Conceptual paper

Impact of Dividend Policy on Shareholder’s Wealth: A study on Manufacturing Industry listed in NASDAQ, America

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Abstract

The purpose of this research carried out is to study the impact of Dividend Policy on Shareholder’s Wealth in manufacturing industry of NASDAQ Stock Exchange, United States of America. The study engages Two (2) Independent variables (Dividend Payout Ratio and Dividend Yield Ratio) and Four (4) dependent variables (Lagged Price Ratio, Earnings per Share, Market Share Price and Return on Equity) to gauge the impact of dividend policy on shareholders wealth. The time span for this study is from 2011-2015 with a sample size of 300 companies which is been extracted from Three (3) subsectors of manufacturing industry. Based on the empirical and theoretical discussion, the study concludes with an efficient conceptual framework with two independent (Dividend Payout Ratio and Dividend Yield Ratio) and Four Dependent (Lagged Price Ratio, Earnings per Share, Market Share Price and Return on Equity) to gauge the impact of Dividend policy on shareholders wealth in manufacturing firms registered in NASDAQ.

Key Terms: Dividend Yield, Dividend Payout Ratio, Lagged Price Ratio (LPR), Return on Equity (ROE), Earnings per Share (EPS), Market Share Price (MSP)
1. Introduction

The purpose of this study is to gauge the impact of Dividend Policy on Shareholder’s Wealth in manufacturing firms registered in NASDAQ within time span 2011-2015. Divided policy has been a puzzled topic since Linter (1956) and Black and Scholes (1976) conduct a study to address the impact of dividend policy in United States of America. Following to it, numerous studies has been conducted to identify the impact of the dividend phenomena on the wealth of the shareholders in developed and developing economies. Some notable compilations amongst them are; Zafar, Muhammad and Muhammad (2014) conducted a research in Pakistan on textile, sugar and chemical sector; Agnes, Lim, Lim, Ow, and Tan (2014) did a study on Malaysian food producer sector; Azhagaiah and Sabari (2008) did on chemical sector in India; Calistus, Fredrick and Ambrose (2014) addresses Kenya’s agriculture sector; Ajanthan (2013) conducted research on Hotels and Restaurant Companies in Sri Lanka; Oyinlola and Ajeigbe (2014) makes a study on Nigerian Stock Exchange; Nicol (2013) conducted a research on bull and bear markets in South Africa; Hamid and Diaedlin (2008) did a study on Saudi Arabian Stock Exchange; Pavel (2006) studies on Russia’s National Association of Real Estate Investment Trusts (NAREIT); Edward (2014) did a research on Ghana Stock Exchange. While flipping to the globe to the developed economic corridors, Joseph and Kingsford (2015) conducted a research on United Kingdom retail industry; Benjamin and Anete (2002) conducted research on non-financial firms in Finland; Michael and Anjan (2004) makes a study on America listed New York Stock Exchange.

Further narrowing the contextual background of the topic, empirical studies mainly addresses sectors such as food, sugar industry, textile, and cement, chemical, pharmaceutical, oil and gases (Mohammad, 2013; Ozuomba, Okaro and Okoye, 2013; Azhagaiah and Sabari, 2008; Tahir and Sarfarz, 2014; Irtaz, Arslan and Syed, 2015 and Kanwal, 2012).

An explanation of dividend policy has been one of the most difficult challenges confronting financial analyst and economists (Bhattacharyya, 2007). Dividend policy explains the proportion as how much a company’s earnings should be given to shareholders and how much should be retained by the firm for investment purposes. Therefore, this study will examine the impact of Dividend Policy on Shareholder’s Wealth.

To succeed this next objectives are expressed:

- Identify the impact of dividend policy on Lagged Price Ratio (LPR)
- Identify the impact of dividend policy on Return on Equity (ROE)
- Identify the impact of dividend policy on Earnings per Share (EPS)
- Identify the impact of dividend policy on Market Price per Share (MPS)

2. Literature Review

There are various researchers and authors defined the concept of Dividend Policy. Linter (1956) as the leading researcher on dividends believes most of the shareholders prefer a stable rate of dividends and company with a constant rate will be the most attracted company to common shareholders. According to Ronald C. (2000), Dividend Policy is the practice that firms monitors in making dividend payout decisions, also for arrangement and size of cash circulations over the time to shareholders. As Moyer (2001) stated, Dividend Policy controls the central circulation of the firm’s earnings between cash and retention dividend earnings of shareholders.
While exploiting the theoretical addressing to the payout phenomena, Modigliani and Miller (1961) brought up with the pioneering work of “Dividend Irrelevance Theorem” which primarily assumes that paying dividend has no impact on the wealth of the shareholders. Brennan (1971) and several researchers supported the irrelevancy theorem of Modigliani and Miller theory where they conclude that any rejection of this theory must be based on the dissenting of the principle of equality market rationality and the statement of independence of irrelevant information which is eventually rare to find ion today’s business world.

Since the other side of the shore, The Dividend relevance approach is been broadly divided into two scholarly works of Gordon (1959) and Walter (1963). The Gordon (1956) model of dividend relevance signifies that external shareholders control high and uncertain returns from their investments. Modigliani & Miller (1961) criticized this theory where the policy of dividend does not affect the cost of capital as those investors are unconcerned if they receive high dividend or capital gains. As compared to Miller & Modigliani proposition, the “Bird in the hand” theory, Graham, Dodd and Cottle (1962) basically have found better way to describe the impact of dividend policy. They came out with the view that dividends are worth more to investors (Graham, Dodd and Cottle, 1962).

James E. Walter (1963) argues that the choice of dividend policies almost always affect the value of the firm. Walter’s model shows the importance of the relationship between the firm’s rates of return in determining the dividend policy that will maximize the wealth of shareholders. The idea of Walter (1963) was that shareholders would accept low dividends when the expected rate of return is higher than market capitalization rate but would prefer higher dividends when the former is less than the latter. Jensen et al. (1992) support Walter’s model where the implication of the dividend is relevant in either growth or decreasing firm but would be inappropriate in a standard firm.

Lastly while measuring the indirect impact theoretically; signaling theory is a firm that uses its dividend policy to provide information to shareholders and investors in the stock market. This is because management has the essential information about the financial position and strategy of the firm and can be used to make forecast about upcoming incomes and earnings of the company, (Modigliani and Miller 1961). The investors and shareholders may decide to make a choice about a specific price of a company because of that company's dividend policy and some may not choose that price. For this reason, the pattern and the size of dividend of a company may seem to be more relevance to many investors and shareholders. However, signaling dividend has been arguably considered to have information content. In the presence of imperfect information, Bhattacharya (1979) indicates that managers can use high dividend to predict expected cash flows.

The table below shows the key summary of the variable identified:
<table>
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<th>Authors/Article</th>
<th>proposal</th>
<th>Variables</th>
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2. Dividends per share (DPS)  
3. Retained earnings per share (RPS),  
4. Price earnings ratio (PER)  
5. Lagged price earning (LAGPER)  
6. Earnings (EAR)  
7. Lagged market value (LAGMPS) |
2. Lagged dividend ratio  
3. Debt equity ratio  
4. ROE |
2. Earning volatility  
3. Long term debt ratio  
4. Growth in assets  
5. Liquidity  
6. ROE |
2. Earnings per share (EPS)  
3. Lagged Market Price Ratio (LMPR)  
4. Lagged Price Earnings Ratio (LPER)  
5. Price Earnings Ratio (PER)  
6. Retained Earnings Ratio (RER)  
7. Market price per share (MPS) |
2. Dividend per share  
3. Retained earnings  
4. Lagged price  
5. ROE |
2. Market Price per Share  
3. Earnings per Share  
4. Dividend yield  
5. Earnings per share |
2. Dividend per share  
3. Dividend payout  
4. Earnings per share  
5. Price earning |
Asma Tahir, Nain Tara Sarfarz Raja (2014)  
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| Empirical | 1. Dividend payout ratio  
| 2. P/E ratio  
| 3. BV/MV equity ratio  
| 4. Holding period yield |

Therefore ploughing the empirical research on the topic, Dividend yield and Dividend payout ratio has been engaged as the independent variables to gauge Dividend Policy and lagged price ratio, Earnings per Share, Return on Equity, and Market Share Price as dependent variables to measure shareholders wealth. With reference to empirical literature, there are numerous studies that blend similar set of variables to investigate the phenomena, some notable scripts amongst them are; GejaLakshmi & Azhagaiah (2015), Agnes, Kai, Lim, Yong, Tan (2014), Sarwar (2013) and Wajid, Arshad, Ali, Bakhtiar & Mohammad (2014) did on earnings per share. Sujata Kapoor (2009) did dividend yield, dividend payout ratio and market share price for the variables, similarly to Johannes & Mvita (2013), Wajid, Arshad, Ali, Bakhtia& Mohammad (2014) and Asma Tahir, Nain Tara Sarfarz Raja (2014). Ansar, Butt & Shah (2015), Mohammad (2013) and Sujata Kapoor (2009) did on ROE and Lagged price ratio variables. Therefore, all of the variables had link between each one of them.

Meanwhile discussing each factor included in the conceptual framework solely, Dividend policy is measured by dividend payout ratio. Based on Arnott and Asness (2003), they discover a strong positive relationship between dividend payout ratio and future earnings growth which is also supported by both Zhou and Ruland (2006) and Gwilymet et al (2006). Also, Amidu and Abor (2006) studied shows that dividend payout ratios were positively related to profitability, cash flow and tax but are negatively related risk and growth.

Chen et al. (1990) show that tests relating returns to dividend yields are sensitive to the method of risk return adjustment. Gordon (1959, 1962) and Lintner (1962) discover that dividend policy does affect the shareholders wealth, and they provide some early evidence to support the view that a higher dividend payout reduces the cost of capital, for instance investors more prefer to dividends. Other researchers like Okafor & Mgbame (2011), the result of their research show that overall impact of dividend yield on price volatility has a high significant levels, which measure the dividend policy have vary in inverse with ordinary share price volatility over period.

Azhagaiah &Priya (2008) finds out that lagged price ratio is related to changes in expected dividend growth. As Joshi (2011) examine that lagged price ratio has significant relationship with market per share also lagged price earnings ratio impact the stock price. From the results of Hashemijoo et al. (2012), he concluded that lagged price ratio is significantly positive relationship with shareholder’s wealth. Lewellen (2001) had studied on dividend growth predictability apparently faces the usual results of regressions that use lagged price ratios to predict future price returns and dividends. Further, Price (2012) shows in his research there are significant relationship between Dividend policy and the return on shareholders’ equity which was similarly found in the studies of Hedensted & Raballe (2008), Liu & Hu (2005), and Masum (2014) research. Mokaya et al. (2013) studied there is relationship between dividend payout and market share value. The result shows there is a strong and positive correlation between dividend payout and market share value. Besides, Joshi (2011) and Ilaboya & Aggreh (2013) study show that dividend per share has strong effect on market price per share and also dividend per share has greater effect on earnings per share.

Hypothesis Development:

**H1: Dividend Payout Ratio has a significant positive impact on Lagged Price Ratio**
**H2:** Dividend Yield Ratio has a significant positive impact on Lagged Price Ratio  
**H3:** Dividend Payout Ratio has a significant positive impact on Market Share Price  
**H4:** Dividend Yield Ratio has a significant positive impact on Market Share Price  
**H5:** Dividend Yield Ratio has a significant positive impact on Return on Equity  
**H6:** Dividend Yield Ratio has a significant positive impact on Return on Equity  
**H7:** Dividend Yield Ratio has a significant positive impact on Earnings per Share  
**H8:** Dividend Yield Ratio has a significant positive impact on Earnings per Share

**Conceptual framework diagram**

![Conceptual framework diagram](image)

3. **Research Methodology**

The research design adapt for this study will be descriptive explanatory as this type of research supports the testing of hypothesis. Further the research methodology used for this is quantitative method as it will assist the research to generalize its context. Secondary data will be collected from the annual reports of the sample companies. The population for this study is is 3174 companies registered under the umbrella of manufacturing sector in NASDAQ while the sample selected is through random probability sampling within the time span of 2011 - 2015. The research will cite data from the SEC audited annual reports of the sample companies which are available online to ensure accessibility and reliability of the data. Since the nature of the study mainly required secondary data it will be saved from the severe ethical issues though copyrights and legal access to data will be ensured while conducting the study. Lastly, collected data for the study will be analyzed by E-views software to measure the descriptive statistics, correlation and regression analysis result of this research.

4. **Conclusion**
This research was conducted specifically to measure the Impact of Dividend Policy on Shareholders’ wealth in manufacturing industry registered in NASDAQ, United States of America with the sample size of 300 companies registered in manufacturing sector NASDAQ. Hence from the literature analysis above, a mixed pattern is observed regarding the impact of dividend policy on the wealth of the shareholders. Therefore, an efficient conceptual framework has been designed considering the theoretical and empirical work done on the topic to investigate the concern phenomena within the context of manufacturing companies registered in NASDAQ.

Reference


