

Dividend Policy and Its Impact on Performance of Indian Information Technology Companies

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Abstract This study is an attempt to evaluate the impact of dividend policy on profitability of Indian Information Technology (IT) companies listed on Bombay Stock Exchange. Companies were selected for the study based on market capitalization. Correlation matrix and panel regression model were used for testing of hypotheses. The major findings of the study reveal that the selected companies do not follow consistent pattern of dividend payments and the association between Price Earning Ratio (PER) and Dividend Payout Ratio (DPR) is low positive. However, there is a strong relation between ROE-ROA. Hausman Test reveals that random affect model is appropriate thereby indicating that performance of selected companies have significant impact on dividend policy of selected companies. Dividend policy still regarded as one of the complicated area in corporate finance. Thus, the study will help all the stakeholders to develop further understanding on dividend policy.

Keywords Dividend, Firm Performance, Earnings per Share, Price Earnings Ratio, Return on Assets, Return on Equity

1. Introduction

Dividend decisions are integral part of firm's strategic financial decisions. It is a compensation payable to shareholders for risk tolerance, which is directly proportional to degree of risk taken (Lipson et al, 1998). Dividend decision has been one of the most complicated and critical aspect of corporate finance. Even after several decades since evolution of dividends theories; dividend decision has been one of the important unresolved problems in finance (Brealey and Myers, 2002).

It involves how much of the firm's earnings after interest and taxes should be distributed among shareholders after their investment in firms and how much be retained for future growth of the company. Among host of factors, affecting firms' value, dividend policy is one of them. Shareholders return in the form of dividend or capital appreciation influenced by dividend policies of the firm like other financial decisions. Dividend policy primary goal is to maximise shareholders' wealth. Whether firm's dividend policy is relevant or not is still a subject matter of debate among financial economist. However, general opinion is

that if dividend policy is relevant then there must be optimum dividend policy and if not relevant then any dividend policy is satisfactory.

Rest of the paper are organised as follows: Literature subject were reviewed in section 2, research design has been discussed in section 3, data were analysed using appropriate statistical tools in section 4 and concluding remarks has been presented in section 5.

2. Review of Literature

Dividend distribution and its policy is always an important area of concern for every business organization, investors, researchers, and funding agencies etc. Over the year's financial economist have propounded different theories on dividend. Some are of the view that dividend is an important factor in influencing the value of firm while some are of the opinion that dividend is irrelevant factor.

Dividend Irrelevance Theory stress that dividend policy neither influence the value of firm's shares nor the cost of capital. This is because the value of firm's shares depends upon firm's earning capacity and riskiness of assets held by the firm. Dividend may affect the value of firm's share due to information effect relating to management expectations and clientele effect where the payout patterns attract the shareholders due to dividend preferences. Thus, value of firm's share is not dependent upon firm's dividend policy under perfect market conditions (Miller & Modigliani, 1961).

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However, some are of the opinion that Miller and Modigliani ideal situation is hypothetical situation and does not actually exist as we cannot ignore factors like transactions cost, taxes, inflation, and bankruptcy. Therefore, dividend policy and firm's performance are interdependent and shareholders prefer a higher dividend policy (McCabe, 1979; Anderson, 1983 and Abor & Bokpin, 2010). Dividend policy of a firm can affect the value of firm's share and will ultimately lead to shareholders' wealth maximization (Barker et al, 2001). Quantum of wealth maximization is an important parameter of firm's performance (Azhagaiah & Priya, 2008). Factors like quantum of dividend paid, historical and project profits and earnings growth pattern etc. have been influencing the dividend policy of a firm (Pruitt & Gutman, 1991). Unlike interest, dividend is not a fixed obligation for companies. Firms are normally averse to change in dividend policy. Stable earnings are an indicator of good image of the company (Foong et al., 2007). Shareholders give relatively higher preference to current dividend rather than future uncertain capital gain. Thus, these theories indicate that firm value and dividend payout are inter-related (Amidu, 2007).

Shares of companies paying higher dividends trade at a higher price in capital market because shareholders give more preference to current yield than capital appreciation in future, which is uncertain. This is the basic crux of bird-in-the-hand theory. Dividend is regarded relatively more certain than capital appreciation so firms should maintain higher dividend payout ratio and facilitate higher dividend yield. This policy would help in upward movement of stock price (Lintner J, 1956; 1962).

There is an information gap among managers and investors. The managers have private information about current and future prospects of firm while outsiders are not having such privileges. Thus, dividend policy of a firm can be used as an indicator of firm's future prospects for investors (Al-Malkawi, Rafferty & Pillai, 2010).

The frequency with which firms can access the equity markets to raise additional capital increases with the increase in payment of dividend. Agency cost arising from disagreement between ownership and control influences the dividend policy (Easterbrook, 1984). It is not necessary that managers may always adopt a dividend policy that would lead to wealth maximization for shareholders. Managers may also choose a dividend policy that may maximize their personal benefits. Some financial economists are of the opinion that higher dividend payout ratio can reduce the free cash flows left for the managers still they prefer to pay dividend to ensure wealth maximization for shareholders (DeAngelo & DeAngelo, 2006; DeAngelo et al., 2007).

Several studies have attempted to establish a relationship of dividend policy with ratios such as profitability, debt to equity etc. Return on Assets has a positive correlation with dividend payout ratio while debt to equity ratio and return on equity has a negative correlation with dividend payout ratio (Khan et al, 2016). Regression analysis conducted on Nigerian companies revealed that dividend policy has a positive

relationship with profitability ratios (Adediran and Alade, 2013). Thus, effective dividend policy will enable companies to attract investors.

Kolawole, E. et al (2018) through their study concluded that the dividend payout and retention ratios have a positive impact on EPS in the oil and gas firms of Nigeria which they observed.

Priya, et al (2013) advocated that dividend policy ratios have a significant effect on all firm performance ratios except return on investment (ROI) and return on equity (ROE). EPS, P/E and PB are significantly correlated with ROA while P/E is significantly correlated with ROE. Finally EPS and PB are significantly correlated with ROE.

Yegon, C., Cheruiyot, J. & Sang, J. (2014) found that there is a significant positive relationship between dividend policies of organizations and firm's profitability, there is also a significant positive relationship between dividend policy and investments and there is a significant positive relationship between dividend policy and Earnings Per Share.

Khan, W., Naz, A. (2013) The results reveal that profitability of any firm positively affects dividend payouts while leverage has no significant effect on firm dividend payouts.

Nishant B. Labhane, Jitendra Mahakud (2016) using the static panel data models prove that the firm with larger profitability, maturity and liquidity tend to have higher payout ratio while the firm with higher investment opportunities, leverages and business risk have a lower dividend payout possibilities.

Kanwal, M. & Hameed, S. (2017). The result of this study shows that dividend payout positively influenced financial performance of firm.

Masum, A. (2014) Panel data approach is used to observe the association between dividends and stock prices considering Earnings per Share, Return on Equity, Retention Ratio which positively correlated with Stock Prices, while the Dividend Yield and Profit after Tax has a negative, insignificant relation with stock prices. Thus, the study indicates that Dividend Policy has a significant positive effect on Stock Prices.

Khan, et al (2016) results show that dividend payout ratio and leverage have a significant negative relation with the return on equity in their study on the stock listed in PSE. While a positive relation was found between return on assets, dividend policy, and growth in sales.

Thirumagal, P.G. and Vasantha, S. (2018) observed a negative impact of dividend policy announcement on share price of Automobile, Infrastructure & Construction, Energy, Information Technology and Pharmaceutical industry. The study found that dividend payout had a significant negative impact on shareholders' wealth for majority of the Indian industries. There was a significant difference in share price between pre and post dividend announcement.

Dividend payout is one of the significant components to enhance the performance of a firm's share price. Most of the

studies advocated that dividend policy has a positive impact on profitability, particularly EPS (Kolawole, E. et al (2018), Priya, et al (2013), Yegon, C., Cheruiyot, J. & Sang, J. (2014), Khan, W., Naz, A. (2013), Nishant B. Labhane, Jitendra Mahakud (2016), Kanwal, M. & Hameed, S. (2017), Masum, A. (2014) while very few studies shows that there is a negative impact of dividend policy or dividend announcement on share price/firm performance (Khan, et al (2016), Thirumagal, P.G. and Vasantha, S. (2018).

In this backdrop this study is an attempt to explore; how dividend policy of a firm would be influencing profitability of a firm listed on Bombay Stock Exchange (BSE). The other objectives of the paper are as follows:

- Check how dividend policy of a firm and its profitability are associated.
- Analyze the impact of dividend policy on firm's Return on Equity (ROE).
- Evaluate impact of dividend policy on firm's Return on Assets (ROA).

In order to achieve the above objectives following hypothesis were framed and tested using correlation matrix and panel regression model.

- μ_{01} : There is no significant impact of DPR, PER and EPS on ROA across the panel.
- μ_{02} : There is no significant impact of DPR, PER and EPS on ROE across the panel.

3. Research Methodology

This section deals with the research methodology adopted to accomplish the study. This study is an attempt to find impact of dividend policy on performance of firm.

3.1. Sample of the Study

The sample for the study is companies from IT sector. The companies were selected based on market capitalization (Table 1).

Table 1. Profile of Sample Companies Under Study(BSE)

S. No.	Name	Year of Establish	Headquarter	Services	M-Cap (Rs. Crore)
1.	WIPRO	1945	Bangalore	Digital Strategy, Business Consulting and IT Services	145,225.31
2.	HCL	1976	Noida	IT, Business Consultancy, Outsourcing Services	147,981.87
3.	INFOSYS	1981	Bangalore	IT, Business Consultancy, Outsourcing Services	257,344.77
4.	TECH MAHINDRA	1986	Pune	IT, Business Consulting, Outsourcing Services	68,660.40
5.	TCS	1968	Mumbai	IT, Business Consulting, Outsourcing Services	652,082.92
6.	L&T	1938	Mumbai	Real Estate, Construction, Financial Services, IT Services	24,120.32
7.	ROLTA	1989	Mumbai	IT Services, IT consulting	1,078.36
8.	MINDTREE	1999	Bangalore	IT Services, IT consulting	16,022.98
9.	NIIT	2004	Noida	IT, Business Consulting, Outsourcing Services	6,099.56
10.	MPHASIS	2000	Bangalore	IT, Business Consulting, Outsourcing Services	17,446.56

Source: BSE.

3.2. Source of Data

Market capitalization data were collected from the official website of BSE. In order to calculate the ratios the data published by companies in their annual report were taken. The study is confined to only five financial years from 2012-13 to 2016-17.

3.3. Tools and Techniques for Data Analysis

Correlation Matrix and Panel Regression Model (Fixed & Random Effect) are used to accomplish the study. Hausmann Test was used to the hypothesis.

3.3.1. Independent Variable

Dividend Payout Ratio, Earnings per Share and Price Earnings Ratio are used as proxy variables for dividend policy.

- **Dividend per Share (DPS):** DPS is the ratio between total dividend paid by the company and total number of shares outstanding. Total dividend includes even interim dividends also.

$$DPS = (Total\ dividends\ paid\ out\ over\ a\ period - any\ special\ dividends) / Shares\ Outstanding$$

- **Earnings per Share (EPS):** EPS is the quantum of Profit After Tax (PAT) and preference dividend that could be distributed among each shares held by equity shareholders. It helps in estimating the company's capacity to pay dividend to its equity shareholders. It is one the important parameter in estimating market price of the equity shares of the company.

$$EPS = (PAT - \text{Preference Dividends}) / \text{Number of Shares held by equity share holders}$$

- **Dividend Payout Ratio (DPR):** DPR is the proportion of dividend (DPR) distributed among the equity shareholders. It measures a relationship between earning available for equity shareholders and dividend paid to them. This ratio also helps in determining percentage of profits that is being retained by the company for the purpose of reinvestment or debt repayment.

$$\text{Dividend Payout Ratio} = DPR / EPS$$

- **Price Earnings Ratio (PER):** PER indicates the number of times the Earning per Share (EPS) is covered by its market price (MPS). This ratio is an important indication of risk and return profile of the particular company's share. It helps the investor in determining whether or not to buy the shares of a company at a particular price. A high growth firms is expected to have a higher PER while share which is risky will have low PER. Higher ratio is an indicator of investors' confidence in company's future. It is also believed that firms with low reinvestment needs will have relatively higher PER.

$$PER = (MPS / EPS)$$

3.3.2. Dependent Variable

Return on Asset (ROA) and Return on Equity (ROE) are used to proxy for firm's performance.

- **Return on Assets (ROA):** ROA measures the relationship between net profits and total assets of the company. It is a measure of overall profitability and operational efficiency of the firm in using its total assets.

$$ROA = PAT / \text{Total Assets}$$

- **Return on Equity (ROE):** ROE is the measures on the total equity funds of ordinary shareholders. It helps in indentifying that proportion of earning generated with ordinary holders' funds.

$$ROE = \text{PAT minus Preference Dividend} / \text{Shareholder's Equity}$$

4. Results and Discussions

Correlation matrix and panel regression models are employed to obtain the results and their results are interpreted to draw the conclusion for the study.

4.1. Correlation Matrix

Correlation Matrix is employed to verify the degree of association within the independent variables and between the dependent variables and independent variables. It helps us to find out which pair of variables has the highest correlation.

Table 2. Correlations Matrix

		DPR	EPS	PER
DPR	Pearson Correlation	1	-.127	.282*
	Sig. (2-tailed)		.379	.047
	N	50	50	50
EPS	Pearson Correlation	-.127	1	.066
	Sig. (2-tailed)	.379		.649
	N	50	50	50
PER	Pearson Correlation	.282*	.066	1
	Sig. (2-tailed)	.047	.649	
	N	50	50	50

*, Correlation is significant at the 0.05 level (2-tailed).

The value of coefficient between the independent variables DPR-EPS is -0.127, DPR-PER is 0.282 and PER-EPS is 0.649 respectively, which are less than 0.80. The result indicates that there is no multicollinearity exists among the independent variables. However, the correlation coefficient between the dependent variables viz. ROA and ROE is significantly high at 0.915.

4.2. Panel Regression Model

Regression Model is a statistical tool used to establish association among variables. It facilitates in establishing fact that how the particular value of dependent variable will changes with any change in one of the independent variables; while keeping other independent variables fixed. Panel Regression Model helps in conducting multidimensional analysis over a period.

In order to go for panel regression, first we will try to know that which method is best for our model. Two methods are available

- **Fixed effect model:** It is assumed that attributes of certain variables does not vary across time and may or may not be correlated with the individual dependent variables. Therefore, it is tested to ascertain that whether fixed effects or random effects would be required to develop the model. It can be checked using Hausman test.
- **Random effect model:** In this model, parameters are random variables and have similarity with hierarchy liner model. It is used to analyse panel data when we assume no fixed effects.

Result and Discussions: Model I: (ROA c DPR PER EPS)

μ_{01} : There is no significant impact of DPR, PER and EPS on ROA across the panel.

First, we estimate the model with random effect and then estimate the Hausman test to conclude about the method to

be used for hypothesis testing. If the prob. Value of Hausman Test is less than 0.05; the null hypothesis will be rejected. This would indicate that using Fixed Effect Model for the study would be appropriate. If a null hypothesis accepted, it would be appropriate to use Random Effect Model.

Table 3. Correlated Random Effects - Hausman Test

Test cross-section random effects				
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	5.985074	3	0.1123	
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var (Diff)	Prob.
DPR	2.326758	2.280160	0.385410	0.9402
PER	0.224224	0.177819	0.009282	0.6301
EPS	0.083836	0.096895	0.000330	0.4721
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11.54742	3.526041	3.274896	0.0023
DPR	2.326758	2.710201	0.858519	0.3961
PER	0.224224	0.169266	1.324687	0.1934
EPS	0.083836	0.034323	2.442600	0.0195
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.835471	Mean dependent var		19.46500
Adjusted R-squared	0.782111	S.D. dependent var		7.317103
S.E. of regression	3.415522	Akaike info criterion		5.513432
Sum squared resid	431.6342	Schwarz criterion		6.010558
Log likelihood	-124.8358	Hannan-Quinn criter.		5.702741
F-statistic	15.65708	Durbin-Watson stat		2.314255
Prob(F-statistic)	0.000000			

As the prob. value (0.1123) is greater than 0.05; the null hypothesis is accepted. Thus it could be concluded that fixed effect regression model is not appropriate as depicted in Table 3. It would be appropriate to use random effect model.

Apart from that, the other necessary and sufficient conditions are also approving the model and its results. The probability value of the model is also less than 0.05 (0.0000) suggesting that inference drawn from the model is correct and results justified. This also suggests that there is no possibility of type I and type II errors. The R square is 0.83 suggesting that variation in the dependent variable is explained by the independent variable with a percentage value of 83% and the rest of 17% may be due to the presence of other factors having erratic behaviour and movements. The Durbin-Watson statistics deals with the problem of autocorrelation and stationarity alike. Because the D-W statistic value is between 2 and 3 (considered acceptable

under the lenient approach) there is no problem of autocorrelation and nonstationarity in the model as reflected in Table 4.

Table 4. Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11.42773	3.203235	3.567559	0.0009
DPR	2.280160	2.638140	0.864306	0.3919
PER	0.177819	0.139171	1.277706	0.2078
EPS	0.096895	0.029124	3.327027	0.0017
Effects Specification				
			S.D.	Rho
Cross-section random			4.752799	0.6594
Idiosyncratic random			3.415522	0.3406
Weighted Statistics				
R-squared	0.185843	Mean dependent var		5.955699
Adjusted R-squared	0.132745	S.D. dependent var		3.784746
S.E. of regression	3.524602	Sum squared resid		571.4495
F-statistic	3.500045	Durbin-Watson stat		1.631277
Prob(F-statistic)	0.022724			
Unweighted Statistics				
R-squared	0.286681	Mean dependent var		19.46500
Sum squared resid	1871.363	Durbin-Watson stat		0.563799

Table 5. Correlated Random Effects - Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.		Prob.
Cross-section random	2.431285	3		0.4878
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var(Diff)	Prob.
DPR	1.816530	2.160839	0.991177	0.7295
PER	0.086439	0.067219	0.025886	0.9049
EPS	0.077991	0.097706	0.000916	0.5147
Cross-section random effects test equation:				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	22.66451	6.549772	3.460350	0.0014
DPR	1.816530	5.034315	0.360830	0.7203
PER	0.086439	0.314418	0.274916	0.7849
EPS	0.077991	0.063756	1.223274	0.2290
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.800729	Mean dependent var		28.45560
Adjusted R-squared	0.736101	S.D. dependent var		12.35028
S.E. of regression	6.344479	Akaike info criterion		6.751942
Sum squared resid	1489.339	Schwarz criterion		7.249068
Log likelihood	-155.7985	Hannan-Quinn criter.		6.941250
F-statistic	12.38973	Durbin-Watson stat		2.436635
Prob(F-statistic)	0.000000			

Result and Discussions: Model II (ROE c DPR PER EPS)

μ_{02} : There is no significant impact of PER, DPR and EPS on ROA on ROA across the panel.

The prob. value of Hausman test (0.4878) is greater than 0.05. Thus, the null hypothesis is accepted. This means that the result is significant. Thus, it could be concluded that fixed effect regression model is not appropriate as depicted in Table 5. It would be appropriate to use random effect model.

Table 6. Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	21.72917	6.443994	3.372004	0.0015
DPR	2.160839	4.934891	0.437870	0.6635
PER	0.067219	0.270135	0.248835	0.8046
EPS	0.097706	0.056116	1.741131	0.0883
Effects Specification				
			S.D.	Rho
Cross-section random			10.49858	0.7325
Idiosyncratic random			6.344479	0.2675
Weighted Statistics				
R-squared	0.066126	Mean dependent var		7.424037
Adjusted R-squared	0.005221	S.D. dependent var		6.321662
S.E. of regression	6.305137	Sum squared resid		1828.719
F-statistic	1.085729	Durbin-Watson stat		1.914833
Prob(F-statistic)	0.000589			
Unweighted Statistics				
R-squared	0.145318	Mean dependent var		28.45560
Sum squared resid	6387.843	Durbin-Watson stat		0.615159

The necessary and sufficient conditions are also endorsing use of Random Effect Model and its result. The probability value of the Model is also less than 0.05 (0.0000) suggesting that the interference drawn from the model is correct and result is justified. It is also an indication that there are chances of Type I and Type II errors. The R square is 0.80 suggesting that the variation in the dependent variable is explained by the independent variable with a percentage value of 80 % and the rest of 20% may be due to the presence of other factors having erratic behavior and movements. The Durbin –Watson statistics deals with the problem of auto correlation and stationarity alike. As D.W. statistics value is between 2 and 3 (which is considered acceptable under the lenient approach) there is no problem of auto correction and nonstationarity in the model as depicted in Table 6.

5. Conclusions

Different dividend ratios considered for the study reveals that sample companies do not have any consistent pattern of dividend payment and trend is skewed in nature. It has also been observed from the correlation matrix that a very low positive association exists between Price Earnings Ratio and

Dividend Payout Ratio at 5% level of significance. Similarly it was also observed that association between ROA – EPS, ROE - EPS was low positive and significant at 1%. However, there is strong association positive between ROE- ROA at 1% level of significance.

In this study two regression models were also used (i) *Model I: ROA c DPR PER EPS* and (ii) *Model II: ROE c DPR PER EPS*. The results of both the Models were significant thereby indicating that random effect regression model is appropriate. It could be concluded that performance of firm has a significant impact on the dividend policy of companies belonging to Information Technology Sectors.

6. Implications of the Study

IT sector plays a significant role in service sector, which contribute maximum revenue to the Indian GDP. Dividend policy and pattern of its distribution has been an important issue of discussion in finance. The study would be helpful for users like managers who are interested in profit planning and investment. The paper will help the reader to develop further understanding on dividend policy, which is still on the most complicated subject in corporate finance. This study is also significant because an attempt has been made to develop appropriate dividend policy models.

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