Determinants of Dividend Policy and Its Role: Empirical Evidence in Textile Sector of Pakistan

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Abstract:
Purpose: The purpose of this study is to find out the relationship between dividend policy and its factors focusing the Textile sector of Pakistan. There is a positive as well as negative relationship exists between determinants and dividend policy. **Design**: The data of this study is gathered from the financial statements of textiles companies of Pakistan. The sample of one hundred and ten companies is used from the period 2009 to 2014(www.kse.com.pk). The relationships are computed by regression results like fixed effect and random effect. Dividend Policy is taken as a dependent variable and leverage, profitability, liquidity and free cash flow are taken as independent variables. **Findings**: The results of this study show a positive relation between dividend payout policy and profitability because if the company' earning per share is high then it will pay dividend to its shareholders. There is positive relation between free cash flow and dividend payout policy and negative relation between dividend policy and liquidity and leverage of the firms.**Research Limitation and suggestions**: The findings of the study are limited because there are many others factors that affect the dividend policy. I have taken only four variables like leverage, profitability, liquidity and free cash flow between dividend policy. More studies can be conducted to explore others factors that affect the dividend policy and its role.
Keywords: Leverage, Profitability, Liquidity, Free Cash Flow, dividend Payout

Introduction and Background of the Study
Normally Companies make profit and decide what to do with their profit. Companies in normal circumstances have two types of Options. Firstly, they can retain their profit for further investment and secondly they can pay out to their shareholders. After deciding about dividend they must establish a fairly permanent dividend policy. Dividend policy put a lot of impact on investors and company's future planning and perception in the financial Market. Dividend is a form of profit which is given to the shareholders of the company in case of any surplus amounts paid to any preference shareholders.

It depends on various circumstances and condition as to whether give shareholders profit on their respective portion in capital of the company or utilize the profit for investment purpose. Many theories have emerged during various times highlighting as to whether a company should pay shareholders or to invest its earnings. Theories such as (Lintner, 1956) were the first on the topic of distribution of dividend. (Miller & Modigliani, 1961) presented a theory known MM supporting the idea of about dividend.

Bhattacharya (1979) found that Investors are Likely to receive profit on the number of share heldby them. It is indeed a great responsibility and effective decision making strategy regarding the earnings of the company.

Iturriaga and Crisóstomo (2010) done a research on listed companies of Brazilian from 1995 to 2004 to find out the relation between leverage and dividend payout policy and its impact on growth. Normally shareholders feel hesitation to make an investment in such a firms having great risk.

John and Muthusamy (2010) conducted a research in Indian paper mill and found relationship between leverage and dividend payout policy. In this study dividend payout policy is taken as dependent variable. Earnings per share and growth and market value of firms are taken as an independent variables. We also got Earnings per share and Price earnings ratio are negatively associated to dividend payout ratio and the outcome is contrary to the 1 previous studies. The outcomes of this study propose that the leverage is negatively linked with dividend payout out ratios.

Abor and Fiador (2013) conducted research in Ghana and found that companies tend to pay dividend when the external financing having low cost. Normally investors are more interested to make an investment when company uses low debt in capital structure.

Akyildirim, Güney, Rochet, and Soner (2014) characterized the ideal profit arrangement and demonstrate that these two macroeconomic components have contradicting impacts: taking all things into account, firms disseminate more profits when interest rates are high and less when issuing expenses are high.

Imran (2011) had done a study in Pakistan engeenring sectors using data from financial statement of engeenring companies to find out the role of dividend in this sector. He taken listed companies in Karachi Stock Exchange. Dividend payout policy is taken as dependendt variable and cash flow, dividend per share and profitability are taken as an independent variables. Dividend payout has positive relation with each variables like profitability, dividend per share and cash flow.

Uwuigbe, Jafaru, and Ajayi (2012) done a study to find the impact of financial performance on dividend policy in Nigeria. They checked the relationship between ownership structure, dividend policy and size of the firms. Regression analysis is used to find out the results of this study. There were fifty companies taken to this study. Data is used from 2006 mto 2010. There is a positive significant relation between performance of the firms and dividend policy.

Investment decisions are influenced by various factors such as market conditions, shareholders expectations and share value of the company. However, currently studies also show a relationship between financing decision, investment decision and pay out decision.

1.1. Dividend

A part of net income which is distributed among the shareholders is called dividend.

1.2. Types of Dividend

Following are the types of Dividend.

1.3.1. Cash Dividend

In the form of cash when dividend is paid to shareholders of the companies called cash dividend. Company does not want to give dividend in the form of Stock dividend. The interests and incentives of manager and shareholders clash over such issues as the ideal size of the firm and payment to shareholders (Bhattacharya, 1979). In this study we are focusing on cash dividend.

Ahmad, Abbas, Iqbal, and Ullah (2014) found that empirical findings suggest that Tunisian investors respond to firms that distribute cash dividends among share holders. Tunisian managers face tough situation because investors give more response to cash dividend.

2.1. Literature Review

Literature review is presented to explain the factors on which a dividend policy is based upon which is presented by various researchers. Linter was the first to present theory regarding dividend policy which was supported by (Fama & Babiak, 1968). A theory known as MM theory coined by Millen and Modigliani in 1961 explained the idea of perfect market, the dividend is not affected by firm value, shareholders are not interested in receiving personal cash flows in term of dividend as a capital gain depending upon the fact that firm didn't changed the investment policies.

Cash‐flow position is also a vital determinant of profit payouts. A poor liquidity position implies less liberal profit because of lack of money. (Massey et al., 1993) reveal that profit installments depend all the more on money streams, which mirror the organization's capacity to pay profits, than on current income, which are less intensely affected by bookkeeping practices. They assert current income don't really mirror the company's capacity to pay profit.

Back ground of the study

A study was directed by (Hashemijoo, Mahdavi Ardekani, & Younesi, 2012).This study demonstrated critical negative relationship between offer value instability with two primary estimations of profit approach which are profit yield and profit payout. In addition, a noteworthy negative relationship between offer value unpredictability and size is found. In light of discoveries of this study, profit yield and size have most effect on offer value unpredictability amongst indicator variables. A study was led on the relationship between influence and profit payout by (Hashemi & Zadeh, 2012). This study indicates there is a significance full and negative connection between financial influence and profit strategy also there is an importance full and positive connection between working income, size of organization and profit strategy. This experimentally explores the factors that focus the dividend payout choices among This experimentally explores the factors that focus the dividend payout choices among banks. For exact investigation the information of sixteen banks recorded in the Karachi Stock Exchange (KSE) are utilized. The outcomes show that winning per share, a year ago's dividend payouts, capital proportion and size of the bank are urgent factors in the determination of dividend payouts, while cash flow is negatively connected with dividend payouts banks. For exact investigation the information of sixteen banks recorded in the Karachi Stock Exchange (KSE) are utilized. The outcomes show that winning per share, a year ago's dividend payouts, capital proportion and size of the bank are urgent factors in the determination of dividend payouts, while cash flow is negatively connected with dividend payouts.

Jensen and Meckling (1976) gave the concept of the (Agency theory) which was dependent on the work differences between managers and shareholders. An investigation regarding the collision of the agency conflict which might exist between the managers and shareholders, the theory specified that the ratio of equity restricted by the insider ownership. After that period of time these were many researcher have been completed. These subjects have been presented and a vast majority of them are mixed describing the situation and the time for the payment of dividend. It is asserted after the study of various theories is that the essential factors are policies for dividend six that are adopted worldwide .

The arrival on speculation can be isolated in capital addition and profit payouts. It is a troublesome assignment for administration to distribute an adequate sum in both sections, particularly to keep from organization issues. The organizations pay profits just when enough sums have subsequent to meeting their necessities and short term needs. The reason for the present study is to exactly examine the variables focus the profit payout choices on account of Pakistan's building segment by utilizing the information of thirty-six organizations recorded on Karachi Stock Exchange from the period 1996 to 2008. By utilizing different board information strategies like altered and irregular impacts, the outcomes propose that the past profit per offer, income per offer, productivity, income, deals development, and size of the firm are the most basic components deciding profit approach in the building area of Pakistan.

A study conducted by (Ajanthan, 2013).The primary purpose of this study is to figure out the relationship between profit payout and firm gainfulness organizations in the Colombo Stock Exchange (CSE). Relapse and connection investigation were done to set up the relationship between profit payout and firm gainfulness. The discoveries showed that profit payout was a pivotal component influencing firm execution (R = 0.725 & R2 = 0.526). Their relationship was likewise solid and positive. This along these lines demonstrated that profit strategy was pertinent. It can be finished up, taking into account the discoveries of this examination that profit strategy is important and that supervisors should give sufficient time in planning a profit strategy that will upgrade firm productivity and in this way shareholder esteem.

Bird in the hand theory gives the idea that the shareholders want the dividend in the form of cash rather waiting for future payment and another theory was presented by the (Baker & Wurgler, 2004) indicating that the manager should give motivation to the shareholder who can satisfy their wants and demands. This relates to give smooth dividend to shareholders.

(Bhattacharya, 1980) with the help of Easterbrook (1984) described the concept of Agency cost trouble by presenting the types of agency. The first being cost controlling and second cost of risk avoidance. In (T. H. Lee et al., 1985) mentioned the asymmetric data of shareholder and the mangers of the distribution of information inside the company. Prices of stock will be the factors that will be affected to the payments of dividend.

The study was conducted by (D'souza & Megginson, 1999) which depicted the relation between the policy of a international firm and investing opportunity with agency cost and market risk, 349 worldwide companies were used for analyzing. The result obtained via using the multiple regression models. they found insignificant relationship between investment opportunities for the world wide firms and dividend policy. This study didn’t support previous findings of negative relationship between investment opportunity and dividend policy but supported negative results of market risk and agency cost on dividend payouts.

Lintner models was used in (2004) by the Omit to find the trend of Jordon capital market via using DPSIT depending upon EPSIT and explanatory variable as DPSIT-1 total 44 Jordon based companies that were registered on Amman securities market (ASM) The analysis give the opinion that the company should follow a stable dividend policy. it also suggested that the dividend of the listed concern is not effected the least by dividend per share and tax burden on dividend

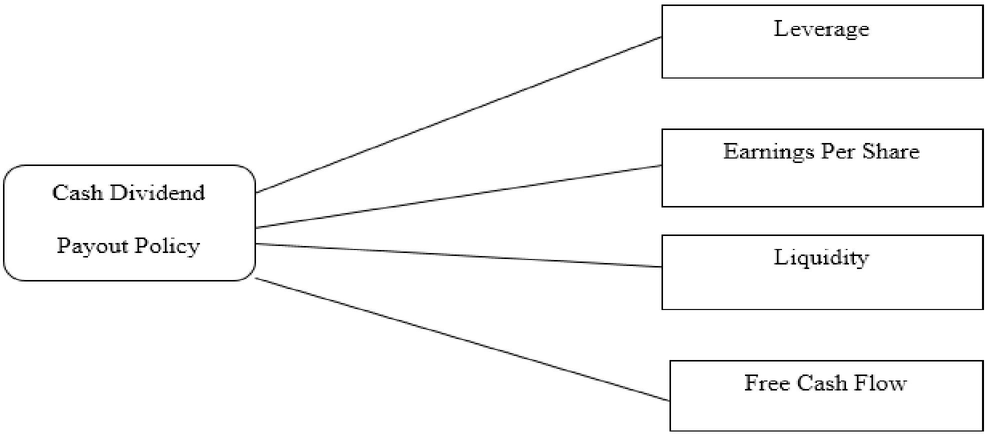
Myers and Bacon (2004) theory gave important clue. It was stressed by them that company wanted to increase the debt to use it in finance in order to increase the dividend to pay `out a strong message to the business owners to manage the access to capital along with the aim of increasing repute of the firm. In (J. Lee, 2004) suggested that agency cost and dividend policy. this study explained the causes why the company should payout dividends. Results showed that the relation between the ratio of earned equity with that of the equity controlling growth, leverage, size of the firm, profitability and history of dividends with it.

Mitton (2004) gave the concept that firms are able to payout dividends only with strong corporation governance and harmony to models of dividend, 365 firms from 19 countries were taken under study. Negative relationship exists with the growth opportunities and dividend policy and it was in a firm position with reasonable governance. In the countries where strong investors was present resulted in a positive relationship between dividend payment policy and corporate governance.

DeAngelo, DeAngelo, and Stulz (2006) initiated a study regarding dividend policy and earnings via utilizing the capital mixed concept. It is generally considered that the ratio of the dividend declared by the nonfinancial organizations in much higher but depending upon a fact that they are in a better position to payout dividend when the retained earnings portions in a greater percentage with respect to the equity. In case of the equity being negative dividend is not paid out. They evaluated their theory by using the size of the firms' dividend payout ratio, along with the dividend history cash balances that caused to retained some parts of the earnings with commencement and the profit margins.

THEORETICAL FRAME WORK

It is Theoretical Frame Work of Dependent and Independent variables of this study. It shows expected relationship between dependent variable and independent variables.



H_1 = There is negative relationship between leverage and dividend payout policy.
H_2 = There is positive relationship between profitability and dividend payout policy.
H_3 = There is negative relationship between liquidity and dividend payout policy.
H_4 = There is positive relationship between free cash flow and dividend payout policy.

Regression Analysis

This section represents the empirical findings of relationship between dependent variable dividend payout and independent variable like leverage, profitability, liquidity and cash-flow in textile sector of Pakistan.

Table 01: Model Summary of Fixed Effects Model

Dividend Payout	Coefficient	Std. Error	P-Value
Leverage	-.0138	.0151	.362
Profitability	.1344	.0057	.000
Liquidity	-1.1125	.6133	.070
Free Cash flow	2.6364	1.0685	.014

Predictor (constant)= Leverage, Profitability, Liquidity, Free Cash flow
R- Square= .5138, F-Test= 0.0000

- R square value is .5138: It means that independent variables are explaining 51.38% to our dependent variable.
- F Test value is 0.0000: this value is less than .01 so that we can say that our model is fit.
- Coefficient Values show that change in independent variable like leverage, profitability, liquidity and free cash flow -.0138, .1344, -11.1125 and 2.6364 respectively will bring change in dependent variable up to 1%.
- Standard deviation shows the level of common errors.
- Probability values show the level of significance at which the dependent and independent variables of my study become significant.

Table 02: Model Summary of Random Effect

Dividend Payout	Coefficient	Std.Error	P-Value
Leverage	-.0100536	.0140	.475
Profitability	.143192	.0051	.000
Liquidity	.162790	.2874	.571
Free Cash flow	.583756	.1727	.001

Predictor (constant)= Leverage, Profitability, Liquidity, Cash inflow
R- Square: .5073

- R square value is .5073: It means that independent variables are explaining 50.73% to our dependent variable.

- Coefficient values show that change in independent variable like leverage, profitability, liquidity and free cash flow -.010056, .143192, .162790 and .583756 respectively will bring change in dependent variable up to 1%.
- Standard deviation shows the level of common errors.
- Probability values show the level of significance at which the dependent and independent variables of my study become significant.
- **Hausman Test Value** is less than .05. So we use **Fixed Effect Model of Regression** in this study.

Leverage has insignificant and negative relationship with dividend payout which was supported by Ahmad &Attiya (2009) Afza & Hammad 2010. The Expected relationship of leverage with dividend policy is negative. This relationship is supported by many researchers Gugler and Yurtoglu (2003) Zadeh, and Z.K. (2012) proved a negative relation of dividend policy and financial leverage and a positive relationship of size of company, operating cash flow, and dividend policy.

Manneh and Naser (2015) conducted study that shows outcomes of the analysis exposed that dividend policy is significantly and positively linked with the corporate profitability, free cash flows, risk, majority shareholders, size, and industry. However, dividend policy was significantly and negatively related with the corporate leverage level. Thus, this study confirms the agency theory.

Profitability has significant and positive relationship with dividend payout which was supported by Myer and Frank (2004) Ahmad and Attiya (2009) and Afza and Hammad (2010). A study conducted by Ajanthan (2013) shows findings indicated that dividend payout was a crucial factor affecting firm performance ($R = 0.725$ & $R2 = 0.526$). A significant positive relationship was also found. Liquidity has negative relationship with dividend payout policy. This proxy is used by many researchers in their studies. This study was supported by Reddy (2006) and Amidu and Abor (2006) and Belans et al (2007) Attiya and Ahmad (2009) and Omet (2010).

Recommendations:

It is necessary for the managers to make some decisions in textile sector of Pakistan in order to reduce the level of risk and increase the level of shareholders trust.

- Leverage is very important factor that affect the dividend policy. My study also shows a negative relation between dividend policy and leverage. So the management of the company takes decision very careful about using fixed cost (leverage) in capital structure. Capital structure of the company is composed by debt and equity. Equity shows that the part of investment which is made by owners. If the equity portion of the company is more then it stimulates the investors to make investment because company has low risk.
- Profitability has positive relation with dividend payout policy which is supported by my results. So the management should try to take such decisions that stimulate the earning per share of the company. If company pays dividend to its investors it will increase the market value of the shares because investors want cash dividend rather than reinvestment of the profit.
- Liquidity has negative relation with dividend payout policy. More liquidity ratio shows that company uses its retained earnings for further investment and does not pay dividend. So management of the company should maintain a middle level of liquidity ratio. Company's net income is used for two purpose like retained earnings and pay cash dividend to shareholders. More retained earnings increase the current assets. It shows that company does not pay dividend to its shareholders.

If the operating cash flow of the firms is more than financing cash flow than company should pay dividend to its shareholders. If the company meets its current obligations efficiently then it will pay dividend to its shareholders. On the other side if company pays more debt cost then it will not pay dividend to its shareholders.

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