An Analysis of Dividend Policy and Market Value of Listed Manufacturing Companies in Sri Lanka

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Abstract : It is in the light of this that dividend decision ought to be evaluated with the aim of maximizing the value of the firm to its shareholders through market price of the shares and the current dividend. Shareholders' wealth is represented in the market price of the company's common stock, which, in turn, is the function of the company's investment, financing and dividend decision. The study is an attempt to study dividend policy and market value of listed manufacturing companies. For the study purpose nineteen companies eight years data are drawn. Analysed results explores that dividend policy of the companies does not influence on market value and at the same time market value also does not granger cause dividend policy. Therefore the study consist with Irrelevance theory.

Keywords : Dividend policy, Market value , Dividend pay out and Dividend per share, Share price, Earning Volatility, Asset Growth Debt to Equity and Size

Introduction

The Dividend Policy is one of the financial decisions that refer to the proportion of the company's earnings to be paid out to the shareholders. Earnings retain of the company and the Dividends payments are major duties of a Financial Manager. High (low) pay-out means a low (high) retention ratio. Those firms seek new capital from the market, distribute earnings largely. Others rely on retain earnings for the company expansion. According to the Gunathilaka (2009) Sri Lankan firms rely on retained earnings; retained more than 70% of their earnings over five years 2001-2005. Further researcher finding express Sri Lankan firms have no constant dividend payments; successive dividends show a negative relationship .therefore the firms use dividend as a signalling device and maintain the market. But based on Miller and Modgliani, (1961) arguments the Dividends are irrelevant, further dividends policy have no influence on the share price.

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From researchers point of view, Shareholders desire dividend and managers pay dividends to mollify investors. DeAngelo and Skinner, (1992) express that the current income remains a critical determinant of corporate dividend policy and regulatory constraints, investment magnitude, debt and firm size also affect dividend policy. Managerial views of dividend policy are essentially unchanged number of decades; dividends are paid because shareholders expect continued dividend growth. Managers believe that dividend payments are necessary to maintain.

Problem statement

Dividend policy is a debatable topic in the financial management. There have been many studies which have looked at the relationship between dividend policy and profitability. Myron Goldon(1959) and John Lintner (1956) developed the bird in the hand theory . They argued that there was a relationship between dividend payout and the firm's value. Since investors value capital gains as risker than dividend, firms have to have a higher dividend payout ratio to maximize the share price. In other words, high dividend payout would improvements the stock price. Miller and Modigliani(1961) investigated the impact of dividend policy on share price of the firm .They exhibited that given a perfect capital market, a firm's dividend policy would not impact the firm's value. Glen (1995) found that dividend policies in emerging markets contrasted from those in developed markets significantly. They reported that dividend pay-out ratios in developing countries were only about two thirds that of developed countries and low dividend yields exist in emerging markets. In countries like Sri Lanka equity of companies are not widely held. Therefore the research addresseshow far dividend policy impact on Market Value and what extent Market value influence on Dividend policy?

Research question

Research question of the study are as follows:

- How far dividend policy impact on Market Value?
- How far Market Value impact on divided policy?

Research objective

Objectives of the study are:

- To investigate what extent dividend policy impact on Market value.
- To examine what extent market Value impact on Market value

Literature Review

GejaLakshmi,. S and Azhagaiah,R (2015) their results proved that DPS and RPS had significant positive co-efficient on EPS before global financial meltdown of FMCG firms in India. DPS LAGPER and LAGMPS had significant positive co-efficient on EPS after global financial meltdown of FMCG firms in India. Hence, it was inferred from the results that the shareholders' wealth was dependent on the DPS, RPS, Lagged price earnings ratio, and Lagged market price per share. On the whole, the results revealed that the selected variables viz DPS, RPS, LAGPER and LAGMPS had significant impact on earnings per share (SW)

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Azhagaiah, R and Sabari Priya,N (2008) analysed Impact of Dividend Policy on Shareholders' Wealth in Organic and Inorganic Chemical Companies in India during 1996 –1997 to 2005-2006. They found that, wealth of the shareholders is greatly influenced mainly by five variables viz., Growth in Sales, Improvement of Profit Margin, Capital Investment Decisions (both working capital and fixed capital), Capital Structure Decisions, Cost of Capital (Dividend on Equity, Interest on Debt) etc. As far as the dividend paying companies were concerned, there was a significant impact of dividend policy on shareholders' wealth in Organic Chemical Companies. Even though as far as the Inorganic Chemical Companies were concerned, Shareholders' wealth was not influenced by the dividend payout.

In outline with Lintner's study a research was carried out by Baker (2002) The study investigated the corporate managers of NASDAQ firms that regularly pay cash dividends to determine their insights on dividend policy and the relationship between dividend policy and firm value to observe how they view dividend policy. The sample size was 188 firms. The main result of the survey indicated that NASDAQ managers believed that dividend policy affects firm value as reflected in shares price, and concluded as dividend policy matters .Further findings point out that more than 90 percent of managers agreed that a firm should gap increasing its regular dividend if it expects to reverse the dividend decision in a year or so. The firms should attempt to maintain stable dividend payment. Furthermore, the Baker et al (2002), revealed that the majority of managers thought that the market places greater value on stable dividends than stable pay-out ratios. More than 60 percent agreed that the firm should set a target dividend pay-out ratio and periodically adjust its current pay-out toward the target.

Rimza .S and Nadia. N(2014) study results shows that Earnings per share and dividend per share had positive impact on shareholders' wealth further they added The dividend paying companies had positive impact on their internal shareholders and outsiders called investors to invest in bulk due to the strong economic condition of company. Therefore it proved that dividend paying companies show strong economic condition. They recommended that investors prefer bird in hand type of dividend policy and The accounting standard bodies like international chartered accountants enforce standards on dividend policies

Fathia AR., and Mohamed Abdullah M.A(2014) The results of the study revealed that there was a significant relationship between dividend payout and corporate profitability in terms of return on assets, return on equity and earnings per share. A positive significant relation was found between dividend payout and return on assets and return on equity for the whole sample while significant negative relationship was found between dividend payout and earnings per share as far as the dividend paying sample was concerned

Werner-Ria Murhadi(2008) finding indicated that signaling theory still relevant in influencing movement of share price. Besides, research finding also supported agency theory developed by Jensen in seeing influence of free cash flow to share price. For the influence of structure of ownership to share price, the result supported entrenchment argument. While influence of structure of ownership to dividend policy found by result which do not support agency theory. Life Cycle theory in this research is obtained by result which is research confirmation before all, where there are influence of cycle step of company life to dividend policy.

Dewasiri N J and Weerakoon Banda Y K(2014) study results revealed that cross section random effect model revealed that there was a significant negative impact from dividend payout, a significant positive impact from company size and no evidence of significant impact from dividend yield on stock price volatility. Granger causality tests revealed that there is no short term impact from dividend payout on stock price volatility and it showed a feedback exist between company size and stock price volatility in any lag level. findings suggested that, high dividend payout would lead to less volatile stock price, whilst higher dividend yield pave the way towards more volatility in stock price in the short run.

Dharmarathne, D.G (2013) analyzed stock price reaction to subsequent dividend announcements and information efficiency in Sri Lankan Share Market with a sample of 61 major companies from those listed on the Colombo Stock Exchange (CSE), which had made 137 dividend announcements for the period of 1999-2005. study employed that event study methodology. More specifically, it employed the market model in generating abnormal returns surrounding subsequent dividend announcements. Findings show that there was a considerable informational content of dividend announcements in Colombo Stock Exchange. Overall, this research study results indicated that there was a considerable informational content of dividend announcements in Colombo Stock Exchange. The investors consider dividend announcements as favorable news. The results in this study supported with the semi-strong form of the efficient capital market hypothesis; that is, on the average, the stock market adjusts in an efficient manner to new dividend information.

Hussainey , Chijoke and Aruoriwo M (2011) analyzed the relationship between share price volatility and dividend policy in UK. They selected 123 English companies and the period of their study was from 1998 to 2007. Their work was based on Baskin (1989) and Allen and Rachim (1996), used multiple regression analyses to explore the association between share price changes and both dividend yield and dividend payout ratio. Their results revealed that a positive relationship between dividend yield and stock price changes and a negative relationship between dividend payout ratio and stock price changes. In addition, their results show that firm's growth rate, debt level, size and earnings explain stock price changes. Their study supported the fact that dividend policy was relevant in determining share price changes for a sample of firms listed in the London Stock Exchange and further they suggested to managements/accountants to improve the quality of the financial statements (i.e. income statement) to avoid producing wrong information which could lead to wrong decisions by investors.

Waithaka, John Karanja N, Jonah Kipkogei A, , Itunga, and Kirago,P(2013) The study concluded that higher pre-tax risk adjusted returns associated with higher dividend yield stocks to compensate investors for the tax disadvantages of returns affected tax incentives and that investors whose portfolios had low systematic risk preferred high-pay-out stocks.The study also found out that an increase in firms' stocks trading volume affected the share price The study further concluded that free cash flow caused conflict between management and shareholders which in turn affected the share price and that the executive option plan persuaded management to reduce corporate dividends by an amount that was equal to the option plan. The study recommended that companies consider all pertinent issues before issuing dividends. Since the share market was positively responsive to the dividend announcement, companies should always strive to pay divided consistently for their shares to perform well at the stock exchange.

Sumninder and Prabhjot 2013 examined impact of Dividend Policy on Shareholder's Wealth. For this study purpose secondary data had been collected from Prowess database of CMIE of the selected companies in india for the period of time frame 2006-2010.panel data methodology had been applied analysis results revealed stated that the dividend paying companies were concerned; there was a significant impact of dividend policy on shareholders' wealth in IT sector companies.

Zuriawati,Joriah and Abdul (2012) evaluated divided the data to 3 stages starting from pre-crisis (2005 – 2006), during crisis (2007 – 2008) and post crisis (2009 – 2010) in Malaysia . This study analysed the data based on the least square regression method by using E-views software. Analysed results explored there was a significant positive relationship between the Dividend payout ratio(DPR) of a firm and share price volatility. Dividend yield was insignificant and negatively related to the movement of stock prices. Their finding suggested that, higher DPR will lead to a more volatile share prices.

Abdullah Al Masum(2014) examine "Dividend Policy and Its Impact on Stock Price – A Study on Commercial Banks Listed in Dhaka Stock Exchange ",for this study purpose data were drawn from thirty commercial banks listed in Dhaka Stock Exchange (DSE) for the period of five years from 2007 – 2011. The study results shows that the empirical estimation based on the Fixed Effect and Random Effect Model show significant negative relation between Dividend Yield and Stock Price while Retention Ratio had a negative but statistically insignificant relationship with Stock Market Prices. further shown that Return on Equity and Earnings per share have statistically significant positive impact on stock price and Profit after Tax has a significant negative impact on Stock Market Prices of the commercial banks of Bangladesh .

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Methodology

Conceptualization

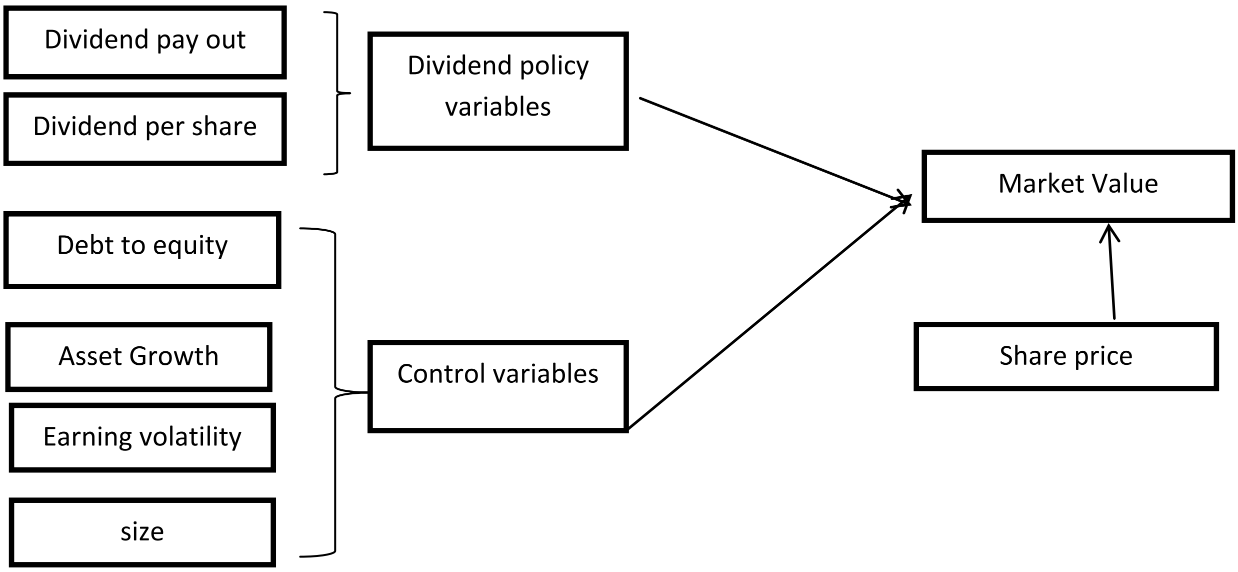

Figure 1. Conceptualization

Table 1 Measurement of Variables

Concept	Variable	indicator	Measurement
Dividend policy variables	Dividend per share	Total distributable income divided by no of share	$\frac{\text{Profit after tax \& interst}}{\text{No. of share}}$
	Dividend payout	Dividend per share divided by earning per share	$\frac{\text{Dividend per share}}{\text{Earnings per share}}$
Control Variables	Earning volatility	Current Earnings Per share minus previous Earnings Per share divided by previous Earnings Per share	$\frac{(EPS_1 - EPS_0)}{EPS_0}$
	Debt to equity	Total debt divided by total equity	$\frac{\text{Debt}}{\text{Equity}}$
	Assets growth	Total Assets for the year minus total assets for the previous year divided by total assets for the previous year	$\frac{(TA_1 - TA_0)}{TA_0}$
	size	Natural Log Value of the Total Assets	Log_{10} (TA)
Firm value	Share price	Fiscal year price	Market value

Hypotheses

Following hypothesis formulated for the study

H1: there is significant relationship between dividend policy and market value

$Sp= \beta_0 + \beta_1 DPS+ \beta_2 DP+ \beta_3 AG+ \beta_4 S+ \beta_5 EV+ \beta_6 DE+\varepsilon$…………….. 1

Where DPS = Dividend per share ;DP = Dividend payout; S = size ; EV= earnings volatility and DE= debt to equity

H_{2a}: Dividend policy granger cause market value

H_{2b}: Market value granger cause dividend policy

Sampling & data collection

Nineteen listed Manufacturing companies eight years data are drawn on random sampling method.The research focus on secondary data collection method therefore data are drawn from annual reports which are published in Colombo stock exchange web site.

Data Analysis and Discussion

Table 2 Regression Analysis

Dependent Variable: SP
Method: Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.210095	5.749168	0.732296	0.4654
DPS	1.306971	0.158849	8.227777	0.0000
DPO	-5.314851	1.329793	-3.996752	0.0001
DEBT_EQUITY	0.023716	0.120636	0.196595	0.8445
EARNINGSVOLATILITY	0.052920	0.093924	0.563433	0.5742
ASSET_GROWTH	6.02E-05	0.000816	0.073777	0.9413
SIZE	0.176047	0.630327	0.279294	0.7805

R-squared	0.377524	Mean dependent var	7.636434
Adjusted R-squared	0.346911	S.D. dependent var	7.966406
S.E. of regression	6.437966	Akaike info criterion	6.615038
Sum squared resid	5056.583	Schwarz criterion	6.770222
Log likelihood	-419.6700	Hannan-Quinn criter.	6.678092
F-statistic	12.33194	Durbin-Watson stat	1.102996
Prob(F-statistic)	0.000000		

Table 2 also shows that there is an impact of dividend policy on share price and the percentage is determined to be 37.75%. The coefficient for each explanatory variable reflects both the strength and type of relationship with dependent variable. The positive or negative sign of the relationship indicates whether the relationship is positive or negative. Above table 2 shows that there is Negative relationship between dividend pay-out and the share price and positive significant relationship between the dividend per share andthe share price. There is a positive significant relationship between earning volatility, asset growth, size Debt to equity and share price. Therefor Research can reject (H1).

Granger Causality Analysis

Table 3 Granger causality test of Dividend policy ganger cause Market value (Share price)

Dependent variable: SP

Excluded	Chi-sq	df	Prob.
DPS	0.685317	2	0.7099
DPO	0.061070	2	0.9699
All	1.071460	4	0.8988

Above table 3 express ganger causality test whether dividend policy ganger cause market value (Share price). From the output, the value of the test statistic of DPS is .0685 and DPO is 0.0611and the associated pvalue is greater than 0.05(p>0.05). So Researcher reject H_{2a}, which means that dividend policy doesn't cause Market value.

Table 4 Granger causality test Granger causality test of Market value (Share price)ganger cause dividend policy variable (DPS and DPO)

Dependent variable: DPS

Excluded	Chi-sq	df	Prob.
SP	2.866374	2	0.2385
DPO	4.885659	2	0.0869
All	5.824339	4	0.2127

Dependent variable: DPO

Excluded	Chi-sq	df	Prob.
SP	5.249671	2	0.0725
DPS	38.22416	2	0.0000
All	42.02442	4	0.0000

Above table 3 express ganger causality test whether cause market value (Share price) ganger cause dividend policy variables. From results express, the value of the test statistic of SP is2.863, 0.073 and theassociated pvalue is greater than 0.05(p>0.05). So Researcher can reject H_{2b} which means that Market value does not ganger cause Dividend policy.

Conclusion

The study is an attempt to reveal whether dividend policy impact on Market value of Listed Manufacturing companies in Sri Lanka. For the study purpose eight years data were drawn. Analysed results shows that dividend policy has 37.75% impact on market value (share price) and there is Negative relationship between dividend pay-out and the share price and positive significant relationship between the dividend per share and the share price. There is a positive significant relationship between earning volatility, asset growth, size Debt to equity and share price .Therefor Researcher can reject (H1). Ganger causality analysis results shows that the value of the test statistic of Dividend per share is .0685 and Dividend payout is 0.0611and the associated pvalue is greater than 0.05(p>0.05). So Researcher reject H_{2a}, which means that dividend policy doesn't cause Market value. Value of the test statistic of SP is 2.863,0.073 and the associated pvalue is greater than 0.05(p>0.05). So Researcher can reject H_{2b} which means that Market value does not ganger cause Dividend policy. Therefor this study consist with Irrelevance theory.

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