

Dividend Policy and Shareholders' Wealth of Listed Manufacturing Companies in Sri Lanka

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Abstract

In finance, over the years impact of a firm's dividend policy on shareholders' wealth is an unresolved issue. The main issue of debate revolves around the optimal Dividend payout which is maximizing the Shareholders' wealth of investors. The country's manufacturing sector is enjoying a stronger pace in earnings growth post war in Sri Lanka. Therefore the necessity of manufacturing sector is realized for the country's economical development. This study aims to investigate the impact of dividend policy on shareholders' wealth of listed manufacturing companies in Sri Lanka. The common approach in empirical studies has been to examine the relationship between dividend policy and shareholders' wealth. The sample of this study composed of twelve listed Manufacturing companies in Sri Lanka and period of five years from 2008 to 2012. The required data and information for the study were gathered from published annual reports and hand book of listed companies in CSE. The correlation and regression analysis were used for data analysis. The result of this study reveals that there is a significant relationship between the dividend policy and shareholders' wealth and further dividend per share has a significant impact on shareholders' wealth of listed manufacturing companies in Sri Lanka.

Keywords: Dividend policy, Shareholders' wealth, Dividend per share

Introduction

Dividend policy has been an issue of interest in financial literature. Dividends are commonly defined as the distribution of earnings (past or present) in real assets among the shareholders of the firm in proportion to their ownership. Dividend policy is an integral part of the firm's financing decision as it provides internal financing. Pandey (2003) defines dividend as that portion of a company's net earnings which the directors recommend to be distributed to shareholders in proportion to their share holdings in the company. Dividend policy is concerned with determining the proportion of firm's earnings to be distributed in the form of cash dividend and the portion of earnings to be retained. Shareholders' wealth is represented in the market price of the company's common stock, which, in turn, is the function of the company's investment, financing and dividend decision. Managements' primary goal is shareholders' wealth maximization, which translates into maximizing the value of the company as measured by the price of the company's common stock.

Over the years a firm's dividend policy on shareholders' wealth are an unresolved issue and have been subjected to many empirical discussions within the finance literatures. The optimal dividend policy is the one that maximizes the company's stock price, which leads to maximization of shareholders' wealth and thereby ensures more rapid economic growth. Shareholders like cash dividends, but they also like the growth in EPS that results from plugging earning back into the business.

Dividend policy involves the decision to payout earnings as dividends or to retain and reinvest them in the firm. Any change in dividend policy has both favorable and unfavorable effects on the firm's stock price. Higher dividends mean higher immediate cash flows to investors, which is good, but lower future growth, which is bad. The optimal dividend policy balances these opposing forces and maximizes stock price. The firm retains the earning; its impact can be seen in many factors such as decreased leverage ratio, expansion of activities and increase in profit in succeeding years. Therefore there are many dimensions to be considered on dividend theories, policies and practices.

There are some researchers conducted on dividend policy related to shareholders' wealth. In Sri Lanka few studies have analyzed the relationship between the shareholders' wealth and dividend payment. But no studies are in listed manufacturing companies in Sri Lanka during the period of 2008 to 2012. Therefore this study is undertaken to examine the impact of dividend policy on shareholders' wealth of listed manufacturing companies in Sri Lanka for the period from 2008 to 2012.

Research problem

Dividend policy is an integral part of financial management decision of a business firm. There is considerable debate on how dividend policy affects shareholders wealth. Some researchers believe that dividends increase