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The Determinants of Corporate Dividend Policy: An Investigation of Pakistani Banking Industry

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Abstract
The paper investigates the impact of different firm specific factors on the dividend policy of companies by selecting a sample of 18 banks listed in KSE for the period 2006-2011. The dependent variable is dividend policy where as explanatory variables include, firm size and risk, profitability, firm's growth and leverage. It was found that out of 18 banks 11 banks pay dividends whereas seven banks do not. The results have shown that the independent variables growth, profitability and firm size have positive coefficient of correlation when the dependent variable is dividend yield and Dividend Payout Ratio. However there is strong linear association between profitability and firm size with dividend policy but the variable growth rate has weak positive correlation with dividend policy. In contrast, the variables leverage and firm risk has inverse linear relationship with dividend policy. Banks that pay dividends were found, when we use method of correlation coefficient more profitable, stable and less risky as compare to banks that do not pay dividends.
Keywords: Dividend Policy, Listed Banks, Pakistan

1. Introduction

Dividend policy can be describe as the policy a company uses to decide how much it will pay to shareholders in dividends. Dividend policy that a firm adopts has implications for different stakeholders such as lenders, investors and managers. Since Miller and Modigliani (MM) presented dividend irrelevance theory. This theory discloses that firm value and shareholders' wealth are not related to the decision of whether or not the firm pays dividend. However, on the other side Bird-in-the Hand theory strongly suggest paying dividend (see for instance Linter, 1956; Gordon, 1956; and Gordon and Brigham, 1968). There are several researches on dividen

policy till date, which deal with different aspects of the policy. Stability of dividend is an important decision to be made by any firm just as other decisions made. Brealey and Myers (2005) listed top ten problems that are unresolved in advance corporate finance and one of them is dividend policy. In empirical literature, one of the important issues that are investigated intensively is to find the factors affecting firm's dividend policy. It is noteworthy that dividend policy is not only influenced by internal factors but external factors also play significant role (Jensen &Johnson, 1995; Jensen & Smith, 1984; Lintner, 1956). Internal factors include investment opportunity, profitability and liquidity, whereas among external factors, macroeconomic problems like growth, stability, change in technology, and change in consumer taste are most important Roberto (2002).

Despite the importance of the issue, limited number of research studies is available for a developing country like Pakistan and especially in the banking sector. Most of the studies are conducted in developed markets. Previous studies related to Pakistan show that dividend announcement affects the share price and market efficiency Akbar & Baig (2010). Ahmed & Attiya (2009) find that dividend policy is affected by earning per share (EPS) and by previous dividend per share. However, these studies are limited to non-financial firms only. Thus, the objectives of this study are:

I. The first aim is to search out those banks that pay dividends and those that do not, from banks listed in Karachi Stock Exchange (KSE).
II. The second aim is to look at yield of dividend and payout ratio in order to observe the trend of dividend distribution of Pakistani listed Banks.

III. By analyzing different firm specific factors the third aim is to distinguish the characteristics of banks that pay dividend and those that do not pay dividends.

IV. To investigate the association between firm specific factors and dividend distribution.

2. Literature Review

How firms decide their dividend policy has been a puzzle to financial economists for many years. Based on previous work done, Fisher Black's in 1976 found that "dividends" is a puzzle. This conclusion of Fisher motivates researchers to study the dividends in more detail, especially those factors that play an important role in determining the dividend policy for emerging country like Pakistan. Different studies have been conducted on emerging countries including Pakistan is done by Aivazian, Booth and Clearly (2003). They stated that profitability and Investment opportunities play a significant role in determining dividends. Similarly Hu and Liu, (2005) found a positive relationship between the current earnings of a company and the cash dividend they pay to their shareholders, and a significant negative relationship between the debt to total assets and dividends.

Different researches have explained that the disputed dividends are outcomes of bird-in-hand theory. The bird-in-hand means cash dividends, in comparison it considers birds-on-the-bush (capital gains). This theory states that investors prefer cash dividends to capital gains. This leads firms to lay high dividends, which will result in the increase in value of shares. (Brigham & Gordon, 1968; Gordon, 1956; Lintner, 1956) The theory of Gordon-Lintner was criticized by MM as Bird-in-hand fallacy because many investors use to reinvest their dividends in the stocks of similar companies. So, the investors are exposed solely to the risk of firm's cash flows, which are associated with the firms' assets riskiness during the long time. All these theories prescribe the financial managers with a diverse approach. There is no single perfect dividend payout policy. The firms should adjust higher payout of dividend ratio so that the stock prices can be raised. Many empirical studies afterwards proved that the results gained from the researches were not consistent.

According to Miller, Merton & Franco (1961) dividend policy does not affect firm value under a certain set of assumptions; which include perfect capital markets, no transaction costs, no flotation costs and no taxes. Their independence will be observed between systematic information, dividend policy and equity costs. Most of the financial researcher and academics acknowledged this theory with a surprise because previous researches focused and suggested that share price and shareholder equity is affected if dividend policy is properly managed, similarly structure of a capital is affected by cash dividend Gordon (1959).

Most of the prior literature suggests that large companies due to greater access to capital markets have better opportunity to raise funds comparatively at lower cost. Therefore, they do not rely on their retained earnings and pay higher dividends to their shareholders (Fama and French, 2001; Holder *et al,* 1998). Large firms are more mature and thus have easy access to capital markets and thus have little dependence on internal funds and allow high dividend paying ratios. Previous studies suggest positive association between payout of dividend ratio and size because larger firms face higher agency costs and inferior issuing costs. A study based on agency cost, earned equity and dividend policy was conducted by (DeAngelo *et al,* 2004) who focused on why the firms pay dividends? They found that there is a significant relationship between the choices to pay or not to pay dividends and the leverage, profitability, cash balance, firm size, growth and past dividends. A similar study in the context of Ghana was conducted by Amidu and Abor (2006). The results indicate that there is positive association between profitability and dividend policy and liquidity and dividend policy. They found a positive association between the payout of dividend ratio, cash flows, profitability and corporate tax.

A study regarding banks' dividend policy is conducted by Dickens, Casey, and Newman (2000). They show a negative relationship between yield of dividend and investment opportunities, signalling, ownership structure, and risk and a positive relationship with size and dividend history. In Pakistan, a recent study was conducted by Ahmad and Attiya (2009), who investigate different factors determining dividend policy. The sample of the study was from 2001 to 2006. The results showed a trend that Pakistani companies fix their dividend payments through past dividends and current earnings. Second analysis of determining factors of dividend payout showed that stable companies pay higher dividends. Growth variable did not appear to have any significance influence on dividend policy while size of the firms found to be negatively correlated.

3. Research Methodology and Variables

3.1. Data Collection Procedure

For identifying the characteristics that affect the dividend policy of Pakistani Banks, population consists of 25 Banks in Pakistan that are listed in Karachi Stock Exchange (KSE). The final sample after considering any missing data consist of 18 banks. Thus the sample consist of a major fraction 72% of banks listed in KSE from 2006-2011. The data sources are the audited financial reports collected from KSE, SECP, SBP and bloom burg business week.

In order to be included in the study all banks must meet two criteria. (1) The bank needs to be listed in the

KSE during 2006-2011 and (2) data needs to be available on all variables. We have used simple correlation to measure the link between dividend policy and several firm specific factors.

3.2. Variables Measurement

The explanatory attributes that influence banks dividend policy in Pakistan are discussed in this section and how they are measured. Following Fama, and French (2001), La Porta et al, (2000), Grullon et al, (2002), Chen et al, (2005), Collins and Kothrai (1989), Ghosh (2006), Gugler (2003), Chung and Charoenwong (1991) and Stacescu (2006) we used firm size, growth oppurtunities, firm risk, firm performance, and leverage as explanatory variables. The first variable is size that is measured as Ln of total assets. The attribute growth oppurtunities is measured as percentage increase in total assets, whereas profitability is proxied by using the ratio return on assets, and return on equity. The next explanatory variable is leverage, we have proxy it by taking total debt and divide it by total equity. Risk of the firm is measured by firm's beta.

We have defined a dividend-payer bank as one, which have at least two dividend payments during six-year period from 2006 – 2011, in contrast a bank will be considered as non dividend payer bank if it does not make at least two dividend payments during the study period. The ratio yield of dividend and dividend payout is used to investigate the dividend distribution of Pakistani listed banks. Yield of Dividend is defined as stocks annual dividend divided by its current market price whereas payout ratio is measured as dividend per share divided by earning per share. Both yield of dividend and payout of dividend ratios are used as dividend variables.

4. Discussion of Findings

4.1. Dividend Payers and Non- Payers

As it can be seen in table 1 presented below that out of total 18 banks 61% pay dividends while 39% do not.

4.2. yield of *Dividend and payout of Dividend Ratio*

The average mean values of yield of dividend and payout of dividend ratio are presented in table 2 from 2006-2011 for the entire sample. Yield of Dividend has a mean value of 27.77% whereas payout of dividend ratio is 20.21%.

4.3 Comparison of Financial and Performance Variables for Dividend-Paying and Non-Dividend-paying Banks

The mean values of different firm specific factors are shown in table 3 for dividend payers and non-payers. Firm specific factors are firm size, growth rate, firm risk, leverage and profitability.

Table 4 shows the correlation coefficients of different firm specific factors, when payout of dividend ratio as the dependent variable. It can be seen that the independent variables growth, profitability and firm size have positive coefficient of correlation with the dependent variable payout of Dividend Ratio. However there is strong linear association between profitability and firm size with payout ratio but the variable growth rate has weak positive correlation with payout ratio. In contrast, the variables leverage measured as debt over equity and firm risk measured by beta has inverse linear relationship with payout ratio. The analysis of single year data on 2011 shows similar result as the average results, except for Growth opportunities, Return on Equity and Total Revenue which show stronger linear association with 0.124209, 0.416006 and 0.741162 respectively.

Table 5 shows the correlation coefficients of different firm specific factors, when yield of dividend ratio as the dependent variable. The results are in line with the results between dividend payout and firm specific factors. It can be seen that the independent variables growth, profitability and firm size have direct positive association with the dependent variable Dividend. However there is strong linear association between profitability and firm size with yield of dividend but the variable growth rate has weak positive correlation. In contrast, the variables leverage and firm risk has negative association with yield of dividend. The analysis of single year data on 2011 shows similar result as the average data of 2006-2011, except for Growth opportunities , Return of Equity and Total Revenue which show stronger relationship as compared to average data of 2006-2011 with 0.108229, 0.424412 and 0.715992 respectively.

The results show that growth, firm size and profitability variables have positive association with payout of Dividend Ratio and yield of Dividend Ratio. Furthermore, there is stronger association between size, profitability of the firm and both dependent variables. The reason behind this result is that profitable companies are large in size and due to high profitability they disburse higher dividends. Moreover, we have found positive but insignificant association between other explanatory variables and dependent variables. The two variables risk and firms leverage adversely affects its dividend policy, thus as a result high leveraged firm avoid payment of dividend. In the context of Norwegian companies Baker (2006) found similar results.

5. Conclusion

The paper investigates the impact of different firm specific factors on the dividend policy of companies by selecting a sample of 18 banks listed in KSE for the period 2006-2011. It was found that out of 18 banks 11 banks pay dividends whereas seven banks do not. The results have shown that the independent variables growth, profitability and firm size have positive coefficient of correlation when the dependent variable is yield of dividend and payout of Dividend Ratio. However there is strong linear association between profitability and firm size with dividend policy but the variable growth rate has weak positive correlation with dividend policy. In contrast, the variables leverage measured as debt over equity and firm risk measured by beta has inverse linear relationship with dividend policy.

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Table 1: Analysis of Dividend Payers and Non-Payers

Industry	Dividend payer	Non-dividend payer
Banks	11	7
Total	11	7

Table 2: yield of Dividend and payout of Dividend Ratio

Variables	Mean 2006-11
yield of Dividend Ratio (%)	27.76502
Dividend Payout Ratio (%)	20.21419

Table 3: Comparison between Dividend-Paying and Non Dividend-Paying Banks

Variables	Dividend Paying Banks Mean	Non-Dividend Paying Banks Mean
% increase in Total Assets (Growth opportunities)	0.211566	0.451351
Ln of Total Assets (Firm Size)	12.12773	10.09286
Earning volatility before depreciation (Firm Risk/ Beta)	0.036325	0.035773
ROA (Firm Profitability)	0.015536	-0.01719
ROE(Firm Profitability)	0.270999	0.16616
Debt over Equity Ratio (Leverage)	0.905073	0.792191

Table 4: Coefficient of correlation for dividend payout ratio and firm specific factors

Variables	Coefficient of Correlation (Average 2006-2011)	Coefficient of Correlation (2011)
Growth opportunities	0.084173	0.124209
Return on Assets	0.467492	0.446434
Return on Equity	0.173829	0.416006
Total Revenue	0.627498	0.741162
Debt over Equity	-0.11236	-0.03521
Beta	-0.15961	-0.33913

Table 5: Coefficient of correlation for yield of dividend and firm specific factors

Variables	Coefficient of Correlation (Average 2006-2011)	Coefficient of Correlation (2011)
Growth opportunities	0.065759	0.108229
Return of Assets	0.448559	0.424412
Return of Equity	0.128754	0.324906
Total Revenue	0.647934	0.715992
Debt over Equity	-0.13938	-0.11812
Beta	-0.11054	-0.2447