

Dividend Policy and Shareholders' Wealth of Listed Manufacturing Companies in Sri Lanka

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Abstract

In finance, over the years impact of a firm's dividend policy on shareholders' wealth is an unresolved issue. The main issue of debate revolves around the optimal Dividend payout which is maximizing the Shareholders' wealth of investors. The country's manufacturing sector is enjoying a stronger pace in earnings growth post war in Sri Lanka. Therefore the necessity of manufacturing sector is realized for the country's economical development. This study aims to investigate the impact of dividend policy on shareholders' wealth of listed manufacturing companies in Sri Lanka. The common approach in empirical studies has been to examine the relationship between dividend policy and shareholders' wealth. The sample of this study composed of twelve listed Manufacturing companies in Sri Lanka and period of five years from 2008 to 2012. The required data and information for the study were gathered from published annual reports and hand book of listed companies in CSE. The correlation and regression analysis were used for data analysis. The result of this study reveals that there is a significant relationship between the dividend policy and shareholders' wealth and further dividend per share has a significant impact on shareholders' wealth of listed manufacturing companies in Sri Lanka.

Keywords: Dividend policy, Shareholders' wealth, Dividend per share

Introduction

Dividend policy has been an issue of interest in financial literature. Dividends are commonly defined as the distribution of earnings (past or present) in real assets among the shareholders of the firm in proportion to their ownership. Dividend policy is an integral part of the firm's financing decision as it provides internal financing. Pandey (2003) defines dividend as that portion of a company's net earnings which the directors recommend to be distributed to shareholders in proportion to their share holdings in the company. Dividend policy is concerned with determining the proportion of firm's earnings to be distributed in the form of cash dividend and the portion of earnings to be retained. 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. Managements' primary goal is shareholders' wealth maximization, which translates into maximizing the value of the company as measured by the price of the company's common stock.

Over the years a firm's dividend policy on shareholders' wealth are an unresolved issue and have been subjected to many empirical discussions within the finance literatures. The optimal dividend policy is the one that maximizes the company's stock price, which leads to maximization of shareholders' wealth and thereby ensures more rapid economic growth. Shareholders like cash dividends, but they also like the growth in EPS that results from plugging earning back into the business.

Dividend policy involves the decision to payout earnings as dividends or to retain and reinvest them in the firm. Any change in dividend policy has both favorable and unfavorable effects on the firm's stock price. Higher dividends mean higher immediate cash flows to investors, which is good, but lower future growth, which is bad. The optimal dividend policy balances these opposing forces and maximizes stock price. The firm retains the earning; its impact can be seen in many factors such as decreased leverage ratio, expansion of activities and increase in profit in succeeding years. Therefore there are many dimensions to be considered on dividend theories, policies and practices.

There are some researchers conducted on dividend policy related to shareholders' wealth. In Sri Lanka few studies have analyzed the relationship between the shareholders' wealth and dividend payment. But no studies are in listed manufacturing companies in Sri Lanka during the period of 2008 to 2012. Therefore this study is undertaken to examine the impact of dividend policy on shareholders' wealth of listed manufacturing companies in Sri Lanka for the period from 2008 to 2012.

Research problem

Dividend policy is an integral part of financial management decision of a business firm. There is considerable debate on how dividend policy affects shareholders wealth. Some researchers believe that dividends increase

shareholders' wealth (DeAngelo and DeAngelo, 2006) others believe that dividends are irrelevant (Miller and Seholes, 1978) and still others believe that dividend decrease share holders wealth (Baker et al, 2001). Therefore this research problem focuses on "Impact of Dividend policy on the shareholders' wealth of listed Manufacturing companies in Sri Lanka". Dividend refers to that portion of a firm's net earning which are paid out to the shareholders. Whether dividends have an influential on the value of the firm is the most critical question in dividend policy.

The retained earnings of the business may be reinvested and treated as a source of long-term funds. The dividend should be distributed to the shareholders in order to maximize their wealth as they have invested their money in the expectation of being made better off financially. Dividend policy has presented different issues to academicians and practitioners.

From this research problem, the researchers have identified the following research questions.

- Whether dividend policy has significant impact on the shareholders' wealth of listed manufacturing companies in Sri Lanka?
- Is there any relationship between dividend policy and shareholders' wealth of listed manufacturing Companies in Sri Lanka?

Need of the Study

Net earnings are divided into two parts. One is retained earnings and other is dividends. The retained earnings of the business may be reinvested into business for growth purpose. The dividend is distributed to shareholders in order to meet their own requirements. The decision regarding how much to retain and how much to distribute is a big issue for corporate houses. So the present study attempts to identify the relationship between dividend policy and shareholders wealth in case of Sri Lankan listed manufacturing companies. It is also very important for business houses to formulate such a dividend policy which enhances the wealth of shareholders as well as the value of firm.

Objectives of the Study

The objectives of this study are as follows,

- To investigate the impact of dividend policy on shareholders' wealth of listed Manufacturing companies.
- To identify the relationship between dividend policy and shareholders' wealth of listed manufacturing companies in Sri Lanka

Literature review

Many researchers have conducted research on this topic and it is the vast area to research on. Linter has conducted research in 1956 about dividend policy and raised questions which are important in this field of study. Linter (1956) what are the choices of management that influence the firm size, shape, and timing of dividend policy? After the Linter's contribution in determining dividend policy decisions Miller and Modigliani (1961) conducted research in dividend policy decisions and presented the theory of dividend irrelevance which showed that the dividend policy does not affect the stock prices.

Dividend decisions plays vital role to forecast the future of a firm and also has great impact on the market price of the share. This indicates that decisions associated with dividend are very important for shareholders' wealth maximization (Anand, 2004).

Gul, et al (2012) investigated relationship between dividend policy & shareholder wealth in Pakistan. For this purpose they used sample of 75 listed companies & data collected from State Bank of Pakistan & Karachi Stock Exchange 100 index for period of 2005 to 2010. Shareholders' wealth dependent variable measured by market price per share & dividend policy independent variable measured by dividend per share and multiple regression & stepwise regression model used in this research for data analysis. The result of this study showed that significant influence of dividend policy on shareholders' wealth as far as dividend paying companies are concerned and also find difference in average market value relative to book value of equity is high between dividend paying companies & non dividend paying companies.

Azhagaiah & Priya (2008) conducted study on the impact of dividend policy on shareholder wealth in South India. Secondary data used which collected from center for monitoring India economy. Sample of 28 companies in chemical industry has been chosen from 114 listed companies in Bombay stock exchange using multi stage random sampling techniques for period of 1997 to 2006. Multiple regression & stepwise regression model were used for data analyzing. Dividend per share, retained earnings per share, lagged price earnings ratio & lagged market price were independent variables & market price per share was dependent variable. There is a significant impact of dividend policy on shareholder wealth in organic chemical companies while shareholders wealth not influenced by dividend payout as for as inorganic chemical companies.

Hashemijoo et al. (2012) conducted the study of dividend policy on share price volatility in stock market of Malaysia. The aim of this study was found that the relationship between dividend policy and share

price volatility on consumer product company in Malaysian stock market. They have taken a sample of 84 listed companies from the period of six years in 2005 to 2010. In this study the share price volatility is the dependent variable and dividend yield or payout ratio is the independent variables. Multiple Regression model are used in this study to analyze the results. The results of this study show that the dividend yield or dividend payout has negative effect in share price volatility.

Balagobei (2003) found that some of the firm characteristics have influenced more on the dividend policy decision among listed Beverage food and Tobacco companies in Sri Lanka. In particular, the research investigates the extent to which firm's characteristics such as firm size, profitability, leverage and tangibility affect on corporate dividend policy for the period from 2008 to 2011. Pearson's correlation and multiple regression models are used to analyze the data. Based on the sample of 10 listed Beverage food and Tobacco companies the results reveal that firm size and profitability have significant impact on dividend policy and Leverage also has the significant negative impact on dividend policy.

Asquith & Mullin (1983) showed that an increase in dividend payout is effective for a firm because it enhances the market price of the share and has great impact on shareholders wealth. Based on the literature review the following hypotheses are developed for the study purpose.

H₁: There is a significant relationship between dividend per share and shareholders' wealth.

H₂: There is a significant relationship between dividend payout ratio and shareholders' wealth.

H₃: There is a significant relationship between ROE and shareholders' wealth.

H₄: Dividend per share has a significant impact on shareholder's wealth.

Conceptualization

Based on the literature survey and problem statement of the study, the following conceptual frame work has been constructed to show the relationship between dividend policy and shareholders' wealth of listed manufacturing companies in Sri Lanka.

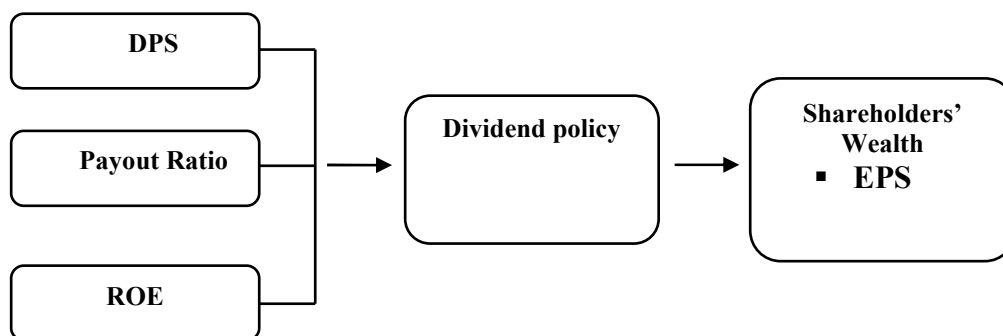


Figure 1: Conceptualization Model

Source: Developed by researcher

Data Collection

This study used secondary data for the data analysis. Secondary data is data that have been previously collected for some other purpose. The financial statements which are made up of income statements and balance sheets of the sample listed manufacturing companies were the main sources of data for this study. These data were obtained from the annual reports of listed manufacturing companies. Further scholarly articles from academic journals, relevant text books on the subject and the internet search engines were used. Specifically, the financial statements of listed companies in the sample were collected for the period 2008-2012 for the study.

Data retrieved to analyze are intended to be reliable because they are retrieved from CSE hand book and web site of each company.

Sample of the Study

The Colombo Stock Exchange (CSE) has 241 companies representing 20 business sectors in 2012. This study utilizes the listed manufacturing companies in Sri Lanka as its population. The sample of this study composed of twelve listed companies in manufacturing sector in Sri Lanka and five years from 2008 to 2012. Out of thirty seven manufacturing companies the following companies were selected based on random sampling method for the present study.

Table 1: Listed Manufacturing Companies

NO	Listed Manufacturing Companies
1	Abans Electricals PLC
2	ACL Cables PLC
3	ACL Plastics PLC
4	Acme Printing & Packaging PLC
5	Bogala Graphite Lanka PLC
6	Ceylon Grain Elevators PLC
7	Kelani Cables PLC
8	Kelani Tyres PLC
9	Piramal Glass Ceylon PLC
10	Royal Ceramics Lanka PLC
11	Singer Industries (Ceylon) PLC
12	Blue Diamonds Jewellery World Wide PLC

Method of the Study

The following methods are chosen to derive the results in this study are as follows,

- Dividend Per Share = Dividend / No. of ordinary shares
- Dividend payout ratio = Dividend per share / Earnings per share
- Return on equity = Net profit after tax / Shareholders' equity
- Earnings per share = Net profit after tax / No. of ordinary shares

According to the hypotheses developed, this study constructs the regression model for carrying out the empirical analysis. The following regression model has been developed to analyze the impact of dividend policy on shareholder's wealth of listed manufacturing companies in Colombo Stock Exchange.

$$SW = \beta_0 + \beta_1 DPS + \beta_2 DPO + \beta_3 ROE + e_i$$

Where,

- $\beta_0, \beta_1, \beta_2, \beta_3$ - Regression co-efficient
- SW - Shareholders' wealth
- DPS - Dividend per share
- DPO - Dividend payout ratio
- ROE - Return on equity
- e_i - Error term

Mode of the Analysis

The following statistical techniques are used in the study:

- Descriptive statistics: These are used to describe and summarize the behavior of the variables in a study. They refer to the ways in which a large number of observations are reduced to interpretable numbers such as averages and percentages.
- Inferential statistics: These are used to draw conclusions about the reliability and generalizability of the findings. In order to test the research hypotheses the inferential tests used include the correlation and regression analysis.

Analysis and Interpretation

Descriptive Statistics

The table 2 shows the values of minimum, maximum, mean and standard deviation of independent, and dependent variables. Dividend per share has 8.75 of maximum and 0.9812 of mean with 1.77518 standard deviation. Dividend payout ratio has -7.41 of minimum and 11.0199 of Mean. Return on equity has -166 of minimum ratio, 45.07 of maximum ratio and .9984 of mean. Earnings per share have 46.35 of maximum rupees and -13.19 of minimum rupees.

Table 2: Descriptive Statistics of variables

	N	Minimum	Maximum	Mean	Std. Deviation
Dividend per share	60	.00	8.75	.9812	1.77518
Payout ratio	60	-7.41	58.14	11.0199	13.65611
Return on equity	60	-166.00	45.07	.9984	31.98884
Earnings per share	60	-13.19	46.35	5.6940	10.14200
	60				

(SPSS OUTPUT)

Correlation Analysis

Correlation analysis was performed for the purpose of identifying the strength of the association among the variables of the study.

Table 3 : Correlation Matrix for Manufacturing Companies

	DPS	DPO	ROE	EPS(SW)
DPS	1			
DPO	.493** .000	1		
ROE	.182 .163	.243 .061	1	
EPS (SW)	.658** .000	.259* .045	.334** .009	1

*. Correlation is significant at the 0.05 level (2-tailed).

** . Correlation is significant at the 0.01 level (2-tailed).

Table 3 shows the correlation between dividend policy and shareholders' wealth of listed manufacturing companies in Sri Lanka. The value of correlation coefficient between dividend per share and shareholders' wealth of listed Manufacturing companies is 0.658** which is significant at 0.01 levels; represents a significant positive relationship between dividend per share and shareholders' wealth of listed Manufacturing companies in Sri Lanka. The value of correlation coefficient between dividend payout ratio and shareholders' wealth (EPS) of listed manufacturing companies in Sri Lanka is 0.259* which is significant at 0.05 levels, represent positive relationship between dividend payout ratio and shareholders' wealth of listed manufacturing companies in Sri Lanka. The value of correlation coefficient between return on equity and shareholders' wealth (EPS) of listed manufacturing companies is 0.334** which is significant at 0.01 levels. Therefore there is a positive relationship between return on equity and shareholders' wealth of listed manufacturing companies.

Multiple Regression Analysis

Multiple regression analysis is the most suitable way in order to examine the impact dividend policy and shareholders' wealth.

Table 4 : Results of regression coefficient

Model	Beta	Standard Error	t value	Significant
Constant	2.909	1.257	2.314	.024
DPS	3.889	.626	6.213	.000
DPO	-.100	.082	-1.218	.228
ROE	.077	.031	2.470	.017
R ² = .494				

a. Dependent Variable: Earnings per share (EPS)

From the table 4 it is observable that 49.4 % of the observed variability in shareholders' wealth (EPS) can be explained by the differences of independent variables namely dividend per share (DPS), dividend payout (DPO) and ROE. The remaining 50.6 % is not explained which means that the remaining 50.6 % of the variance in EPS is related to other variables not depicted in this model. In the above table 5, t values are significant for independent variables namely DPS and ROE (Sig< 0.05). Both variables have a positive coefficient, which means EPS increases with increasing level of DPS and ROE.

Hypothesis Testing

Table: 5 Hypothesis testing

No	Hypotheses	Results	Tools
H1	There is a significant relationship between dividend per share and shareholders' wealth.	Accepted	Correlation Analysis
H2	There is a significant relationship between dividend payout ratio and shareholders' wealth.	Accepted	Correlation Analysis
H3	There is a significant relationship between ROE and shareholders' wealth.	Accepted	Correlation Analysis
H4	Dividend per share has a significant impact on shareholder's wealth	Accepted	Regression Analysis

Conclusion

This research has been completed with two important objectives that are to identify the relationship between

dividend policy and shareholders' wealth and to examine the impact of dividend policy on shareholder's wealth of Listed Manufacturing companies in Sri Lanka. Correlation analysis showed that dividend per share, dividend payout ratio and return on equity have a significant positive relationship with shareholders' wealth and further regression analysis revealed that the dividend per share has a significant impact on Shareholders' wealth of Listed Manufacturing companies. These findings are supported with previous studies such as Azhagaiah & Priya (2008) Hashemijoo et al. (2012). Based on the findings the researcher concluded that the dividend policy has generated impact on Shareholders' wealth. It is recommended that Organizations should ensure that they have a good and robust dividend policy in place because it will enhance their shareholders' wealth and attract investments to the organizations.

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