firm but he also said that firms should engage in growth opportunities and future investment decisions because that in long run increases the firm's value. They also discussed that when there are more taxes imposed that firm's tries to retain their dividends and it also signals that not paying dividends does not decrease the shareholder value.

Baker, Kapoor, & Jabbouri, (2018) examined the dividend policy in India and the behavior of organized stakeholders to the dividends. They concluded that the dividends are taken as a most important aspect by the stakeholders in determining their investment decisions also keeping in mind the effect of taxes but not the liquidity. Also discover a innovative signal of positive relation amongst the inflation and dividend payments

Yusof, & Ismail, (2016) in their paper said that the dividend impacts the firm value in a lot of ways like if they are paying too much dividends then they may be compromising many internal wealth and if they are paying less dividends then they will be compromising external wealth that we may also termed as the firm's reputation. It has been found that there is some research that is being done on this topic worldwide and this area is still unexplored and some international studies has also been done on the topic that will provide support to this paper.

Chenchehene & Mensah, (2015) recommended in their paper that there should be some research done on this topic in future. They recommend that companies should not raise the size of their firm just with the purpose to increasing investors' wealth. Furthermore, the debt and investments should be controlled using precaution. Also, the management should involve investors in their decision making and it will give them a sense of ownership and they will be persuaded that the management will profit them.

Ansar, et al., (2015) studied dividend policy and shareholder wealth. The sample used consisted of a mix of companies from the textile, cement and chemical sectors. The testing technique used to analyze to sample was regression and it was inferred that the dividend policy has a strong positive correlation with the investor's wealth.

Faraz et al., (2017) also concluded in their paper that shareholder wealth is affected by the dividend policies. They searched on dividend plan and stockholder's capital: evidence from Pakistan cement sector. The research was conducted in 2015 in Pakistan. In this paper dividend was independent variable though shareholder wealth, lagged prices per share, ROE, retained earnings were taken as dependent variables. The tests which were applied in this research are descriptive statistics, regression analysis and correlation coefficient test. The outcomes of study discovered that 49.37% variant in shareholder's capital is because of transformation in independent variables. It additional discovered that LAGMP, REPS and DPS, have statistically optimistic significant rapport with MPS. Outcomes

confirms the fact about, capital of stockholders is significantly linked to its dividend plan in cement zone of Pakistan.

Hamza, & Hassan, (2017) studied the listed companies of NYSE & AMEX. They analyzed in their paper that the earnings of shares are not affected by the payout there remains the stability whether the companies are paying or not paying and the stockholders more look into the stock gains rather than payout policies. They suggested that there should also be future researches done on this topic by increasing the data and duration of the holding time.

The FMCG sector of India was studied for dividend policy and shareholder wealth. It is also one of the largest sectors of India and discussing it Azhagaiah and Gejalakshmi, (2015) says that those who pay consistent dividends having a rising trends effects in growing market value of the share and all of the FMCG sector will imply the similar results.

Setiawan, Bandi, KeePhua, and Trinugroho, (2016) discussed in their paper while studying dividend policy and ownership structure. They said that the multinational companies practice the laws in the host country extensively. They have better governance and transparency as they have to make their reputation good. So, they said that the multinational companies might pay higher dividends to the shareholders.

Sharma & Grover, (2015) analyzed the dividend policy, capital structure and investor's wealth. In their study they analyzed that dividend policy and capital structure have an impact on shareholder wealth and EVA method is used for that. Economic Value Added (EVA) is the income that is left to the company after they have paid their cost of capital. So basically the income left is left for the shareholders' value creation. That's why it is said that when the EVA is positive it is considered a good sign. They used a sample of 30 firms' from the stock exchange's 5 years data and applied regression technique. Their result showed that the shareholder wealth is impacted by 40% from the dividend policy and capital structure of the firm.

Kajola, Adewumi, and Oworu, (2015) concluded in their paper that dividend is very crucial for the investor and also the investors not only invest in corporations that pay high dividends but also they withdraw their investment from the one not paying and reinvest in those paying dividends. They analysed that firm pays to the shareholders when their profitability is increased. So always there is some kind of information signalling involved

The firm's main objective is to increase its shareholders wealth and in doing so it requires great governance, ethics and management. A manager should always work for the shareholders well-being and this practice in long run will also keep the agency problem at a bay (Frankel et al, 2018). They concluded in their paper that the manager should work for the best interest of the shareholder but with that he may also keep his interest too as this will allow him to work more motivated if he will think that his wealth is also increasing under the boundaries of law.

Farrukh, et al., (2017) conducted the research in Pakistan. The research commends the execution of constant, efficient and effective, well managed and goal-oriented dividend strategy by company's financial executives alongside with efficient and effective managerial framework administered by capital marketplace controlling bodies to enrich organization performance and stockholders capital in Pakistan. Also, suitable firm revelation with respect to dividend expenditure and dividend per share is required to lookout the potential financiers in creating the right investing opportunities in listed companies. The major goal of this study is examining the outcome of payout strategy on company's growth and that of stockholders' value. All the 51 companies from stock exchange of Pakistan index were sampled for the time series 2006–2015 by take on shared perpetual effect model. Regression findings define that dividend strategy is positively associated with share price and earning per share. Furthermore, dividend strategy is also significantly surely connected with return on equity. Grounded on the finding, these variables of stockholders wealth are reliable with the bird in hand philosophy, clientele effect concept and philosophy of free cash flow. Findings acquired for dividend strategy are reliable with signaling effect concept. They also concluded that the Pakistani market is full of competition and it's very tough to keep going successfully without struggling. They concluded that if they want to keep their share prices going upwards and create the shareholder value then they should keep on giving good and even dividends

De Cesari, and Huang-Meier, (2015) summarized that past and present information about many variables is helping firms to predict the forthcoming payout policy and whether it's a public or private firm its beneficial for both. Sharif, Adnan & Jan, (2015) studied the relationship between

stock prices and dividends and their analysis concluded that the firms should continue to pay normal dividends and that will results in a rise in share prices also the increasing reserves could a decline in the share prices.

Lashgari and Ahmadi, (2014) say dividend has great importance for the shareholder and it indicates them that they are following a good corporate governance policies their findings said that the payments has a negative impact on the share price volatility rather it's growing assets of the firm that has positive relation. Ndung'u, Simiyu, Galo and Mbogo, (2014) said in their paper that just dividend announcements increase the price of share and stocks and the investors react to it by purchasing more stock of that share and thus resulting in an increase in the price of the market of the share.

Baker and Jabbouri, (2016) studied the manager's perspective to the dividend policy and found a relation between the share price and the firm's capital's cost. Their survey stated that the firms have to keep poise between the payouts and the growth plans in order to increase the investor's capital. They stated in their findings that the utmost key things affecting the dividend plan are the stable earnings over the years and the arrangement of the dividends.

Hooi, Albaity, and Ibrahimy, (2015) discussed Malaysian listed companies and they concluded that there are several factors that have an impact on policy of dividend as if the corporation is planning expansion plans in the future. Also if the shareholders have the knowledge and facts about the earnings and disbursements related to the dividends then they can do better with their wealth and take decisions accordingly

If we look at the Pakistan Stock Exchange from year 2008 to 2018 there are many phases in which its performance varied from worst to excellent but there were some shares that remained consistent and kept giving on dividends and sometimes also retained. Zainudin, et al., (2018) said that dividend and share volatility has a negative relation that means the shares that give good dividends has a stable price and are less volatile.

Rehman, Zaman, and Mian, (2014) worked on Factors of Payout Policy of dividend. There was a single dependent variable, dividend payout ratio and several independent variables like firm growth, asset tangibility, firm size and firm profitability. The outcomes of this study showed that, tangibility and growth are negatively correlated towards dividend payout. But Profitability and Size is positively correlated towards dividend payout. The Growth, Tangibility and Profitability are statistically correlates insignificant. This study also shows that, their insignificancy actually affecting the dividend disbursement in non-financial businesses of Pakistan. In the whole descriptive variables the profitability was extremely insignificant. This shows that, this variable has a superior effect on the company's dividend disbursement and size is statistically substantial. And the hypothetical signs of those associations specify that; business theory gives the superior trustworthy evidences than others dividends disbursement concept like; pecking order concept, in explicatory the factors of dividend disbursement plan in non-financial businesses of Pakistan. This research was fundamentally started for the aim to practically assess the factors of dividend disbursement that effect the corporation's dividend percentage in stock exchange of Karachi registered Non-financial companies of Pakistan. The trade-off concept mainly enlightened the dividend disbursement plan activities in the KSE Non- financial companies.

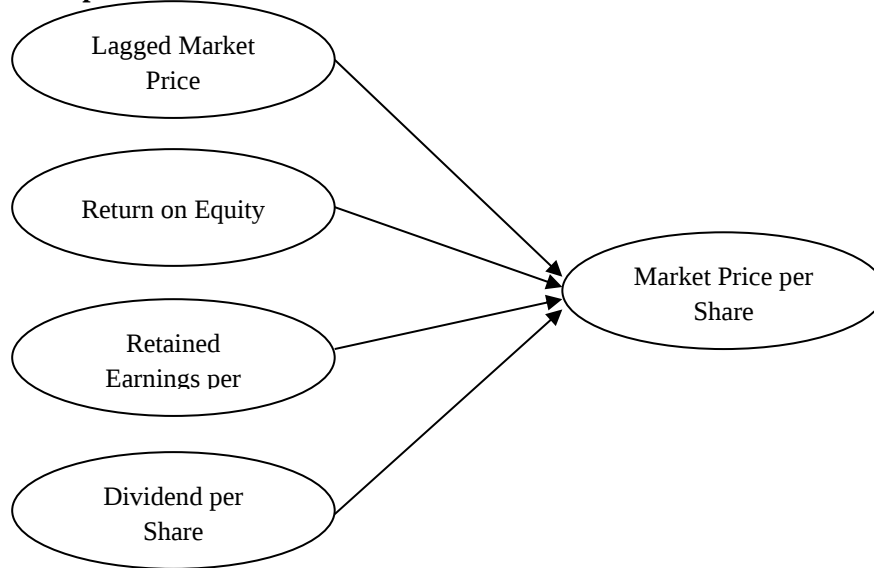
Nadeem, Bashir, and Gulzar, (2018) discussed many theories about dividend policy in their study and their relation with the performance of the Pakistani Banks. They took the panel data of 10 years from 24 Pakistani Banks and the regression test was applied on it. Their result confirmed the following and application of various dividend theories in the Pakistani Banks plus they also stressed that the earnings growth, future investment projects and the past payouts have an impact on the policy of the Banks related to dividends

A research was conducted by Magnusson and Enebrand, (2018) on Swedish Market. Their motive was to find out whether the dividend payment influences company's performance and its share price. To analyze it they took different variables from 10 years and correlation and regression was applied. Their results showed that the share prices and the dividend payments are more dependent on the firm's performance and a positive relation was found between the performance and share prices. They also presented the Bird in Hand theory in their findings saying that the investor also takes the high dividend firms better than the low dividend firm.

Salman, (2019) surveyed the top management in the 8 companies for the years 2017 and 2018 asking them questions about the shareholders and the management relations regarding the dividend policy, their agency issues and decision making related with dividend payments. The researcher said

that through dividends we can measure the satisfaction level of the shareholder and the situation of the company. From the context of the investor the dividend paying firms has a stable position in the market as well as in the eyes of shareholders

Conceptual Framework



We have adopted the research model from Ansar et al, (2015). In this model there are four independent variables Lagged Market Price Per Share, Return on Equity, Retained Earnings per share and dividend per share and one dependent variable that is the Market Price per share. In our research we are calculating the shareholder wealth through the Market Price per share. When the Market Price per share increases it indicates the demand and overall satisfaction level of the shareholders for a share of a company.

Hypothesis Statement

- H1.** There is an impact of dividend per share on market price per share
- H2.** There is an impact of retained earnings per share on market price per share
- H3.** There is an impact of return on equity on market price per share
- H4.** There is an impact of lagged market price on market price per share

METHODOLOGY

Sample

The sample was Top Performing companies of Pakistan Stock Exchange that it announces every year. Similarly this year too PSX announced the Top performing companies based on their cost-effectiveness, market capitalization, their relations with the investors, corporate governance and their abidance by the listing rules and regulations by the securities exchange. All data of 25 firm's would have been taken but 3 companies among them are less than ten years old so in order to avoid unbalanced data, the top 22 companies have been taken. Total numbers of observations that are going to be part of this study are 220. Annual data for last 10 years (2009 to 2018) 22 selected companies have been analysed to scrutinise the hypothesized model. The main sources of collection the data were the financial statements of the companies, keeping in mind our dependent and independent variable. Also there were other sections i

The Top performing companies that are the part of sample are

1. Fauji Fertilizer Company Limited
2. Unilever Pakistan Foods Limited
3. Lucky Cement Limited
4. Nestle Pakistan Limited
5. Golden Arrow Selected Stocks Funds
6. ArifHabib Limited
7. International Industries Limited
8. Sui Northern Gas Pipeline Limited

9. Habib Bank Limited
10. Colgate Palmolive Pakistan Limited
11. Atlas Honda Limited
12. Kohinoor Energy Limited
13. Mari Petroleum Company Limited
14. The Hub Power Company Limited
15. Millat Tractors Limited
16. Shifa International Hospitals Limited
17. Al Ghazi Tractors Limited
18. United Bank Limited
19. Meezan Bank Limited
20. Atlas Battery Limited
21. Murree Brewery Company Limited
22. Bank Al Habib

Nature Of Research

This research is quantitative in nature as our data is all numbers and will be analysed on E-views that is statistical software. In order to determine the impact of proposed independent variables on dependent variable, correlation and regression analysis is applied.

Here in this study multiple regressions are being applied. The mathematical model is provided below;

$$MP = b_0 + b_1 (DPS) + b_2 (RE) + b_3 (ROE) + b_4 (LMP)$$

Where;

Market Price per Share = MP

Dividend per Share = DPS

Retained Earnings per share = RE

Return on Equity = ROE

Lagged Market Price = LMP

RESULTS AND DISCUSSION

Correlation Analysis

The table given below shows the correlation analysis between our variables. The research model that we are using in that the independent variables are ROE, REPS, DPS and LMPS. Whereas the dependent variable is MPS. So according to the research model and the correlation analysis performed. It can be seen that there is a strong positive correlation between ROE & MPS (i.e. 0.6), positive correlation between REPS & MPS (i.e. 0.5), and a perfect correlation between DPS & MPS and LMPS & MPS (i.e. 0.86 and 0.95) respectively. So before applying the regression analysis to our variables it is determined that there is a positive relation between all the independent and the dependent variables.

Table No. 1

	ROE	REPS	MPS	LMPS	DPS
ROE	1.000000	0.058130	0.606850	0.559309	0.586175
REPS	0.058130	1.000000	0.512285	0.521590	0.455731
MPS	0.606850	0.512285	1.000000	0.951836	0.864412
LMPS	0.559309	0.521590	0.951836	1.000000	0.849478
DPS	0.586175	0.455731	0.864412	0.849478	1.000000

Talking about the data that was collected from the annual reports of Top performing Companies of Pakistan Stock Exchange, It is quite obvious that it doesn't belong to one sector and it is a mix of many companies belonging to different industries. Therefore before applying the regression analysis the stationarity is checked for all the independent and dependent variables through the ADF Unit Root test.

The ADF test for the ROE show that the calculated value is greater than the tabulated value hence we reject the null hypothesis. The ROE variable is stationary and does not have a Unit Root.

ROE (Return on Equity)**Table No. 2**

		t-Statistic	Prob.*
		-	
Augmented Dickey-Fuller test statistic		10.08747	0.0000
	1%	-	
Test critical values:	level	3.460173	
	5%	-	
	level	2.874556	
	10%	-	
	level	2.573784	

The ADF test for the DPS shows that the calculated value is greater than the tabulated value hence we reject the null hypothesis. The DPS variable is stationary and does not have a Unit Root.

DPS (dividend Per Share)**Table No. 3**

		t-Statistic	Prob.*
		-	
Augmented Dickey-Fuller test statistic		5.921452	0.0000
Test critical	1%	-	
values:	level	3.460453	
	5%	-	
	level	2.874679	
	10%	-	
	level	2.573850	

The ADF test for the MPS shows that the calculated value is greater than the tabulated value hence we reject the null hypothesis. The MPS variable is stationary and does not have a Unit Root.

MPS (Market Price per Share)**Table No. 4**

		t-Statistic	Prob.*
		-	
Augmented Dickey-Fuller test statistic		5.624945	0.0000
	1%	-	
Test critical values:	level	3.460739	
	5%	-	
	level	2.874804	
	10%	-	
	level	2.573917	

The ADF test for the REPS show that the calculated value is greater than the tabulated value hence we reject the null hypothesis. The REPS variable is stationary and does not have a Unit Root.

REPS (Retained Earnings per Share)**Table No. 5**

		t-Statistic	Prob.*
		-	
Augmented Dickey-Fuller test statistic		4.122184	0.0011
	1%	-	
Test critical values:	level	3.460313	
	5%	-	
	level	2.874617	
	10%	-	
	level	2.573817	

The ADF test for the LMPS show that the calculated value is greater than the tabulated value hence we reject the null hypothesis. The LMPS variable is stationary and does not have a Unit Root.

LMPS (Lagged Market Price per Share)**Table No. 6**

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	5.614138	0.0000
Test critical values: 1% level	3.460884	
5% level	2.874868	
10% level	2.573951	

Regression Analysis**Table No 7**

Dependent Variable: MPS

Method: Least Squares

Date: 07/14/19 Time: 12:03

Sample (adjusted): 2 220

Included observations: 219 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	262.8686	70.32143	3.738102	0.0002
ROE	4.683709	1.004119	4.664497	0.0000
DPS	12.96852	1.469673	8.824086	0.0000
REPS	3.754267	0.872825	4.301281	0.0000
LMPS	0.425693	0.040533	10.50225	0.0000
R-squared	0.864041	Mean dependent var		792.6559
Adjusted R-squared	0.861500	S.D. dependent var		1933.751
S.E. of regression	719.6576	Akaike info criterion		16.01799
Sum squared resid	1.11E+08	Schwarz criterion		16.09537
Log likelihood	-1748.970	Hannan-Quinn		16.04924
F-statistic	340.0008	Durbin-Watson stat		1.109242
Prob(F-statistic)	0.000000			

The regression analysis is performed in the table given above. And the results shows all the variables i.e. ROE, DPS, REPS and LMPS have come to be significant (< 0.05) which means that we reject the null hypothesis. The shareholder wealth is affected by all the variables in the model. The R-squared and the adjusted R-squared indicates that the 86% of variation in the shareholder wealth i.e. MPS is caused by the independent variables in the research model. The independent variables define the dependent variable by 86%. Also the model is also suited for the population as the probability for F statistics has also come to be significant. (< 0.05).

Therefore we reject the null hypothesis and the regression output provides strong evidence to let accept the alternate hypothesis. So we can state that

- H1.** There is an impact of dividend per share on market price per share
- H2.** There is an impact of retained earnings per share on market price per share
- H3.** There is an impact of return on equity on market price per share
- H4.** There is an impact of lagged market price on market price per share

The mathematical model used is as follows

$$MPS = b(1) + b(2)*DPS + b(3)*REPS + b(4)*ROE + b(5)*LMPS$$

From the regression output it can be inferred that with one unit increase in Dividend Per Share the Market Price per Share increases by 12.97, with one unit increase in Retained Earnings per Share the Market Price Per Share increases by 3.75, with one unit increase in Return on Equity the Market Price per Share increases by 4.68, and the last with one unit increase in Lagged Market Price per share the Market Price per share increases by 0.43.

The most important factor that contributes to the Shareholder wealth (MPS) in the model that is used is the Dividend per Share and the least variable that contributes to the Shareholder wealth is the Retained Earnings per Share.

The estimation equation derived from the model is;

$$MPS = -262.87 + 12.97 * DPS + 3.75 * REPS + 4.68 * ROE + 0.43 * LMPS$$

CONCLUSIONS & RECOMMENDATIONS

This research was conducted to find out the impact of dividend policy on shareholder's wealth and the sample was made from the top performing companies of Pakistan Stock Exchange. From the data analysis conducted we can conclude that the shareholder wealth measured by the Market Price per share is affected by all the variables.

The research model came to be statistically significant sample wise and also fit for the population statistics. The sample companies were the top performing companies of PSX. However there were some limitations as far as the sample size is concerned as the 10 years data is taken in this paper and among top 25 companies 3 companies are not old enough for being analyzed for ten years. If in future we take a large sample consisting of more years of observations and a more diverse sector the results could signal other possible factors. Also the number of variables can also be increased for example tax effect can also be added further and then analyze its impact on the shareholder wealth. One more important variable of dividend policy is the dividend payout ratio isn't included in the research model can be also added. The variable taken to measure the shareholder wealth that is Market Price per Share came to be statistically significant, but Earning per Share can also be taken to measure it. Also in future small cap companies or low performing companies can be taken as a sample and analysis can be done on how they work for overall shareholder wealth.

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