AN EMPIRICAL ESTIMATION OF DUAL CAUSAL RELATIONSHIP BETWEEN DIVIDEND POLICY AND FIRM PERFORMANCE: A CASE OF NONFINANCIAL SECTOR IN PAKISTAN

By

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DECLARATION OF AUTHENTICATION

*I, **Arshad Mahmood**, M.Phil student in the Department of Management Sciences, Bahria University, Islamabad, certify that the research work presented in this thesis is to the best of my knowledge my own. All sources used and any help received in the preparation of this dissertation have been acknowledged. I hereby declare that I have not submitted this material, either in whole or in part, for any other degree at this or other institution.*

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Dedication

This thesis is dedicated to my respected teacher Dr. Muhammad Ayub Siddiqui.

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EXECUTIVE SUMMARY

Businesses are the engine of growth. They not only add value to the shareholders and owners but also business activities contribute significantly to the gross domestic product (GDP) of the country. Addition to the wealth of the shareholders dividend is an attraction and incentives for the investors to invest more. In paying back to the shareholders, dividend policy of any company may be considered as playing a critical role. Dividend policy of the Pakistani companies has been a topic of concern for the students of finance and financial economics. Most of the previous studies have focused dividend payout or the amount of dividends in relation with determinants of the dividend. Unfortunately Pakistani companies are not paying the dividends to the shareholders regularly. Therefore, most of the previous studies have faced problems of data constraints in terms of dividends. These studies filled the data gaps by using averages of the given values which provide only information about the dividends in the form of proxy and not the actual information of the amount of dividends. The analysis of the previous studies is not without doubt.

The present study has constructed dividend policy instead of dividend payout or amount of dividends as the final dependent variable without using any proxy variable. The information regarding the payment of dividends has been assigned the values in respect of mathematical numbers known as binary numbers; wherein 0 indicating nonpayment of dividends and 1 representing the payment of dividends. The study incorporates data set of 250 companies from nonfinancial sector listed in the Karachi Stock Exchange (KSE) for the last five years (2007-2011). In respect of dual causal relationship, nonparametric tests have been employed to determine the direction of causality between the dividend policy and direct and indirect performance indicators of the companies (such as ROA, FCFR, Quick Ratio, Market Liquidity, Debt Equity Ratio, Size, risk factor, and Growth). Finally, qualitative response variable model, the logit model, is employed to test the significance of performance variables and risk factor on the dividend policy of the companies of nonfinancial sector of Pakistan.

Size of the company, its growth and ROA play a positive and significant role in the possibility of payment of dividends to the shareholders. Debt equity ratio and risk factor negatively and significantly determine the possibility of distribution of dividends among the shareholders of the business. Market liquidity, liquidity position of the company and free cash flows available to equity holders have been found to have insignificant role in the determination of dividend policy of the business.