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RESEARCH PAPER

Financial Accounting I

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EFFECT OF DIVIDENDS ON SHARE PRICES OF DIFFERENT COMPANIES IN KARACHI STOCK EXCHANGE

Abstract

This paper attempts to determine the impact of dividend yield on stock price risk in Pakistan. A sample of listed companies in Karachi Stock Exchange is examined for a period from 2004 to 2007. Dividend policy measures have significant impact on the share price on the stock exchange. The relationship is not reduced much even after controlling for the above mentioned factors. So dividend policy affects stock prices and they fluctuate accordingly. Price data has been taken from the annual reports and other annual publications of Karachi Stock Exchange. . The empirical estimation is based on a cross-sectional regression analysis of the relationship between stock price volatility and dividend policy after controlling for firm size, earning volatility. Dividend yield and payout ratio have significant impact on the share price volatility. The relationship is not reduced much even after controlling for the above mentioned factors. This suggests that dividend policy affects stock price volatility and it provides evidence supporting the arbitrage realization effect, duration effect and information effect in Pakistan. Whereas payout ratio. Whereas payout ratio measure is having significant impact only at lower level of significance. In overall period the size and leverage have positive and significant impact on stock price volatility. The earnings volatility impact is negative and significant only during reform period. The paper attempts to formulate dividend yield with the help of dividends that are calculated by using formula in the excel sheet. This would give us the idea about effects of change in dividend policies on the share prices. We have also give graphs and figures regarding this information with the help of an equation. This equation shows the relationship between stock

price volatility and no. of outstanding shares. Dividend yield of 93 companies is being analyzed thoroughly after calculation to interpret about the results concerning share prices. All the data is given in appendix A and b. After that article on Dividend policies and share prices are taken into consideration to reach conclusion.

Literature Review:

This topic has been of greater interest for the scholars all around the world and due to its importance in predicting stock market situation in any country. Summary of some of the important articles that we came across is given here.

Nishat (2000) found out that payout ratio measure is having significant impact only at lower level of significance. In overall period the size and leverage have positive and significant impact on stock price volatility. The size effect is negative during pre reform period (1981-1990) but positive during reform period. The earning volatility impact is negative and significant only during reform period. Although the results are not robust enough as in the case of developed markets but are consistent with the behavior of emerging markets.

Kenneth D West (2004) established an inequality that may be used to test the null hypothesis that a stock price equals the expected present discounted value of its dividend stream, with a constant discount rate. The inequality states that if this hypothesis is true, the variance of the innovation in the stock price is bounded above by a certain function of the variance in the innovation in the dividend. The bound is valid even if prices and dividends are non stationary.

Ameer Rasheed (2006) found out that the decision to increase dividends is significantly related to earnings, and the decision to cut dividend is significantly related to the changes in earnings losses.

Allen D E, Rachin V S, (1996) found out that dividend policy remains a source of controversy despite years of theoretical and empirical research, including one aspect of dividend policy: the linkage between dividend policy and stock price risk. His work featured a cross-sectional regression analysis of the relationship between stock price volatility and dividend policy, after controlling for firm size, earnings volatility, leverage and growth. The results do not support Baskin's suggestion that dividend policy per se can influence stock price volatility because it is not clear where the causality resides.

Upananda Pani (2008) attempted to explore the possible links between **policy and stock** price behavior..Dividend **policy** has always been a source of controversy despite years of theoretical **and** empirical research both in developed countries **and** emerging economies. The present paper features a panel data approach to analyze the relationship between dividend-retention ratio **and**

stock-price behaviour while controlling the variables like size **and** long-term debt-equity ratio of the firm.. The results are based on the fixed-effect model, as these perform statistically better than random effects and pooled OLS model. Results of the fixed-effect models indicate that dividend-retention ratio along with size and debt-equity ratio plays a significant role in explaining variations in **stock** returns. The fixed effect models show the presence of firm level effect in explaining the possible links between dividend **policy and stock** price behavior of the

firm.. Although the results are not robust enough as in the case of developed markets but shades some more interesting facets to the existing corporate finance literature on dividend policy..

K Sunita (2004) stated that a cash dividend is cash payment to a corporation's shareholders, distributed from current earnings or accumulated profits. An announcement of cash dividends would instantly seem to have some impact on a stock's prices. To move a stock's price, however, the amount of the dividend or the nature of the dividend must be a surprise. The dividend can be of almost any amount and shareholders have no guarantee of dividend payments. Decreasing or eliminating a dividend is tantamount to an announcement that the firm is financially distressed. Directors weigh dividend policies very carefully, rarely lowering dividends unless they have to, and not raising dividends unless they are confident that they can be sustained. Dividends are considered important because investors view them as a signal about a company's future profitability. When a company announces a larger than expected dividend or unexpectedly announces a dividend cut, the market reaction is dramatic and sudden. Consistent with previous studies, the results show that dividend initiations have significantly positive effects on stock prices. The only way for an individual to take advantage of a positive or negative surprise dividend announcement is to be positioned prior to the Announcement.

Gil Sadka (2007) found out that a significant negative correlation between expected returns and expected earnings, suggesting that variations in a common factor to both may generate significant price volatility. The results are consistent with the dividend-policy irrelevance hypothesis.

Methodology:

All the data was collected from annual reports of the respective companies. This data included details of share capital, number of shares, total annual dividend and net income from income statement. From this data. Two variables of this data are Dividend Yield and Stock price.

Dividend Yield per share (Percentage): It has been calculated by dividing dividend per share by average current price given in the data.

Dividend Yield= dividend per share/current stock price

Average Current Stock Price: It was already given in the data which is attached as appendix B.

Dividend per share of each company was calculated for the four years from 2004 to 2007. From this dividend yield was calculated and then 'Average Dividend Yield' of each year was calculated by dividing the Sum of each year by total number of companies. It is given below.

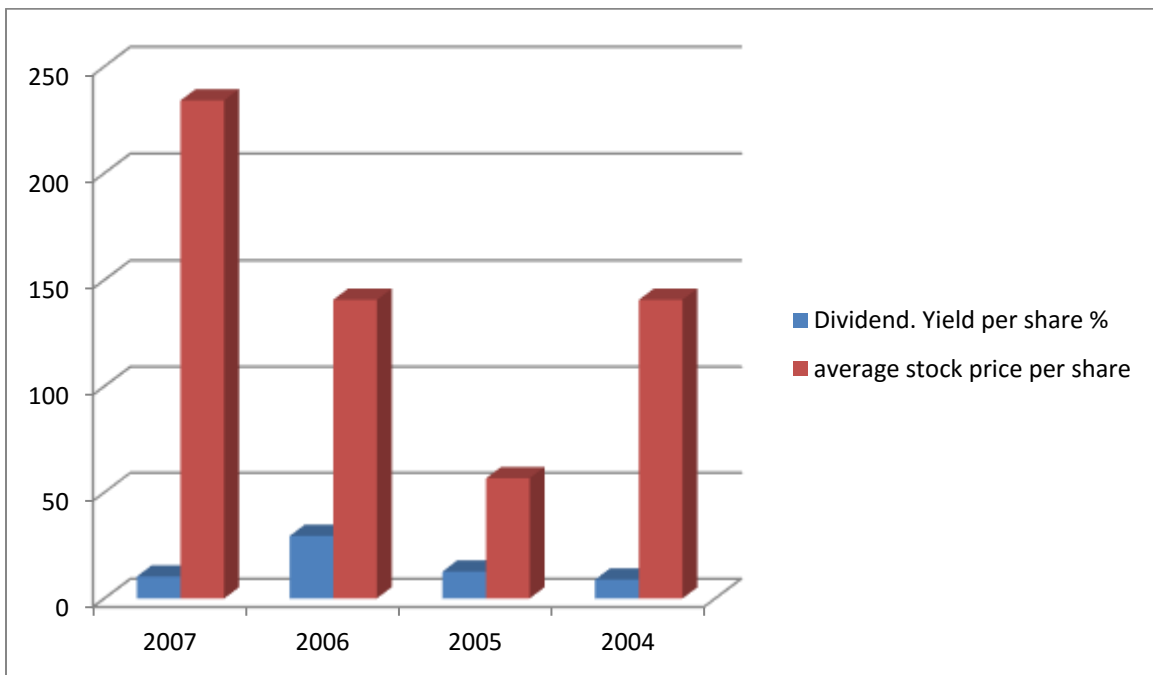
Quantities	2007	2006	2005	2004
Dividend Yield Per Share %	10.40	29.40	12.71	8.95
Average stock price per share	234.21	140.73	56.68	140.73

The relationship is given the useful information its observations are given in the conclusions. A graphical relation is also drawn to get a better idea of the research under taken.

Conclusion:

After a deep observation of the data and its graphical sketch it is clearly seen that whenever there is increase in current stock price of a company there is a decrease in its dividend yield. The rate of decrease or increase in both the values depends upon the nature of the company and the sector in which it operates. For few companies this decrease in the value of dividend yield is greater. The year of 2006 seems to be better as compared to the other years as average increase in the yield is also impressive. Then instead of increasing trend one can observe a poor dividend yield in the year 2007. This may be due to the reason of current economic situation in our country as well as in the whole world. The stock market has been badly hit by the current recession and decline in the dividend yield in 2007 has been proved by the worst situation of stock market in the year 2008 and our country along with the whole world has seen its lowest level of index.

APPENDIX



2007

2006

2005

Companies Name	Stock Price	Dividend Yield %	Stock Price	Dividend Yield %	Stock Price	Dividend Yield %
Orix Leasing Pakistan Limited	29.85	5.64	27.15	7.35	31.53	4.68
Arif Habib Securities Limited	215.58	22.62	422.55	60.73	330	58.71
First Capital Securities Corporation Limited	77.6	3.11	36.2	3.63	28.8	3.19
JS Global Capital Limited	366.6	6.92	207.73	1.84	104.25	2.94
Jahangir Siddiqui & Company Limited	638.5	12.49	198.25	3.86	151.3	5.57
JS Investments Limited	72.85	0.00	0	0.00	0	0.00
Allied Bank Limited	119.78	3.16	94.55	4.66	61.68	2.79
Askari Bank Limited	102.13	4.37	106.5	6.32	101.63	6.34
Bank Al - Habib Limited	69.5	3.89	69.98	5.26	55.98	6.56
Bank Alfalah Limited	53.73	3.41	60.98	1.73	54.38	4.73
Bank of Punjab Limited	107.3	3.43	96.28	4.42	94.63	5.50
Mybank Limited (Bolan)	27.2	0.37	22.65	0.35	18.9	0.00
Crescent Commercial Bank Limited	19.85	0.00	13.38	0.00	13.8	0.00
Faysal Bank Limited	70.13	3.06	73.68	4.51	58.13	9.32
MCB Bank Limited	339.33	8.95	217.38	9.20	113	11.57
National Bank of Pakistan Limited	259.9	7.63	249.05	5.30	141.93	6.82
NIB Bank Limited (NDLC - IFIC)	29.43	0.00	26.58	0.00	29.73	0.00
Saudi Pak Commercial Bank Limited	12.5	0.00	6.9	0.00	6	0.00
Soneri Bank Limited	21.28	2.29	16.03	1.97	13.65	12.23
Adamjee Insurance Company Limited	290.1	4.25	144.2	4.33	104.63	5.38
EFU General Insurance Company Limited	291.88	37.35	212	9.35	138.5	11.78
EFU Life Assurance Company Limited	410.7	4.70	201	3.39	162.5	3.61
IGI Insurance Limited	399.03	14.95	362.35	101.54	249.3	5.30

New Jubilee Insurance Company Limited	161.35	3.32	82.38	15.11	76.25	9.96
Pakistan Reinsurance Company Limited	281.48	111.70	122.75	4.87	67.85	7.79
Fazal Textile Mills Limited	245.7	0.00	138.98	1.41	106.5	1.55
Azgard Nine Limited	37.95	1.07	45.75	0.88	38.03	3.37
Nishat Mills Limited	111.5	2.35	111.93	2.51	94.8	2.73
Shams Textile Mills Limited	43.05	12.68	24.98	0.00	7.68	0.00
Bannu Woollen Mills Limited	50.4	5.22	33.88	0.00	38.78	0.00
Ibrahim Fibres Limited	45.85	0.00	40.1	0.00	45.5	0.00
Thal Limited **	236.4	26.73	202.9	56.38	141.98	54.20
Habib Sugar Mills Limited **	44.2	7.64	42.9	12.41	36.85	14.50
Attock Cement Pakistan Limited	97.15	5.11	50	1,808.13	74.63	2.00
Bestway Cement Limited	66.33	0.00	72.1	1.45	60.2	1.45
D. G. Khan Cement Company Limited	91.28	1.05	107.95	3.04	80.4	1.70
Fauji Cement Company Limited	18.78	0.00	21.55	2.26	19.53	0.00
Javedan Cement Limited	110.03	0.00	77.38	4.51	42.25	0.00
Lucky Cement Limited	100.7	1.20	94.58	0.78	58.15	0.00
Maple Leaf Cement Factory Limited	20.73	0.00	32.3	0.00	31.5	0.85
Pioneer Cement Limited	36.23	0.00	46.15	1.31	39.5	0.27
Pakland Cement Limited	13.08	0.00	14.5	0.00	13.08	0.00
Lakson Tobacco Company Limited	520	7.76	323.7	11.31	285.9	18.95
Pakistan Tobacco Company Limited	134.7	6.59	70.8	7.79	62.25	4.16
Bosicor Pakistan Limited	17.75	0.00	25.38	0.24	19.43	0.00
National Refinery Limited	348	39.87	318.38	25.71	378.5	10.51
Pakistan Refinery Limited	249.85	1.12	290.5	8.33	314.75	13.67

The Hub Power Company Limited	33.05	1.98	24.95	2.97	29.08	6.24
Kot Addu Power Company Limited	51.63	6.59	45.95	10.65	43.75	16.72
Karachi Electric Supply Corporation Limited	6.7	0.00	10.43	0.00	7.15	0.00
Kohinoor Energy Limited	32.3	2.29	26.38	2.27	26.85	6.20
Attock Petroleum Limited	492.63	14.04	349.6	11.95	224	4.28
Pakistan State Oil Company Limited	366	15.69	364.5	40.92	400.75	21.52
Shell Pakistan Limited	442.5	4.66	616.5	37.39	631	41.54
Sui Northern Gas Pipeline Limited	73.08	2.00	93.93	3.18	64.25	2.58
Sui Southern Gas Company Limited	27.78	0.08	35.25	0.49	26.7	0.85
Pakistan Oilfields Limited	328.2	14.64	505	12.31	331.28	10.80
Pakistan Petroleum Limited	229.8	12.77	235.9	7.45	222.58	3.11
International Industries Limited	140.05	5.42	132.83	7.79	234	5.49
Al-Ghazi Tractors Limited	248.55	83.13	221.95	90.30	172.7	100.15
Atlas Honda Limited	171.38	5.89	186.48	7.61	262.3	9.41
Indus Motor Company Limited	304.5	14.91	200.2	20.20	133.95	14.10
Pak Suzuki Motor Company Limited	450.83	3.74	333.45	9.30	155.75	13.29
Agriautos Industries Limited **	105	16.28	80.58	21.84	54.25	19.39
Pak Elektron Limited	78.25	2.20	76.93	2.35	53.45	4.88
Siemens (Pakistan) Engineering Co. Limited	1515	178.74	1107.5	56.41	745	72.66
Pakistan International Container Terminal Ltd.	69.25	1.26	85.45	0.00	48.05	0.00
Pakistan International Airline Corporation Ltd.	8.7	0.00	11.68	0.00	10.58	0.00
Pakistan National Shipping Corporation Ltd.	76.1	2.17	90.35	1.04	106.63	6.52
WorldCall Telecom Limited	15.5	0.00	10.7	2.03	9.48	0.00
Dawood Hercules Chemicals Limited	325.5	18.79	367.23	5.40	208.05	19.13

Engro Chemical Pakistan Limited	237.23	4.81	199.7	6.82	143.25	11.64
Fauji Fertilizer Bin Qasim Limited	38.4	1.77	34.18	1.91	32.08	2.04
Fauji Fertilizer Company Limited	117.45	10.17	125.2	7.50	149	10.66
Abbott Laboratories Pakistan Limited	187.08	11.89	190	2.69	169.95	5.83
GlaxoSmithKline Pakistan Limited	182.95	5.35	184.23	6.95	201.18	8.67
Colgate - Palmolive Pakistan Limited	600	12.20	365.5	20.65	237.5	13.04
ICI Pakistan Limited	177.13	4.36	142	4.06	109.05	7.53
Pakistan PTA Limited	5.7	0.00	7.28	0.00	11.5	0.30
Packages Limited	311.2	2.84	205.58	27.60	170.23	5.12
Wazir Ali Industries Limited	25.08	(1.91)	28.63	0.00	18.73	0.00
Bata Pakistan Limited	330.55	11.48	123	5.89	76.58	5.80
Nestle Pakistan Limited	1448	2.75	978.5	1.54	626.13	10.11
Unilever Pakistan Foods Limited	920.5	36.83	411.75	7.35	326.5	4.68
Rafhan Maize Products Limited	1680	66.68	797.03	82.45	649.5	45.91
Unilever Pakistan Limited	2290	2.73	1885	3.20	1527.5	3.79
Ghani Glass Limited	74.5	1.69	87.55	4.76	72	2.30
Pakistan Services Limited	457	1.09	303	1.91	167.7	1.18
	21782.29	967.99	16539	2747.330	13088	832.11