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An Evaluative Study of Impact of Dividend Policy Exhibiting on Stock Prices of Auto-sector Firms of Pakistan (2006-2015).

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Abstract:-
The study was carried out to examine the effect of firm dividend policies on their respective stock prices. Ten years (2006-2015) panel data was collected from fourteen selected firms of the sector on the basis of the availability of data. Random Effect Model of Regression was used to check the link between the one dependent Market Price and five independent variables i.e. Dividend Yield, Retention Ratio, Profit after Tax, Earnings per Share and Return on Equity. To check various anomalies in data tests were applied. This study found significantly negative relationship of Dividend Yield and Retention Ratio with Market price but significant and positive affiliation of Profit after Tax and Earning per Share with Market Price. But no evidence found the impact of Return on Equity with Market Price. This study found mixed results about chief determinants like dividend yield and retention ratio. Reciprocally did not match each other to support Dividend Relevance theory. On the basis of results this study recommended to the management to develop best policy by considering shareholders wealth and growth of companies.

Key words: Dividend Policy, Dividend Yield, Earning per share, Random Effect Model, Autocorrelation.

1. Introduction

The term dividend refers to that part of profits of a company which is distributed by the company among its shareholders. It is the reward of the shareholders for investments made by them in the shares of the company.

Dividend Policy is the most important financial decision taken by board of directors of a firm. Where board also has to decide about the payment of dividend from their current earnings or to retain/ accumulate reserves. In this policy it is also decided that if company decides to pay dividend from its current profits they have to determine the percentage of earnings allocated for dividends as well as reinvestments for future

envisaged ventures. In addition, the current dividend policies talks on numerous issues, i.e., for attracting investors, increasing market value of firm and to decision to repurchase shares and paying out dividends (Hashemijoo, et al., 2012). Firms use this policy as a tool to regulate allocation of profits amongst the retention and payment of dividend to shareholders (Kretlow 2001). Along with investors this policy is also very important for creditors of the company. As to lenders, if board decides to pay more to its shareholders as dividend then fewer amounts will be available for other payments. Therefore, to match the important features like (shareholders' yield, firm's growth and the firm's value) a best dividend policy is required to be designed so that agency problem could be avoided and shareholders wealth can be maximized successfully. Despite various efforts by academicians to resolve the mysterious issue of impact of dividend policy on stock market prices so for it remained unresolved. It is the most debated topic among financial researchers and economists who named dividend policy as puzzle."Corporate dividend policy remains a topic on which the field has failed to arrive at even a local sense of closure" (Black 1976) & (Marsh and Merton, 1987). Numerous theories have been developed following the publication of Miller & Modigliani (1961) original work to enlighten the stimulus following the dividend policies (Ijaz, 2017). Signalling models (Bhattacharya, 1979; John and Williams, 1985), Miller and Rock (1985) affirmed that dividends intend to communicate information regarding potential forecast of firms, signifying a positive association among dividend variation and future earnings. Another theory the life cycle theory of dividends by (De Angelo et al., 2006) forecasted that firms only pay dividends when their growth stops

The Agency explanations (Easterbrook, 1984; Jensen, 1986) hypothesize that firms utilize dividends to alleviate agency problems involving insiders and outsiders. Venkatesh (1989), Dyl and Weigand (1998), Grullon et al. (2002) theorized that alteration in dividend policy hint variation in risk of firms. Blau and Fuller (2008) state that existing theories do not help understand why some firms never pay dividends, while others consistently pay them. According to Black (1976) "the harder we look at the dividend picture, the more it seems like a puzzle with pieces that just don't fit together." Regardless of dedicated academic and pragmatic investigation, financial economists failed to explain the obstinacy of the phenomenon. Although various studies have been conducted in past but this sector still remain untouched. The study of this sector (i.e. Auto-sector) is likely to resolve the heated debated among the academicians and solve puzzle. The research on this sector can also offer interesting and convincing conclusion to all stakeholders (especially to investors). The automobile sector in Pakistan, has not performed according to expectations even though have prospective of growth because of certain reasons. Major reasons of this low performance are the reluctance of firms to announce dividends regularly due to low profits. So, it is very important to find out the response of shareholders and the impact on share prices of such sector firms. This study has used recent data (secondary) from 2006 to 2015.

2. Study Objectives:

i- This research study has tried to achieve following objectives,

To examine the level of impact of automobile firms' dividend policy on their stock prices listed on Pakistan Stock Exchange.

ii- To estimate the connection among autonomous variables such as dividend yield, Retention Ratio, Profit after Tax, Earning per Share and Return on Equity and stock market prices of Pakistani automobile firms listed on Pakistan Stock Exchange.

3. Literature Review

Various researchers from time to time have carried out their studies to investigate the association of dividend policy with market share price.

Despite utilizing diverse methodologies and techniques their outcomes added to the puzzlement. Hence, (Dark 1976) and (Brealey and Myers 2002) portrayed this arrangement as a riddle. Contradicting hypotheses developed which did not clarify the issue, in any case, expanded the current data for further examinations. The discussion starts with the topic of (Linter 1956) on manager's decisions influencing the size, shape and timing of dividend payments.

The dividend irrelevance theory of Miller & Modigliani (1961) described no relation among dividend policy and stock prices. The research of (Allen and Rachim 1996) found that there is no any relationship of dividend yield with stock market and positive relationship of (stock prices and market size), and negative impact of earnings and leverage link and stock price with payout ratio. They found no any significant link between stock dividends and stock returns, between cash dividends and stock returns (Chen, et al., 2002).

(Asquith and Mullins 1983) also investigated the relationship of dividend declaration and its impact on share price. Their results found positive and statistically significant impact on excess profits of dividend announcement. The study of (Murhadi 2008) also supported the previous results. (Baker, Farrelly and Edelman 1985) Also found similar results that announcement of dividend has impact on market value of the firms it increases there stock price.

The study of (Edward Attah-Botchwey, 2014) tried to solve issues faced by Ghanaian Stock Exchange listed companies by analyzing impact of dividend policy on stock price of these firms. Primary data was collected through questionnaire. Edward concluded that with the increase of dividend of companies positively affects their share price because of the demand pressure on the share. Further suggested that high dividend increases share price and low dividend decreases share price. Rabindra Joshi (2012) in this research article checked impact of dividends on stock price with relevance to Nepal. The descriptive result of his study suggests that dividend is preferred more than retained earnings in case of Nepal. That in both the banking and non banking dividend has significant impact. Kanwal Iqbal Khan (2012) tried to enlighten the consequence of dividend declaration on stock prices of chemical and pharmaceutical industry of Pakistan. Her results point out that Cash Dividend, RR and ROE has significantly positive relation with stock market prices and considerably explicate the difference in the stock prices of chemical and pharmaceutical sector of Pakistan Zahra Lashgari & Mousa Lashgari (2014), examined the impact of dividend policy on price unpredictability of shares in Tehran Stock Exchange. Their result specify that at 5%, error level Dividend payout ratio has a significantly negative effect on stock price volatility and asset growth rate has a significantly positive effect on stock price volatility. Noor M. Memon et al, (2017) conducted research to observe the relationship among firms dividend policy on share value of companies. Their used fixed effect regression and found statistically significant and negative impact of dividend yield and positive impact of dividend payout ratio on market value of shares.

Chikashi Tsuji (2014) by using panel data analyzed the relationship between cash holdings, dividend policies, and stock returns of the automobile related firms registered at the Japanese Stock Exchange of Tokyo. His research focused on two time periods, before and after occurrence of American Lehman shock. Dividends are used to pacify investors and decrease anxieties arising from the separation of management and ownership. Alternatively, dividends can be used to decrease investor anxieties but

executive compensation levels are not a source of anxiety. Dividend and debt levels are positive and significant, consistent with contracting and signalling theory predictions but inconsistent with the trade-off theory of JS&Z (Bob G. Wood Jr., 1994).

3.1 Operational Definitions of variables:

This section defines the variable used in this research.

Market Price (MP): This has been taken as dependent variable. The data for this variable has been collected each year's last three months average of highest and lowest (2006 to 2015). MP has been generally used by researchers as dependent variable for observing the link of dividend policy with market prices of shares in prior research conducted by ((Allen and Rachim 1996); (Rashid and Rahman 2009); (Nazir, et al. 2010); (Al Masum 2014)) and others).

Dividend Yield (DY): DY of a stock entails that the percentage of share price paid to share holders as dividend. Various researchers (Henne, Ostrowski and Reichling 2007) have suggested that with the enhancement of dividend yield company performance improves. DY data was collected by (dividing the annual cash dividends per share by the market price per share). It is considering the importance of this variable in same kind of researches various academicians included this in their researches. Some found positive and statistically significant link of this variable with market price of the stock, Chijoke Mgbame (2011)) and others (Okafor et al. (2011), Baskin (1989)) have obtained significantly negative relation.

Retention Ratio (RR): Another very important variable related with this area of research is Retention Ratio which is known as (plough back ratio) and this is different from dividend payout ratio. It is that part of firm's income which is not distributed among shareholders but retained for the purpose of reinvestment in prospective projects. This is calculated by dividing retained earnings by net income. As, Khan et al. (2011) found negative impact on MP whereas in other study (Pani, 2008) concluded that there is positive impact of RR on MP but results were insignificant. Other researcher found statistically significant and negative impact of RR on MP (Asem & Tian, 2010).

Profit after Tax (PAT): This variable is used a measure of profitability (means net profits after paying all expenditure including various taxes from total revenue). It illustrates a factual profit management can use for paying dividends to its shareholders. Due to important relationship of this variable with market price this variable has been independent variable as observed by earlier researchers (Pani (2008), Al-Kuwari (2009) and Adesola & Okwong (2009)) they found significantly positive impact on MP. And study of Abdullah Al Masum (2014) concluded negative and insignificant impact.

Earnings per share (EPS): EPS used as a sign of performance of firms in terms of profitability. It is the outstanding amount of total net income earned by each common stock holder of a company. Companies with high EPS ratio are in better position to pay considerable dividends. Net income divided by outstanding share of company for calculation of EPS. In past this variable was also used as independent variable in same kind of research studies as ((Asem and Tian 2010), (Chen, Firth and Gao 2002), (K. I.

Khan, et al. 2011), (Al Masum 2014)) they found statistically significant and positive impact Market Prices. And (Adefila, Oladipo and Adeoti 2004) found no impact.

Return on equity (ROE): This is used as an independent variable to check impact of dividend policy on firm's share prices. Calculated as: Annual Net Income divided by Average Shareholders' Equity. It has been found that ROE significantly and positively affects the Market Prices (Liu and Hu 2005).

4. Research Methodology:

The descriptive quantitative technique was used for analysis of data

4.1. Sampling and data collection:

This research has focused on automobile sector firms. This sector is divided into two types of industries such as Automobile Assembler industries and Automobile Parts & Accessories industries). Out of 22 firms working in this sector only 14 companies were selected as sample because of the availability of required data of the selected period from 2006 to 2015. Data was collected from the published financial reports of Automobile sector firms listed on Pakistan Stock Exchange (PSX), SECP and other secondary sources were used for collection of required data.

4.2 Data Analysis:

By using panel data approach for predicting relationship of independent variables (DY, RR, PAT, EPS & ROE) with dependent variable MP the regression technique was used. Haussmann test was performed for checking of model appropriateness. This test suggested that Random effect model is a proper model for this research. Eviews was used for performing data analysis. Also, SPSS was used for checking of Variance Inflation Factor (VIF) and Tolerance test results for Multicollinearity.

4.3 Model Description:

Below is the mathematical description of regression model used in this study:

$$\boldsymbol{MP = \beta 0 + \beta 1 DY + \beta 2 RR + \beta 3 PAT + \beta 4 EPS + \beta 5 ROE + \varepsilon}$$

The literature suggested that four out of five autonomous variables (DY, PAT, EPS and ROE) positively and significantly affects the dependent variable market share price. This suggests that if DY, PAT, EPS and ROE increases then Market Prices of auto-sector companies listed on PSX will also rises. Whereas, the negative association of retention ratio and stock price was anticipated.

5. Findings

5.1 Diagnostic Test Results

Prior to regression analysis, various tests were applied to select an appropriate regression model and to test autocorrelation, heteroscedasticity and Multicollinearity in the data. Eviews and SPSS software were used to perform those tests. Their results are below:

a) Data stationary Test:

Table 1 Levin, Lin and Chu Test Results

Test of Data Stationery	Levin, Lin and Chu Test Statistics		
	Test Critical Values		
	1% Level	5% Level	10% Level
	-3.469451	-2.878618	-2.575954
Variables	t-statistics		Probability
Market Price (MP)	-7.757233		0.0000
Dividend Yield (DY)	-6.803881		0.0000
Retention Ratio (RR)	-3.715526		0.0048
Profit After Tax (PAT)	-7.739109		0.0000
Earnings Per Share (EPS)	-4.464595		0.0004
Return on Equity (ROE)	-6.959362		0.0000

Source: Primary (2017)

Validity of the regression results improves if the data used is stationary. On the other hand, if data is non-stationary, regression model unable to calculate valid findings due to presence of rudiments of Multicollinearity and autocorrelation. Augmented Dickey Fuller (ADF) test was conducted to avoid any drawbacks of the model conducted also to confirm that the data is stationary. The conducted test results were according to requirements. We have tested every variable separately and results confirmed that data is stationary (see table 1).

b) Multicollinearity (Tolerance and VIF):

These tools have been used to measure the level of Multicollinearity (correlation with predictors). Tolerance test results for all the variables are higher than 0.1 and Variance Inflation Factor (VIF) smaller than 10. This proves the non presence of Multicollinearity in data (see Table 6).

c) Homoscedasticity Test

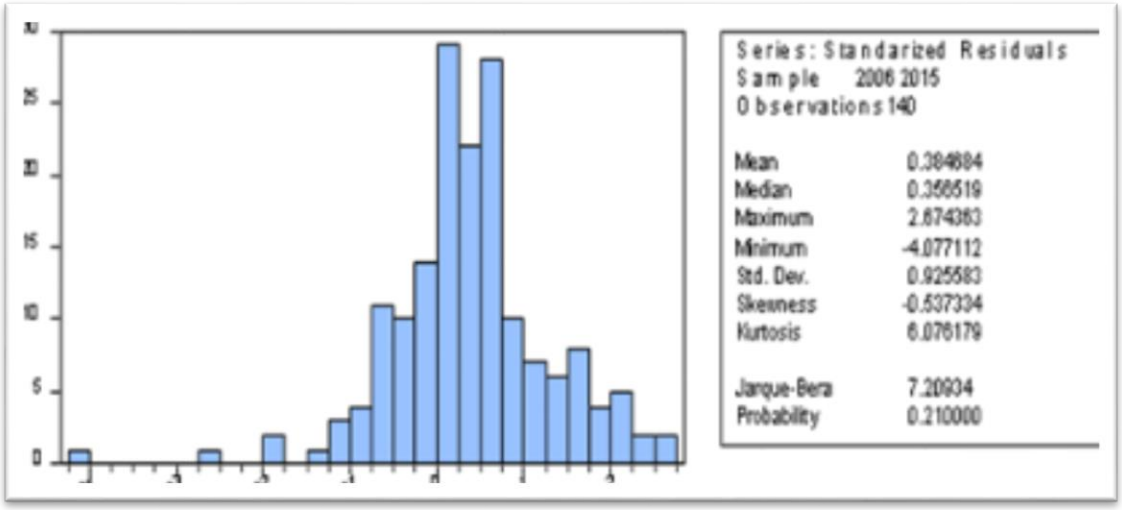
Table 2 Breusch –Pagan Godfrey Test Results

Obs*R-squared	**8.777443**	**Prob.Chi-square (5)**	**0.1183**

To check whether the model is heteroscedastic or homoscedastic or variances of the selected model another Breusch-Pagan Test was applied. The results were found as per expectations, probability chi-square is (i.e. 0.1183) which greater than required value (0.05). So, there is no any reason of presence of heteroscedasticity in the residuals.

d) Normality test:

Table 3 Jarque-Bera Test Results



Source: Primary (2017)

The purpose of using Jarque-Bera test is to find out whether or not the residuals are normally scattered. This research failed to reject the null hypothesis because probability test result of normality is 0.210000 which is greater than 0.05 which verify the normality.

e) Autocorrelation test:

To confirm the absence of autocorrelation, we conducted two tests (viz. Durbin-Watson and Correlogram test). Durbin-Watson results (see table 5) were found to be equal to 2 (i.e. 1.834764) which deny the presence of any existence of autocorrelation among residuals and their lag. Also Correlogram test failed to reject the Null hypothesis. This confirms the non-presence of autocorrelation.

f) Comparison of Random Effect and Fixed Effect Models

Table 4 Hausman Test Results

Correlated Random Effect-Hausman Test			
Test summary	**Chi Square Statistics**	**Chi Square d.f**	**Probability**
Cross Section Random	**1.587257**	**5**	**0.9028**

Source: Primary (2017)

The Hausman Test summarized results shown in (table 4) exhibits (0.9028) probability value that is noticeably bigger than (0.05). It verifies the non-rejection of Null hypothesis which confirms the suitability of Random Effect Model for our data analysis.

g) Model Specification

Table 5 Effects Specification

R-squared	0.623217	Mean dependent variable	15.2014
Adjusted R-squared	0.563188	S.D. dependant Variable	21.2381
S.E. of regression	12.1028	Akaike info criterion	13.13583
Sum squared residuals	3521.158	Schwarz criterion	13.53505
Log likelihood	-907.9375	Hannan-Quinn criterion	13.29806
F-statistic	23.12708	Durbin-Watson stat	1.834764
Prob. (F-statistic)	0.000000		

Source: Primary (2017)

Model specification results show R^2 value is 0.623217 or 62% which means dependent variable (market price) is explained up to 62% by the independent variables. F-statistic 23.12708 and Probability (F-statistic) 0.0000000 confirm the validity of the model. As per the rule of thumb, F-statistic greater than 4 and Probability (F-statistic) lower than 0.05 are inferred that the model used is usable for forecast. The Akaike Info Criterion values 13.13583, Schwarz Criterion 13.53505 and Hannan-Quinn Criterion 13.29806 results proved the usefulness of the this model.

5.2 Model Findings and Discussion:

5.2.1 Model findings

Table 6 Regression Results

Dependent variable: Market Price: Method: Panel Least Square						
Variable	Coefficient	Std. Error	t-statistics	Probability	Tolerance	VIF
DY	-648.7681	243.2931	-2.666612	0.0086	0.818	1.223
RR	-51.21307	21.76884	-2.352586	0.0201	0.812	1.231
PAT	1.440432	1.479428	2.973642	0.0320	0.910	1.098
EPS	7.801538	0.819380	9.521267	0.0000	0.697	1.435
ROE	6.121097	50.41823	0.121406	0.9036	0.626	1.597
C	84.58663	22.85416	3.701148	0.0003		

Source: Primary (2017)

Coefficient of DY is -648.7681. Negative coefficient means that the variable has negative correlation with the dependent variable. With an increase in DY, Stock market prices lowered and vice versa. Probability value is 0.0086 which is far less than 0.05 suggesting highly significant impact of DY on Market Price. Retention Ratio has also negative coefficient (-51.21307) which suggests that there is inverse relationship between RR and Market Price. The results appeared significant at 5% significance level (P=0.0201). PAT related results show that coefficient is 1.440432 and Probability is 0.0320 indicating significant and positive relation between Profit after tax and Market price. Their positive relationship means an increase in PAT augmented market price of stocks and a decrease in PAT lowered market price. EPS appeared positive (7.801538) and highly significant (p-value=0.0000) suggesting that high profitability of the firm brought about an increase in stock prices. Ultimately, ROE associated results are coefficient 6.121097 and probability 0.9036. These values ascertain that there is insignificant link between RO E has positive and statistically insignificant link with Market Price.

5.2.2 Discussion on the model findings:

The inverse relationship of DY and MP shows that the investors not only interested in receiving dividends, they seems to be very much concerned about the use of retained earnings and expect that it will increase their future earnings due to investment in viable new projects. Our results are analogous to (Baskin 1989). Other researchers like (Okafor, et al.2011, and Masum, 2014) found inverse effect of dividend yield on share price. They also claimed that retention ratio negatively affect market price of shares it recommends that prefer dividends rather reinvestments of their retain earnings. So, in case of Pakistan reinvest decision of retained earnings negatively affects the stock market price of shares of related companies. Same was also confirmed by (K. I. Khan, et al. 2011) in their study. The linkage among Profit after Tax and Market Price is statistically significant and positive for this sector which means investors prefer PAT which changes market share price positively. Same results were also found by other researchers like (Pani 2008, Ahmed and Javid 2009, Adesola and Okwong 2009, Al-Kuwari 2009 and (K. I. Khan, et al. 2011). The highly significant positive link among EPS and MP is a signal that enhancement in EPS of these corporations brings on rise in their Stock Market Prices. Corresponding results were found by (K. I. Khan, et al. 2011 and Al Masum 2014). Finally, this research revealed unanticipated results of ROE. ROE has positive but insignificant relation with market price. On the basis of these results, it can be established that the investors related with this sector of industries are not interested in profitability of such firms with reference to each rupee of shareholders' equity. The insignificant and positive link among return on equity and stock market price of shares of this sector recommends that efficient utilization of reinvested funds does not affect share price.

6. Conclusion and Recommendations:

The present study was carried out with intention to find out the impact of dividend policies of listed firms of automobile sector firms on stock market prices. Panel data analysis technique was applied on the data collected from fourteen companies of this sector. The entire results of this research are evidently interesting. We discovered that all variables, apart from RE, greatly influence the MP of this sector companies. It indicates both positive and negative impact of dividend policies on stock market prices of companies working in automobiles industries. But, the results of Dividend Policy (i.e. Dividend Yield and Retention Ratio) showed different results. With relation to impact of retentions ratio on market price of shares the results of dividend yield does not match with Retention Ratio. The negative and insignificant results about the relationship of DY with MP, impact of ROE on MP demands further research. Though, these results are in match with results of other studies conducted in Pakistan and in other countries. It is recommended to the policy makers of these companies especially to the Directors, before forming any dividend policy, they need to consider short-run benefits as well as long-run benefits to the ultimate owners of the firms. The wealth maximization of the owners is still the most important factor. By adopting such policy board of directors can make them loyal for longer time. The future researchers can extend this study by comparing Pakistani automobile sector firms with developing economies of South Asia.

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