

Impact of Dividend Policy on Shareholders' Wealth and Firm Performance

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Abstract

Maximizing the long-term shareholders' wealth by providing a stable dividend payment is always a goal of the firm. The dividend policy has several implications that affect both parties, shareholders, and the firm. The management wishes to strike a balance between the interest of shareholders and the firm's sustainability for future growth and earnings stability. Under the signaling theory, dividend policy signals good news to investors and impacts share price. However, debates on whether dividend policy signals good or bad news and its varying effects have long been discussed. This paper aims to determine whether dividend policies affect shareholders' wealth and firm performance in Malaysian Public-Listed Companies (PLCs). This study measured dividend policy through dividend per share and dividend yield. Meanwhile, the share price is used to measure a shareholders' wealth, and firm performance is measured by lagged return on equity. The data was selected from the top 60 Malaysian PLCs traded in Bursa Malaysia for a period of eleven years, starting from 2010 to 2020. The study used Pearson's correlation coefficient analysis and multiple linear regression analysis. The findings revealed mixed results where the dividend per share has a significant positive relationship whilst the dividend yield has a significant negative relationship with the share price. A positive significant relationship exists between dividend policy on lagged ROE. This study contributes useful insights to the debates on the effect of dividend decisions and their impact on the share price and firm performance in emerging markets, particularly in Malaysia.

Keywords: Dividend Policy, Dividend Yield, Shareholder Wealth, Return on Equity, Firm Performance

Introduction

Dividend policy is viewed as an important and integral part of corporate strategy because it may influence investor confidence whilst indicating the firm's growth sustainability. Dividend decisions are among the most important financial management and corporate finance decisions apart from financing and investment decisions that influence the value of a company to maximize the shareholders' wealth. (Foong et al., (2007). The firm's ability to provide a steady stream of income to investors can be viewed as a form of compensation for shareholders in exchange for their willingness to make financial investments in the company; thus, this method of compensation

can assist shareholders in achieving their goal of maximizing their wealth (Mahirun et al., 2023; Salim & Pardiman, 2022; Yin & Nie, 2021).

The term dividend policy refers to the practice used by the firm when deciding the possibility of paying dividends at certain rates without jeopardizing future investment plus how frequently it should be paid out over time. However, the Malaysian Companies Act 2016 did not regulate dividends as a mandatory payment, thus the firm has no obligation to pay dividends. Typically, the board of directors with the advice of management will declare and approve the percentage of profits as dividends. Corporate dividend policies also differ over time and across a firm and the countries, most notably between developed, developing, and emerging capital markets. Thus, different companies will have different dividend policies at the firm's board discretion (Omar & Echchabi (2019). Dividend policy is influenced by a few factors: profitability, free cash flow, firm size, and others. Ayunku & Markjackson (2019) stated that the decision to pay dividends begins with profits. The term "free cash flow" refers to the cash flow generated after the company has invested in all projects with a positive net present value (NPV). Even though a company is profitable and has sufficient free cash flow, it may opt not to pay a dividend if the profits are retained for future investment purposes. Dividends will be paid based on the company's financial position and investment needs.

Literature Review

Dividend Policy and Stock Price

Several studies indicated that there is a relationship between dividend policy and stock price volatility. It indicates mixed results where the dividend per share shows a significant negative impact whereas the dividend yield indicates an opposite direction which has a significant positive impact on share price movement (Amirthalingam & Rajaratnam, 2022; Koleosho et al., 2022). A company uses dividends to give a signal to the prospects of a company; increased dividends are viewed as positive news, and the stock price rises in response. Due to the information asymmetry between managers (insiders) and investors (outsiders), changes in dividend payments signify future earnings and are used by management to inform the company's investors. This is consistent with signaling theory (Ali et al., 2023; Melching & Nguyen, 2021). In contrast, Karim (2010) investigated the stock market reactions to dividend announcements and the findings are controversial in the sense that the market does not react at all to any dividend announcements for the New York Stock Exchange. However, the market reaction to the London Stock Exchange was found differently where a positive dividend announcement causes a negative reaction, whereas a negative dividend announcement results in a positive market reaction.

Firm Value

An increase in the firm's value will have a greater impact on the shareholders' wealth on capital gain or dividend gain. Prior research used various proxies to measure shareholders' wealth. Chiedu et al. (2020) measured using earnings per share (EPS) represented by a proportion of the earnings allocated to each share of common stock. A few researchers used market price per share (SP) as a measurement of shareholders' wealth that is reflected in the market price of the firm's common stock. Changes in dividend policy will affect the firm's SP in both positive and negative ways, and if a dividend policy can increase a firm's SP, it is ideal (Abdullah et al., 2023;

Amirthalingam & Rajaratnam, 2022; Ullah et al., 2021). The impact of dividend policy on shareholders' wealth has been debated extensively in the finance literature over the years but remains an open question (Khalaf et al., 2023; Koleosho et al., 2022); Kengatharan & Ford, 2021; Yin & Nie, 2021).

Methodology

Hypotheses Development

A prior literature review revealed the inconsistency in the relationship between dividend policy and share price used as a measurement of shareholders' wealth. Changes in dividend policy will affect the firm's SP in both positive and negative ways, with either a significant or insignificant impact on shareholders' wealth (Syed et al., 2023; Ngoc & Cuong, 2021). Mixed results indicate a significantly negative relationship between payout ratio, dividend per share (DPS), and stock price volatility and a positive relationship between dividend yield (DY) and stock price volatility of the companies (Ali et al., 2023; Hanafi et al., 2023; Ullah et al., 2021). However, the previous literature on the relationship between dividend policy and return on equity used as a measurement of firm performance showed almost consistent results indicating that there is a significant positive relationship between dividend policy and firm performance. It can be concluded that ROE will increase if DPS increases and vice versa (Bossman et al., 2022; Farrukh et al., 2017; M'rabet & Boujjat, 2016). A similar measurement of share price for shareholders' wealth and return on equity for firm performance is used in this study. The correlation of the dividend policy on share price and return on equity should be construed together and develop this hypothesis:

H1: There is a significant positive relationship between dividend policy and the share price.

H2: There is a significant positive relationship between dividend policy and the return on equity.

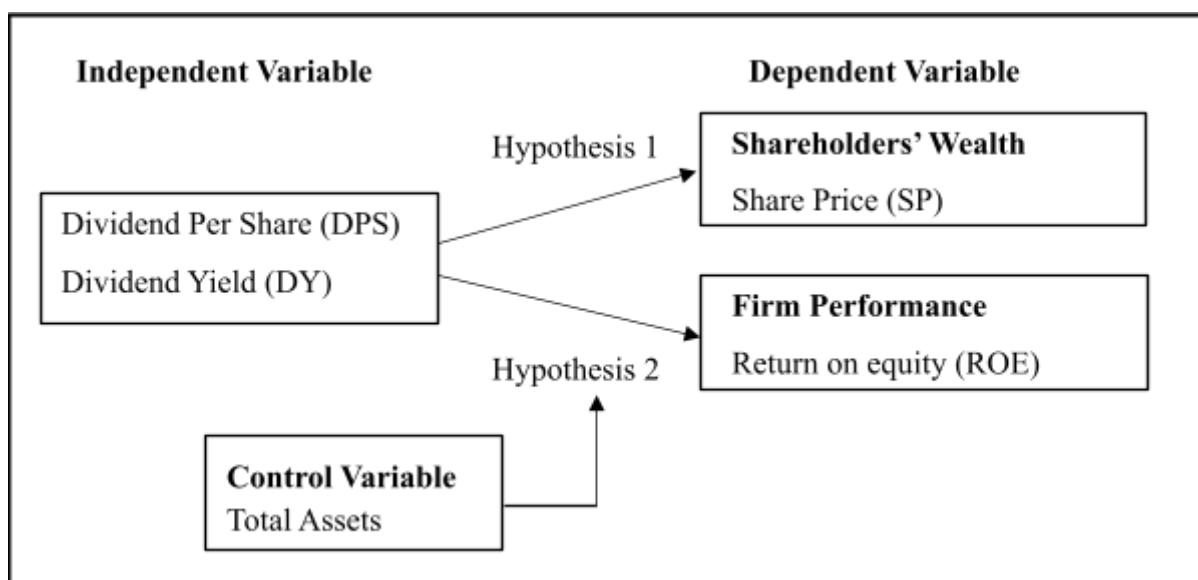


Figure 1: Conceptual Framework

Findings And Discussion

Descriptive Statistic

This study reports the sample distribution across industry classifications determined by Bursa Malaysia, shown in Table 1. The 60 Malaysian PLC firms included in this sample need to meet the criteria; (i) availability of firm's data in DataStream and Annual Report; (ii) availability of dividend payout. Many PLCs are from consumer product services (37%), followed by the plantation sector (15%) and utilities (10%). The least companies are from energy, transportation, and logistics representing 2%.

Table 1: Sample Distribution Industry Classification by Bursa Malaysia

Industry Classification	#Sample Firms	% Sample Firms
Utilities	6	10
Consumer Product Services	22	37
Telecommunication & Media	3	5
Plantation	9	15
Industrial Product Services	5	9
Real Estate Investment	2	3
Energy	1	2
Construction	3	5
Property	4	6
Healthcare	4	6
Transportation & Logistics	1	2
Total	60	100

Conclusion

This study is to examine the impact of dividend policy on shareholders' wealth and the firm performance of PLCs in Malaysia. DPS and DY are the measurements for the dividend policy, whereas SP and lagged ROE are the proxy measurements for shareholders' wealth and firm performance, respectively. Overall, it can be concluded that DPS has a significant positive relationship with shareholders' wealth and firm performance. More interesting, DY indicates mixed results where it has a negative significant relationship with shareholders' wealth but appears to have a significant positive relationship with firm performance. The results revealed that DY has a negative effect on SP. Though DY shows a negative association, it indicates a significant relationship between dividend policy and SP. These mixed results are consistent with signaling theory and prior studies (Hanafi et al., 2023; Ngoc & Cuong, 2021; Ullah et al. (2021) where they found that dividend policy was discovered to be a very determinable determinant of their share prices.

The findings revealed that there is a positive relationship between dividend policy and firm performance measured by ROE. This indicates the higher the DPS and DY, the higher the lagged ROE of the companies. The findings are consistent with Mahirun et al. (2023), Bossman et al. (2022) and Banerjee (2018). This study adds more literature and contributes useful insights to the debates on the effect of dividend decisions in emerging markets, particularly in Malaysia. The findings are expected to serve as a reference for management and investors to analyze the market reaction following the announcement of important corporate finance decisions between in

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