IMPACT OF DIVIDEND POLICY ON SHAREHOLDER WEALTH IN PAKISTAN (EVIDENCE TEXTILE INDUSTRY PERSPECTIVE)

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ABSTRACT

This study examines the impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period of 2001 to 2010. The study intends to provide thorough information to the investors in the textile sector of Pakistan. A sample of fifty textile listed companies was selected from Karachi Stock Exchange and statistical tools like mean, standard deviation and multiple regression models were used by taking market price per share as dependent variable whereas dividend per share, dividend payout, earning per share, price earning, lagged value of market price and lagged value of price earning were used as independent variables. Market price per share is considered as proxy for shareholder wealth. The results shows that all the independent variables used in the study have a direct relation with the market price per share. Earnings per share, price earning, lagged value of price earning and lagged market value have highly significant impact on market price per share, whereas dividend per share and dividend payout have a significant impact at five percent on market price per share. The findings also reveal that dividend policy of the firm has positive impact on stock price of the firm. Therefore it is concluded that dividend policy has significant impact on shareholder wealth in the textile sector of Pakistan. The paper provides sound practical implications for professionals regarding dividend policies and attracts investors towards growing and attractive investment.

Keywords: Market price per share (MPS), Dividend per share (DPS), Dividend payout (DPO), Price earning (PE), Earning per share (EPS).

INTRODUCTION

Dividend refers to the sum of money paid on a regular basis by a company to its shareholders out of its profits or reserves (Baker, 2009) While dividend policy refers to the practice of management making payment decision or cash distributions from profit to shareholders over time (Lease, John, Kalay, Loewenstein, & Sarig, 2008).It is considered as a puzzle in the field of finance since long ago and has been thoroughly examined by previous researchers to know the impact of dividend policy on shareholder wealth. There are different reasons offered in the support of dividend payment; these are addressing organization problems (Fluck, 1998), eliminating organization conflicts (Grossman & Hart, 1980) and risk to minority shareholders in the firms controlled by strategic stakeholders (Shleifer & Vishny, 1986).

It has been thoroughly examined to understand the relationship between dividend policy and shareholder wealth on national and international level. This study examines the impact of dividend policy on shareholder wealth in textile sector of Pakistan for longer period to provide thorough information to the investor during the period from 2001 to 2010. The study intends to highlight the relationship between dividend policy and stock price of the firm. Further, the study will provide a thorough information to investor related to textile sector of Pakistan which will help them to increase investment in the textile sector of Pakistan.

Textile industries play an important[1] role in the economic development of the Pakistan and are considered as the major export and are deemed that textile sector play vital role in the growth of the country. As textile sector is the main contributor in the economy of Pakistan, it is the main driver of foreign currency earning and job creation during the last 50 years. Its contribution to the total GDP of Pakistan is about 9 percent and provides employment to 15 million people. Pakistan textile industries have shown great effort during 2005 to 2007. But later it has shown 11.1 percent decline in 2008 is due to financial and economic meltdown. It is the major export of Pakistan. Pakistan textile exports to the total world trade are 1.88% in 2001, 2.01% in 2004, 2.23% in 2005, 2.15% in 2006, 1.91% in 2007, and 1.81% in 2008.

This study intends to determine the impact of dividend policy on shareholder wealth in textile sector of Pakistan and impact of dividend policy on stock price of the firm for a longer period (2001-2010). Investors in the textile sector need thorough and accurate information, so this study will provide thorough and accurate information to investors about the impact of dividend policy. The period of the study is focused because variation of export and its trading took place in the textile sector during this period up to a great extant. The textile sector showed its strength and boom investment during the period from 2003 to 2007 but due to global economic and financial crises in 2007, affected the sector very badly. As a result, the trading and export volume of textile companies decreased which effected the income and dividend payment of the textile companies. This study therefore, empirically analyzes the impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period from 2001 to 2010.

LITERATURE– DIVIDEND POLICY

Dividend is a payment made by a firm to shareholder, usually from profits (Sullivan & Sheffrin, 2003) while dividend policy refers to the decision making method of a firm regarding dividend distribution. Both dividend and dividend policy are subjects of economic interests and are dubious subjects in corporate finance due to its severe impact on internal and external stakeholders. Black (1976) considers it is a puzzle like pieces of picture which does not fit together. Brealey, Myers, and Myers (2003) count dividend policy in top ten puzzles in finance. Dividend policy is the method and rule through which shareholder

[1]As textile sector is the main contributor in the economy of Pakistan and it contributes 8.5% to the total GDP of Pakistan.

are paid. They argue three types of policies for the payment of dividend to shareholder; these are residual, stability and hybrid method.

Dividend policy is relevant to some scholar while it is irrelevant to some finance scholar as well (Ref).The main argument for the relevance and irrelevance of dividend policy is the existence of perfect and imperfect market. According to (Black & Scholes, 1974; Miller & Modigliani, 1961) dividend policy does not affect shareholder wealth in the perfect capital market. The reason is that when shareholders are paid more dividends; they reinvest the extra cash and when they are paid less dividend then they can only fulfill their basic needs by selling extra shares. But the existence of perfect market is very rare. Due to unavailability of perfect markets dividend policy is given preference and is considered as much relevant. Gordon (1963) argue that dividend is always given preference over capital gain as containing risk for investor and is relevant and important for the firm.

On the other side Azhagaiah and Priya (2008)argues that dividend plays key role in terms of shareholder wealth because it affects the shareholder wealth positively.(Ahmed & Javid, 2008) found that increase in the size of initial payment lead to increase in excess return of the firm. (Dilawer, 2012; Kaleem & Salahuddin, 2006;Nitta, 2006)also argue that dividend payout boosts shareholder value. According toCheong, Lim, Poon, Tan, and Yap (2011) there is relevance of dividend policy in the stock price determining. Dividend policy have positive while investment opportunities have no influence on the stock price(K. I. Khan, 2012; Murhadi, 2008).

Fracassi (2008) found that increase in dividend has positive impact on stock price because increase in dividend signals that agency problem is reduced and earning of the firm will be high in future. According toMehr-un-Nisa (2011)the stock price are greatly affected by the dividend payment while the relation between retained earnings and stock price is weak. (Akbar & Baig, 2010) foundthat stock price is positively affected by the dividend announcement either in the form of cash or stock. (Nazir, Nawaz, Anwar, & Ahmed, 2010)found that stock price is significantly affected by the dividend yield and dividend payout. While (Dilawer, 2012; Hashemijoo, Mahdavi Ardekani, & Younesi, 2012)argues the relationship between share price volatility and two measurements were significant negative. Chung, Elder, and Kim (2010) argues significant co-integration between dividend and stock price.

Nissim & Ziv (2001) argue that a firm having more opportunities for investment presents a positive response to share price. (Brav, Graham, Harvey, & Michaely, 2005; Kaleem & Salahuddin, 2006) also found positive relationship between dividend policy and stock price. According to Ferris, Sen, and Yui (2006) have impact on stock price. Ajinkya and Jain (1989) also found that after the payment of dividend the relationship between dividend yield and stock return was significant. Dividend payout was used as an independent variable because it plays a key role in the determination of dividend policy.

Waithaka, Ngugi, and Kirago (2012) argues that the Price Earnings ratio, Earning per Share growth and sale growth are positively related with dividend payout while profitability and debt to equity are negatively related with dividend payout. Farooq, Saoud, and Agnaou (2012) argue that stock price volatility and dividend payout ratio are negatively related while market adjusted return and dividend payout ratio are positively related in the stable growth period. According toZhou and Ruland (2006) the relationship between dividend payout policy and earning management was negative. Waithaka et al. (2012) found that all independent variables relate negatively to the dividend payout policy. Campbell and Shiller (1988)supplied complete information of dividend payout and dividend policies and suggested researchers to develop new theories or modify the existing views and proposed that maintaining the level of dividend on par with investment decision after the investment spending repurchase are done out from the residual cash flows. Investors want to invest in those companies which show better performance in the market and firm performance can be measured through dividend payment of the firm to their shareholder. Both cash and stock dividend are given preference by the individual investor in Pakistan and Greece(Maditinos, Sevic, Theriou, & Tsinani, 2007). Dividend payment present firm prosperity and performance, Sharma (2001)argue that dividend initiation signals firm prosperity and firm prosperity can be increased by increasing dividend rate.Zhang, Farrell, and Brown (2008)foundhigher returns of dividend paying companies as compared to non-dividend paying companies.

Corporate governance has impact on dividend policy; because good governance lead to firm prosperity and for that the firm have to pay dividend to its shareholder(Butt, Hunjra, & Rehman, 2010; Kato, Loewenstein, & Tsay, 2002). They argue positive and significant relationship between organizational performance and financial management. Booth and Zhou (2008) argue that market power has positive impact on dividend policy because more market power lead to pay more dividend which show better performance in future and low risk. According to Ouma (2012)dividend payout and the performance of the firm have a strong positive relationship. Lang and Litzenberger (1989) Investigated that if dividend policy change can provide information about the firm future earning, then dividend initiation have strong impact on shareholder value.

Grullon, Michaely, and Swaminathan (2002) argue that dividend provide information about the alteration of the firm, the result also present that it is the indication of the firm maturity when the firm is going to increase dividend. White (1996)focused two types of companies that is high growth companies and low growth companies, the companies having high growth have low dividend payout and debt ratio while low growth companies have high dividend payout and debt ratio.Vieira (2008) found that change in dividend present signal to the market and face adverse market reaction to dividend change announcement. There are a large number of factor which affect decision of the firm regarding dividend payment. More investment opportunities, ownership structure and shareholding inside in majority are the determinant factor of dividend payout policy(Ahmed & Javid, 2008). The perception of management about the current and future earning level and liquidating constraints like cash availability and availability of project having positive NPV are the main determinant factor. Butt et al., (2010) argues that firm size, profitability, sale growth earning per share and dividend per share are the main factors which determine the decision of dividend policy in engineering sector of Pakistan. Asifi, Rasooll, and Kamal (2011)argues that financial leverage affect dividend policy and have a negative relationship between them; it was also found that earning change does not affect dividend policy in Pakistani firms. According to the study of A. Khan, Kaleem, and Nazir (2012)there exists a relationship between market value and dividend policy of the firm. While Farsio, Geary, and Moser (2004)argue that relationship between earnings and dividend policy are not significant in long run.

ANALYSIS AND RESULT

To study the impact of dividend policy on shareholder wealth in the textile sector of Pakistan, data of 50 listed companies in Karachi stock exchange from textile sector were selected. This data was empirically analyzed through suited statistical tools like mean, standard deviation and multiple regression models, to find out the impact of dividend policy on shareholder wealth. Table one give complete information about dependent and independents variable and also about their computation. Table two explains descriptive statistics of dependent and independent variable while correlation between variables is explained in table three. The last table presents the result of the empirical model.

The result shows that four variables namely price earning, earning per share, lagged market value and lagged value of price earning are highly significant and two variables dividend per share and dividend payout are significant at five percent to the dependent variable. From analysis it is concluded that dividend policy have positive impact on shareholder wealth. Increase in dividend of the firm will lead to increase the shareholder wealth of that firm and vise versa.

Table 1: Variables used

	Dependent variable	**Abbreviation**	**Measurement**
1	Market price per share	MPS	Closing price of the company share at the end of December annually
	Independent variable		
1	Dividend per share	DPS	Total dividend divided by number of shares outstanding

2	Price earnings ratio	PE	Market price per share divided by earning per share
3	Earnings per share	EPS	Income after tax divided by number of share outstanding
4	Dividend payout ratio	DPO	Cash dividend was taken as proxy for dividend payout ratio
5	Lagged market price	MPS_{it-1}	Taking log of market price per share
6	Lagged price earning	Pe_{t-1}	Taking log of price earnings ratio

Table 02 gives the descriptive statistics of dependent and independent variables. The mean value of market price per share (MPS) is 40.00779 million rupees having maximum and minimum values 776.6400 and 0.490000, respectively. The median and standard deviation of market price per share (MPS) are 15.5000 and 77.28417 respectively. Column 3rd represents the earning per share (EPS) having mean value of 5.117699 million rupees with maximum and minimum values of 356.8712 and -222.8280 respectively, the standard deviation and median of the earning per share (EPS) are 24.28940 million rupees and 1.669946 million rupees respectively.

The mean value of dividend payout (DPO) in column 4th is 10.85155 percent which has a maximum value of 200.0000 and minimum value of 0.000000 percent respectively, the dividend payout (DPO) has standard deviation of 17.30549 and median of 5.000000 percent respectively. Dividend per share (DPS) in column 5th show its mean value of 2.796569 million rupees which has a maximum value of 281.2243 million rupees and minimum value of -0.525519 respectively, while the standard deviation and median of dividend per share (DPS) are 16.38281 million rupees and 0.101054 million rupees respectively. Column 6th which represent the lagged market price per share (MPS_{it-1}) has a mean value of 2.781349 million rupees which has a maximum and minimum values of 6.654977 million rupees and -0.713350 million rupees.

Table 2

	MPS	**EPS**	**DPO**	**DPS**	**MPS_{it-1}**	**PE**	**PE_{t-1}**
Mean	40.00779	5.117699	10.85155	2.796569	2.781349	10.27130	1.455260
Median	15.50000	1.669946	5.000000	0.101054	2.740840	4.666919	1.511072
Maximum	776.6400	356.8712	200.0000	281.2243	6.654977	478.6315	6.170931
Minimum	0.490000	-222.828	0.000000	-.525519	-0.71335	-65.3709	-.417994

Std. Dev	77.28417	24.28940	17.30549	16.38281	1.360442	39.22639	1.416683
Skewness	5.423906	5.349758	4.086722	13.26989	0.010643	6.656154	0.211218
Kurtosis	42.03216	111.0993	34.82315	203.0200	2.814315	75.43091	3.172724

Respectively, the median value of market price per share (MPS_{it-1}) is 2.740840 million rupees while the standard deviation of market price per share (MPSit-1) is 1.360442 million rupees respectively.

The mean value of price earning (PE) is 10.27130 having maximum and minimum value of 478.6315 and -165.3709 million rupees, while the standard deviation and median of price earning (PE) are 39.22639 and 4.666919 million rupees respectively. Lagged price earning (PE_{t-1}) in column 8th has a mean value is 1.455260 which has a maximum and minimum value of 6.170931 million rupees and -3.417994 million rupees, the standard deviation and median of lagged price earning (PE_{t-1}) are 1.416683 and 1.511072 million rupees respectively.

Table 03 explains the correlation between the variables. Column 2 gives the correlation between market price per share (MPS) and its independent variables. For example, the correlation between market price per share (MPS) and earnings per share (EPS) is 0.154749. Similarly column 3 shows the correlation between earning per share (EPS) and other variables. For example, the correlation between earnings per share (EPS) and dividend payout (DPO) is 0.518846. dividend payout (DPO) in column 4th present the correlation relationship between dividend payout (DPO) and other variable like the correlation between dividend payout (DPO) and market price per share (MPS) is 0.266131. Same is the case in column 5th which show the correlation between dividend per share (DPS) and other variable, for example the correlation between dividend per share (DPS) and earnings per share (EPS) is 0.695560.

Table 3: Correlation Matrix

	MPS	EPS	DPO	DPS	MPS_{it-1}	PE	PE_{t-1}
MPS	1.000000	0.154749	0.266131	0.142161	0.678318	0.337557	0.297742
EPS	0.154749	1.000000	0.518846	0.695560	0.192978	-0.013249	-0.114722
DPO	0.266131	0.518846	1.000000	0.678270	0.413669	-0.029834	-0.070789
DPS	0.142161	0.695560	0.678270	1.000000	0.151153	-0.031837	-0.179831
MPS_{it-1}	0.678318	0.192978	0.413669	0.151153	1.000000	0.157308	0.385888
PE	0.337557	-0.013249	-0.029834	-0.031837	0.157308	1.000000	0.602996
PE_{t-1}	0.297742	-0.114722	-0.070789	-0.179831	0.385888	0.602996	1.000000

Lagged market price (MPS_{it-1}) in column 6th which explain the correlation relationship between lagged market price (MPS_{it-1}) and other variable like the correlation between lagged market price (MPS_{it-1}) and price earning (PE) is 0.157308. . In the same case column 7th present the correlation relationship between price earning (PE) and to the rest of variable like the correlation between price earning (PE) and market price per share (MPS) is 0.337557. The lagged value of price earning (PE_{t-1}) in column 8th show correlation relationship with other variable, for example the correlation between lagged value of price earning (PE_{t-1}) and lagged value of market price per share (MPS_{it-1}) is 0.385888

Table 04 givesresults of the empirical model. Four variables namely earning per share (EPS), lagged value of market price (MPS_{it-1}), price earnings ratio (PE) and lagged value of price earning (PE_{t-1}) are significant to the dependent variable, market price per share (MPS) is highly significant while dividend payout (DPO) and dividend per share (DPS) are significant to market price per share (MPS) at five per cent. Result of the empirical model further shows that if earning per share (EPS) is increased by one million rupees then the market price per share (MPS) would be increased by 0.327444 million rupees by keeping other variable constant, similarly if one percent increase in dividend payout (DPO) take place then the market price per share (MPS) will be increased by 0.436649 million rupees when other variable are kept fixed.

Table 4: Results of empirical model (MPS is dependent variable)

Variable	Coefficient	Std. Err	t-Statistic	Probability
C	-100.37	6.59038	-15.22977	0
EPS	0.327444*	0.13971	2.343674	0.0084
DPO	0.436649**	0.21231	2.056687	0.0113
DPS	0.437588**	0.24655	1.774852	0.0171
MPS_{it-1}	40.55194*	2.2365	18.13185	0
PE	0.643322*	0.07825	8.221589	0
PE_{t-1}	9.168740*	2.41268	3.800226	0.0002

Where; *, ** show significant at 1 percent and 5 per cent respectively.

R-squared	0.533167	Mean dependent var	40.00779
Adjusted R-squared	0.527307	S.D. dependent var	77.28417
S.E. of regression	53.13493	Akaike info criterion	10.79787
Sum squared resid	1349547.	Schwarz criterion	10.85826
Log likelihood	-2611.484	Hannan-Quinn criter.	10.82160
F-statistic	90.98679	Prob(F-statistic)	0.000000

The result further present that market price per share (MPS) will be increased by 0.437588 million rupees when dividend per share (DPS) is increased by one million rupees by keeping other variable constant, in the same way when one million rupees increased are brought in Price earning (PE) then the market price per share (MPS) would be increased by 0.643322 million rupees when the rest of variable are held unchanged. Result of the study further shows that all the independent variable namely dividend per share (DPS), dividend payout (DPO), price earning (PE), earning per share (EPS), lagged value of price earning (PE_{t-1}) and lagged value of market price per share (MPS_{it-1}) relate positively to the dependent variable which market price per share (MPS).

DISCUSSION

The company profit may either be kept in the company as retained earnings or it may be distributed among shareholder as dividend. Dividend policy is the method and procedure through which shareholder are paid. Dividend policy plays an important and key role in the field of finance because it affects investor and claimholder within the organization. Market price per share (MPS) has been used as a proxy for the shareholder wealth and is considered as a dependent variable for the study. Dividend per share (DPS), dividend payout (DPO), earning per share (EPS), price earning (PE), lagged value of price earning (Peit) and lagged value of market price (MPSit) were used as independent variable for the study. The data used in the study are secondary and obtained from Karachi stock exchange. The statistical tools like mean, standard deviation and multiple regression models were found to be best fitted and used in the study for analysis. Theoretically all the independent variables has positively related to dependent variable.

Through empirical evidence we found that dividend policy have positive impact on shareholder wealth. This result is consistent with the findings of (Asquith & Mullins Jr, 1983). The study also found that shareholder wealth can be increased through dividend policy and found consistent with the findings of (Lopez de Silanes, Vishny, & Shleifer, 2000; Zhou & Ruland, 2006) while inconsistent with the findings of (Black & Scholes, 1974; Dewenter & Warther, 1998; Miller & Modigliani, 1961). We found out that there is significant impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period from 2001 to 2010. Increase in dividend lead to increase the market price per share of the firm which increase shareholder wealth while decrease in dividend lead to decrease in the market price per share of the firm which decrease shareholder wealth. Therefore it is suggested to textile industries of Pakistan to increase the dividend as it will increase market price per share and ultimately it will increase the wealth of investors. Thus it will attract more investors in the said firms.

The study further found that dividend policy affects the stock price of the firm positively and the stock price of the dividend paying companies were found to be high as compare to the non-dividend paying companies. This result is consistent with the findings of (Chung et al., 2010; Fracassi, 2008; K. I. Khan, 2012; Smith Jr & Warner, 1979;Walter, 1963). The result further showed that stock price of firm can be increased if the firm show better performance in the market and firm performance can be measured through dividend payment of the firm. Dividend paying companies are found to perform best in the market as compare to non dividend paying companies. so for high stock price the performance of industry is necessary. The result of our study are consistent with (Barclay & Smith, 1999; Butt et al., 2010; Grullon et al., 2002; Sharma, 2001;Zhou & Ruland, 2006). Dividend payment increase firms performance which ultimately increase investors for a firm and thus the price of the stock increases.

SUMMARY AND CONCLUSION

The research was conducted to find out the relationship between dividend policy and shareholder wealth and also to find out the impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period from 2001 to 2010. Textile sector was selected for the study because it is the main contributor and play a key role in the economy of Pakistan. So it was the keen desire to work on this sector and to provide thorough information to investors related to textile sector of Pakistan.

Market price per share (MPS) has been used as a dependent variable and is also considered as a proxy for measuring shareholder wealth. Dividend payout (DPO), dividend per share (DPS), earning per share (EPS), price earning (PE), lagged value of market price (MPS_{it-1}) and lagged value of price earning (PE_{t-1}) were selected as independent variable for the study. Annual cash dividend of the selected textile companies were used as a proxy for the dividend payout (DPO) while earning per share (EPS) is calculated as profit divide by outstanding share.

Generally market value of the share increased whenever dividend of the company are increased and when the company dividend are decrease, the market value of the share also decreased, dividend is the most important factor and it present information about the company performance. Payment of the dividend shows that the company has the capacity of earning, Shareholder like salaried individual, retired pensioners and other whose income are limited give preference to current dividend as compare to future income.

From the analysis it is clear that the independent variable like earning per share (EPS), price earning (PE), lagged value of price earning (PE_{t-1}) and lagged value of market price per share (MPS_{it-1}) have significant impact on market price per share (MPS) at one percent while dividend per share (DPS) and dividend payout (DPO) have the significant impact on market price per share at five percent. The result shows that there is significant impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period from 2001 to 2010.

LIMITATION OF THE STUDY

The study has analyzed the impact of dividend policy on shareholder wealth in the textile sector of Pakistan during the period of 2001 to 2010, so it is important to point out the limitations of the study.

The findings of the study are restricted only to time period of 2001-2010. So due to global financial and economic crises the results may be prejudiced. Other limitation of the study is the sample size. For further researchers are suggested to study said phenomenon with great depth by taking large sample size and taking others variables as well.

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