

Relationship between Firm's Dividend Policy and Share Price Volatility

Muhammad Ans Hafeez

MS Business Administration National University of Modern Languages (NUML) Islamabad, Faisalabad Campus

Muhammad Kashif Khurshid

Lecturer Department of Management Sciences National University of Modern Languages (NUML) Islamabad, Faisalabad Campus

Abstract

This study has an aim to explain the relationship between firm's dividend policy and share price volatility. In this review paper critical literature review of sixteen papers related to dividend policy and share price volatility is done. There are difference of opinions about the impact of decisions related to dividend policy of any firm, that are they impact on the value of firm. One school of thought said that decisions related to dividend policy have impact on the value of the firm. On the other side the other school of thought said that decisions related to dividend policy does not affect the value of firm and per share market price. As per our consensus the Payout ratio, dividend yield and size of the firm would be negatively related to stock Price Volatility. On the other side earning volatility and debt would be positively related to stock price volatility.

Keywords: Dividend Policy, Share Price Volatility, Stock Price Volatility

Introduction

This Review paper analyzes the relationship between firms dividend policy and share price volatility. Lot of studies has been done on this topic in many countries to investigate the relationship among the share price volatility and dividend policy that how much it impacts on the prices of stocks. Shareholder always expects a high dividend from its investment and also with a growth in their investment in shape of capital gain, on the other side, companies also want to maximize the wealth of shareholder but they also want a growth in their business by investing in the profitable projects. So there are difference of opinions about the impact of decisions related to dividend policy of any firm, that are they impact on the value of firm. One school of thought said that decisions related to dividend policy have impact on the value of the firm. On the other side the other school of thought said that decisions related to dividend policy does not affect the value of firm and per share market price. Overall, this research attempts to find out a relationship between firm's dividend policy and share price volatility.

Background

Hashemijoo et al. (2012) investigated and showed negative significant relationship among dividend policy & share prices. Dividend yield & payout ratio measured as independent variables, they also include controlled variables Firm size, earning volatility, growth, leverage and debt. They took 84 companies as sample out of 142 companies which were listed in MSM. Multiple regression applied for study of the period from 2005 to 2010. Also study showed negative significant relation between price of shares volatility and firm size.

Masum (2014) examined the relationship between market price of share and dividend of the banks. For this purpose he took all the banks which were listed in Dhaka Stock Exchange. Study consist of a period from year 2007-2011. He took volatility in market price as dependent variable and DY, EPS, ROE, retention ratio and after tax profit as independent and control variables. He used multiple linear regression model for testing the data. Results of the study showed a significant positive effect of dividend policy on stock prices.

Al-Hasan et al. (2013) examined the effect of dividends on market share price in Bangladesh. Market value of share used as study variable and retained earnings of each share and dividend per share as predictor variables for study. Study covers 4 industries cement, automobile, pharmacy and textile. Seven companies from each industry and total twenty eight companies selected from all industries mentioned for the period of 2005-2009. Secondary data used for study. Secondary data was collected form annual reports of each company. Correlation, multiple regression and descriptive statistics used for data analyzing. F test used for testing hypothesis. Results of the study showed that dividend payment effected more than retention on market prices of shares.

Botchwey (2014) investigated the connection between dividend payments and share prices of 36 companies listed on Ghana Stock Exchange. For study purpose 60 respondents (shareholders) were selected randomly from total shareholders of 36 companies. Primary source data collected through questionnaires and secondary data collected from internet and journals. Descriptive analysis used for analyzing the data in form of different types of tables, charts and graphs. Study showed that share prices rises because of pressure on the share as the dividend of company's increases. Also study suggest that firms of high dividend payments have their

share prices going up due to the more demand of their shares. And firms with low dividends have share prices going down because of low demand.

Lashgari and ahmadi (2014) checked the association between share price changes and dividend policy in the stock exchange of Tehran. They select 51 companies listed during 2007 to 2012. Price changes as dependent and payout ratio, earning, leverage, size of firm and growth are used as independent variables. Compound data panel and multiple regression model used for testing data. Results showed a significant negative relationship among share price changes and dividend payout ratio. Study found that leverage, payout ratio and size of firm having adversely impact on share price volatility. But earning volatility and growth impacts directly on prices of stock.

Nazir and Abdullah (2012) studied the association between volatility of share prices and dividend policy of the firms of financial sector which were listed in Karachi Stock Exchange. They used 75 financial firms which were listed on KSE for a period of 5 year 2006-2010 as sample size. Price volatility as study variable and dividend yield & dividend payout as predictor variables. Also included assets growth, earnings volatility, leverage and size of firm as controlled variables. Regression equation used for testing the data. Study showed a significant negative relation among dividend yield and price volatility. Moreover same association showed between price changes and dividend payouts in KSE listed firms.

Duke et al. (2015) investigated the association among dividend policy and valuation of stock prices in Nigerian banks. Investigation was completed by utilizing data of 2 banks which were working in the Nigerian economy First was GT Bank and Second was United Bank Africa from year 2003 to 2013. The data was acquired from government agencies publications & internet. The data used for this study are retention ratio, market price and dividend yield. Retention ratio and dividend yield as predictor and market price used as study variables. They used two techniques for testing the data with the help of ordinary least squares and augmented dickey fuller test. Test were completed with the help of software's. The outcomes of the study showed that share price and dividend yield had a significant positive relation, also share price and retention ratio found a significant negative relation.

Zakaria et al. (2012) investigated the relationship among share price changes and dividend policy of Malaysian construction and material firms which were listed. 77 companies studied for a period of 2005 to 2009. Secondary source of data used and it was downloaded from data streams. Dividend payout & dividend yield as predictor variables and price changes used as study variable. Also size of the firm, growth in business, earning volatility and leverage included as controlled variables. Regression model used. Results of the study showed that there was a significant positive relationship between share price volatility and dividend payouts. Dividend yield related insignificant and negatively to the volatility of stock prices. From the control variable only leverage and size of the firm showed a high correlation with volatility of share prices.

Kenyoru et al. (2013) investigated the association among dividend policy decisions and share price changes in Kenya. Actively trading firms which were listed in Nairobi securities exchange selected for study. Period of study was 10 years 1999 to 2008. Secondary data of these firms was collected from annual statements. Price volatility as study variable and dividend yield & payout ratio as predictor variables. Multiple regression used for analyzing the data. Results showed that the dividend is the main determinants of volatility in share prices in NSE. Share price volatility was less if the payout ratio high, also if dividend yield high the volatility in share prices also high.

Sadiq et al. (2013) analyzed volatility in stock prices, by taking non-financial firms which are listed on KSE. Study was based on panel data which covers thirty five firms listed on KSE for a period of 2001-2011. Data was collected from balance sheets and companies annual reports analyzed by state bank and other business recorder websites for the given period. Sample of the study was companies which have representation from various industries such as communication and technology, automobiles, energy, cement etc. independent variables included in the study was dividend yield and other controlled variables included growth, firm size, earning volatility and earning per share. They used regression model for the study of these variables. Results of the study showed a negative correlation among dividend yield and price volatility, but this correlation was not statistically significant in all the partial regression models. Study also showed a positive but insignificant correlation among price volatility and sizes of firms. Positive significant relationship between price volatility and growth of firms also determined. Study also found negative insignificant relationship between price volatility of stocks and earning per share. Also determined no relationship between earning volatility of firms and price volatility.

Ramadan (2013) investigated the relationship between dividend policy and share price changes in industrial firms of Jordan. 77 industrial firms which were listed at Amman stock exchange for a period of 12 years 2000-2011 were selected. Historical information which were provided by ASE has been extracted. Price volatility as study variable and dividend yield & dividend payout ratio used as predictor variables. Regression equation used for the study and further two controlled variables growth and firm size also included. Study results showed the effect of dividend yield and dividend payout ratio significant negatively on the changes of share

prices.

Majanga (2015) investigated the association of stock prices volatility and firm's dividend among the firms listed on Malawi stock exchange. 13 local companies which were listed on MSE for the period of 2008-2014 take into consideration for study purposes. Secondary source of data used, correlation analysis used for analyzing the data. Stock price volatility as dependent and dividend payouts, retention ratio, per share earnings, return on equity and after tax profit used as independent variables in the study. Results of the study showed a significant positive relationship between stock prices and dividends.

Sulaiman and Migiyo (2015) investigated the effect of dividend decision on stock price volatility in Nigeria. 15 companies from 9 sectors of Nigerian economy considered as sample for the period of 2003-2012. Secondary source of data used which consists of annual financial statements & accounts and fact books of each company collected from the NSE. Stock price used as dependent variable and firm size, earning per share and dividend per share used as independent variables. Panel data regression analysis used. Study showed that per share earnings and per share dividend have a greater positive connection with stock price volatility. Also showed that size of companies negatively insignificantly related with volatility of stock prices.

NJ and YK (2014) investigated the correlation between stock price volatility and dividend policy. Stock price volatility as dependent and dividend payout & dividend yield used as independent variables. Also some controlled variables like growth in assets and firm size added. 40 registered companies in Colombo stock exchange were used as sample for a period from 2003-2012. Secondary source of data with multiple regression model used. Result of the study showed a negative impact of dividend payouts on stock price volatility. Firms with low payout may show higher volatility in their stock price.

Okafor and Mgbame (2011) studied the relationship between dividend policy and share price volatility in the stock market of Nigeria. Dividend payout ratio & yield, firm size, earnings volatility and asset growth as predictor variables and volatility in price used as study variable. Financial summary of firms which were published in their financial statements were used as secondary source of data for the year 1998-2005. For data analyzing regression model used. Results showed that dividend policy effects inversely to share prices volatility and firms with large size have less volatility than small firms. Firms with greater growth chances experience volatility than those firms which have less opportunity for their asset growth. Firms with unstable earnings experience higher price volatility.

Conclusion

Dividend refers to the amount which distributed among the shareholders. Dividend policy refers to the policy in which company decides what amount they will pay as dividend and what amount they will retain as retained earnings for further reinvestment in new projects. Total firm's earnings mostly divided into two major parts, first is the part of earnings which will pay to shareholders as dividend and the second is the part of earnings which will reinvest in to new profitable projects. One of the most important decision in finance is to decide should the profit of the firm distributes to the shareholders or it should be reinvest in new profitable projects. If profit must have to be distributed than how much paid to shareholders and what portion must be retained in to the business. For this problem a manager must give preference to the dividend policy which leads toward the maximization of shareholder's wealth and also which have a positive impact on the prices of the shares.

As mentioned earlier lot of studies has been done on this topic in many countries to investigate the relationship among the share price volatility and dividend policy that how much it impacts on the prices of stocks.

Shareholder always expects a high dividend from its investment and also with a growth in their investment in shape of capital gain, on the other side, companies also want to maximize the wealth of shareholder but they also want a growth in their business by investing in the profitable projects.

There are difference of opinions about the impact of decisions related to dividend policy of any firm, that are they impact on the value of firm.

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Relevancy Theory If the decisions related to dividend policy affects the value of the firm and per share price of that firms it will considered as relevant. In this case firm's movement/ change in dividend payout ratio will immediately bring change in the value of the firm. And on the optimal level of payout ratio firm's market value will be on its highest level.

Irrelevancy theory M&M (1961) Suggested that decisions related to dividend policy are irrelevant. They suggest that shareholders capital did not affected by organization's dividend policy. Furthermore they stated that value of firm or shareholder is depend on the firm's future earnings which depends on the firm's investment decisions.

Payout ratio & dividend yield are the components of dividend policy and previous studies also indicated

that, number of other factors was also influenced both price volatility and dividend policy like earning volatility, debt and size of the firm.

As per our expectations the Payout ratio, dividend yield and size of the firm would be negatively related to stock Price Volatility. On the other side earning volatility and debt would be positively related to stock price volatility.

It reflects that with an increase in dividend yield, payout ratio and size of any firm will be a significant decrease in the share price volatility of firms. And on the other side firms who obtained higher debt and having higher earnings volatility will show the higher price volatility.

Future Recommendations

In Pakistan mostly all the firms also face some other problems like political instability and terrorism etc. these factors also indirectly affected the prices of stocks. These factors can also be taken into consideration for further study.

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