The Effect of Dividend Policy on Share Price: A Conceptual Study

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Abstract

This study has tried to cover the dividend policy that is used by most companies and the purpose of using the dividend policy is to ensure the dividend structure in terms of paying out to the shareholders. In this sense, this study has discussed the four dividend policies as "***regular dividend policy, irregular dividend policy, stable dividend policy and the no dividend policy"*** for the share market. Based on this discussion, this study has covered the strategies to maintain the stakeholders in terms of selling the portion of the shares. With the help of secondary data, this study has tried to evaluate the significance of dividend policy for share prices.

Keywords:

Dividend policy, Constant-payout-Ratio, Regular Dividend Policy, Low-regular and Extra Dividend Policy

Introduction

The dividend policy is always a debated topic and also very controversial in the finance field as this is a basic element in the corporate world. A dividend is a very crucial topic because of the recurring policy of it and the pay-out of it and also a lot of money is involved here. The policy of the pay-out of dividends also maintains exclusive relationships with many companies which invest a lot and also have the regulation. After the dividend theory the policy of it is carried out to the whole world and the main reason for it is the pay-out benefit. Although anyone can get any kind of information about the company without any cost, there is also no fee for taxes or any kind of transaction as far as the range is. In this theory, the main and most important part is to select and identify the investors and the type of investment they are doing. This process is tricky and also a lot of issues can be created in this process. This dividend policy foundation and structural policy were given by Allen and Michael who also give sufficient support in the dividends and also in repurchase although the company value will be decided by the strategy of the investment. This study is going to discuss the policy of dividends and its effects of it on the share price. Moreover, it's based on the relationship between the policy and the effect on the share prices of the whole world.

Aim:

The aim of this paper is to ***investigate the impact of dividend policy on share price.***

Objectives

The objectives of this paper are:

- To identify the effect of dividend policy on share price
- To evaluate the impact of dividend policy on share price
- To analyse the benefits and challenges of share price based on effective dividend policy
- To recommend proper integration of dividend policy on share price

Literature review

Explanation of the dividend policy

The study by Baker (2018) shows that many approaches were quantitative in the topic of determination of the dividend policy and all the data were collected from the markets. In this study, there were almost 190 firms of a company and according to the time period of the years, the total observed firm number was almost 1330. The main theory of the policy is that the company's market value of the company does not affect by the share price of the company and also the company's assets are irrelevant which is efficient for the perfect market which does not have any kind of information on the asymmetry and also the taxes and mainly no cost for the transaction.

In a research paper, Kilincarslan (2018) showed that the payment method of the dividend could be minimized and for that reason, there would be a conflict between the shareholders who are outside of the company and the manager of the company. The conflict arose from the low flow of cash which also forced the financial corporate world to move into the outside markets of those who were capitalized. Although the investors of the companies always hold a huge amount of the stock pierce and they have a lot of experience so they can easily manage and also monitor the whole market firms in the management and mostly they have a lot of incentives.

Types of dividend policies

Obaidat (2018) in his study showed four types of the policy of dividend were shown here. The company actually dictates all the numbers of the dividends and also, they pay for the frequency of it to the shareholders. One company could follow many kinds of policies which all are related to the dividend. After getting profits the company always dedicated where and how the profit would be distributed. The profit would be distributed to the shareholders in a form of a dividend or into retain, which will be decided by the company. The most popular four types of policies of the dividend are "***Regular dividend policy, stable dividend policy, irregular dividend policy, and no dividend policy***".

However, another study by Akhtar (2018) showed that there are only three main and important dividend policy types and the regulations are "***a Stable dividend policy, a Constant dividend policy, and the last a residual dividend policy***". The "***policy of the stable dividend***" is the most popular in the financial market and is also easy to use and most companies use it. The main motto of this policy is to be predictable and also to be stable for the payment method of the dividend and this has to be every year. In the policy of the constant, the organization only always pays for the percentage of the profit it earned. The policy of the residual dividend has a huge value and the reason that binds it is the huge volatility. Some investors only consider this policy.

Effect of dividend policy on the share price

In a research paper Ahmad (2018) and his fellow Mets show they examined the policy of dividends and its effects on the price of the stock and also the frivolity of the listed firms in the exchange of the stock of Amman. They collected all the data of the stock exchange of Amman and listed everything. They studied almost ***228 firms***. Their collection period of the time is from 2010 to 2016 and according to this the data of the firm-year is almost 1596 which is observed. They describe the statistical data and also the relationship between the plan of estimation GMM and the applied person, which is tested. All the tests and observations and results show that the policy of dividend and the yield and also the pay out of the dividend is having an irrelevant relationship with the piece of stock volatility.

Whoever Sondakh (2019) showed in the research paper that the firms released on the public platform are having a target to higher their value in the financial market. The reason behind it is that the firm value is very attractive to the investors and they call the capital of the companies and increasing the value of the firm is increasing the value of the corporate market which is beneficial for the shareholders. In this study, the list of the company's financial background and the period is almost 2015 to 2018 years. This study included more than 12 companies. And by sampling the company's requirements the study collected around 99 companies. This study results also showed that the policy of the dividend is not relatable to the share price of the corporate market.

Benefits of dividend policy:

This research by Tamrin (2018) showed the benefits of the policy of the dividend in the corporate world and also how it affects the profit in the governance in the structure of the finances of the corporation. The study showed that they researched and also collected more than 58 companies and their firms and also, they analyse the data of these companies and observed the profitable margins and the benefits which come from it in the organization.

However, a research study by Harakeh (2020) showed that the relationship links the dividend policy and the firms of the financial corporate company and also explains the benefits of this relationship which is although casual. The reason and the study aim to know about the reactions and the benefits of the dividend policy in the corporate market.

The research paper of Duygun (2018) showed that the factors of the policy always focused on the company's cost and the structure of the ownership. The benefit of the policy is always based on the company side but also it has a lot of beneficial effects for the stockholders. The rate of growth increases and also the flow of cash, and the profit margin all are essential benefits of the policy of the dividend.

Methodology

Dividend payment is a critical component of stock returns to shareholders. Dividend payments and policies could signal to shareholders that the company is following good corporate governance operations (Raza *et al.*, 2018). Dividend distributions can actively attract investors and also increase the company's share policies indirectly. In this part of this study analysis of "***research philosophy***", "***research approach***", "***explanatory research design***", "***secondary data collection method***", "***data collection tools***", "***thematic data analysis***", and "***ethical considerations***" will be discussed.

Research philosophy

The selection of research philosophy for this study is afflicted with practical significance. The four types of research philosophies are such as "***Positivism, Interpretivism, Pragmatism and Realism research philosophies***" and among them, "***Interpretivism research philosophy***" has been chosen for this particular study (Ahmad *et al.*, 2018). This philosophy will help the researchers to understand the share market environment and situations.

Research approach

This report has selected a "***deductive research approach***" to analyse the demand of the share market which is affected by dividend policy rules and regulations. "***Deductive research approach***" has been chosen to collect more unhindered data and it will help to explain the relationships between the investors and the company (Nguyen *et al.*, 2020).

Research design

An "***explanatory research design***" has been chosen in this study to research the method that investigates the reason for the occurrence of some challenges. "***Explanatory research design***" also helps the researchers to make out a particular problem deeply and provide a piece of wide information about a specific problem.

Data collection method

There are two types of data collection processes that existed for the research, "***Primary Data collection method***" and "***Secondary Data collection methods***". The researchers have chosen the "***Secondary and qualitative data***" collection process here. "***Qualitative data***" can be collected from journals and articles on relevant topics. It will help to understand the market's reactions to dividends and also the difference between investor categories. There are various "***data collection tools***" that existed to study the effects of dividend policy on the share market by collecting the data from business journals, social books, share market journals, business magazines, libraries and social media and also from governmental censuses.

Data analysis

This research study chose the "***Thematic data analysis***" method. This type of data analysis does not need the detailed theoretical and technological knowledge of extra-qualitative approaches. "***Thematic data analysis***" helps the researchers to make out the aspects of a circumstance that the participants talk about often in-depth and also the way those aspects of that particular situation may be connected here. Data can be described in this method and it also involves the explanation of the process of choosing codes and building themes (Adam *et al*., 2020).

Ethical considerations

The protection of the data through the application of correct ethical principles is very important in all research studies. In a qualitative study, Ethical considerations have a specific resonance due to the thorough nature of the study process (Nguyen *et al*., 2020). The consideration of ethical problems is major throughout all steps of a qualitative study to maintain the balance between the possible risks of research and the expected benefits of the research.

Limitations

Several limitations are found to performing this research study; dividends can be given in the structure of allowing additional shares to existing shareholders. Facilities in some bond agreements place a maximum quantity on what a company can pay out in dividends (Raza *et al*., 2018). The limitations can be reduced by identifying the risks that the issuer will revert on a bond as it decides to spend too much in dividends to common shareholders. Further research is also required on this particular topic as there is a lack of evidence present in this study which is a barrier for the researchers to explain this topic.

Results

The spending on dividends acts as a superior indicator of the company's financial health and success rate. Here are some points mentioned below that clearly show how dividend policy affects share prices. Many well-known companies made a habit to distribute the profits which are generated consistently and regularly. This draws stability and also increases the brand value and goodness of the company. The investors are inclined to such institutions in a favourable manner than other entities that don't give away dividends as frequently. This compatible dividend-paying mechanism of such organizations is apt to attract more investors and also create demand for the shares. The share price will be increased if more investors drove toward the company.

According to Camilleri *et al*., (2018), a company before distributing the dividend to its shareholders makes a public declaration first. This statement or declaration consists of essential details such as the dividend amount, the record date, the ex-dividend rate and the date on which the dividend is to be expected to get credited to all the equal shareholders of the company. This type of public statement has a higher expected ability to affect the public sentiment for the company's stock in a positive way. As a result of this more shareholders might purchase the share, which can increase the share price.

In addition to this (Singh and Tandon, 2019) describes many traders and shareholders may also purchase the stock of the company for the short-term concerning to capture the dividend problems raised by the company. This move would also lead to increasing the price of the dividend-issuing company’s shares. Phan and Tran (2019) research shows that if the share price rose after the company announced the dividend, this could naturally correct itself on the ex-dividend dates. The reason for this can be any new purchaser of the company's share on or after the ex-dividend date would naturally become disqualified for receiving dividends. The new purchasers will not be eligible to receive dividends and the purchasers might not be prepared to pay a huge surcharge for the shares and thus would start restating lower prices for the shares. Therefore, this might force the sellers to demand lower prices which can affect the company's share price negatively. The research study of (Camilleri *et al*., 2018) showed that many shareholders believe that the holders of future and options arrangements do not receive any dividends and also the shareholders should not worry about the effects on future and options prices.

Discussion

The connection between dividend policy and share price changeability after the insertion of growth as a control variable would be expressive of either the investment or information effect. The share price dividends cannot show result in any proper enhancement in values for the shareholders in the time of distributions (Dereli and Topak, 2018). After the declaration of the dividend policy, the share price frequently enhances. However, a "***stock dividend***" enhances the rate of shares are great, while the cost of the organisation is retaining static. The "***dividend yield***" and "***dividend distribution ratios***" are two ratios that includes assessment of analyst and investors and use for the evaluation of each company's investment for dividend income (Driver *et al*., 2020). The "***dividend yield***" shows the yearly return per share owned so that an investor realizes from cash dividend payments.

The "***dividend yield***" gives a fine minor measurement for an investor to utilise in the comparison of the dividend profit from a company's contemporary holding to prospective dividend income obtainable via investing in another field or "***mutual funds***". Considering the total investment outcomes, it is crucial to note the enhanced share prices deduct the "***dividend yield***" ratio yet the total outcome from owing the share possibly have upgraded substantially (Singh and Tandon, 2019). On a contrary, a reduction in share amount shows a high rate of "***dividend yield***" but can specify the organisation is facing issues and lead to a deducted overall investment return.

The "***dividend distribution ratios***" is reviewed as more appropriate for the evaluation process of a financial situation of a company and the expectations for improving or maintaining its dividend pay-out in future. The "***dividend distribution ratios***" discloses the rate of net income of a particular organisation spending in the aspect of dividends. In the case of high "***dividend distribution ratios***," it may show less probability of a organisation will be capable to sustain this dividend spending in future (Chang *et al*., 2020). The reason for this is the organisation is using a smaller percentage rate of earning which will be reinvested in the company's growth. Therefore, (Adam *et al*., 2020) described that a "***stable dividend***" pay-out ratio is normally preferable over an extraordinarily major one.

A superior way to determine if an organisation's "***dividend distribution ratios***" is a sensible one is to evaluate the ratio of the same organisation within the same industry. "***Dividend per share***" is another factor which is used to measure the total share of profits that an organisation pays out to its investors (Driver *et al*., 2020). "***Dividend per share***" can be measured and extracted by deducting the "***special dividends***" from the additive value of total dividends throughout one year and dividing the amount by the exceptional share. "***Dividend Policy***" is a major monetary decision that involves the payment of investors in return for their investments in shares (Phan and Tran, 2019). Each firm operates in a provided industry which follows a similar sort of dividend payments pattern or dividend policies and it is a financial indicator of every company. Thus, the Dividend policy is important for every stakeholder, manager, leader and investor.

Conclusion

Dividend policy is always a puzzle that is unresolved in the area of the finance of the corporate field. Many studies are done and shown a lot of things that create controversy in the dividend policy. The main question which always arises is whether the policy has any impact on the share market and also on the share prices. The question is valid and also remains a controversial topic after getting and studying all the data and documents by the makers of the policy and the researchers and also the managers. According to the study and research, the dividend policy might be justified in two ways.

First is Miller and Modigliani's opinion on the dividend policy. In their study and research, they concluded that the price of the sock and the policy of the dividend are not relevant. The second opinion on this controversy is the opposite as Gordon shows in his study that the policy of the dividend and the price of the share are relevant in the market of the financial. Of this controversy, the manager of the company and also the investor are in a dilemma about which theory and the firms they should follow. Science, fifty years of research and debate still it's a puzzle not clear whether its effect is the price of the market or not. This study shows all the other variables of the dividend policy which can be used and the test of the variable on the price of the share.

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