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Individual Investors Perception towards Dividend – Pakistan’s Perspective

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ABSTRACT

This research paper premises that there exists a strong preference for dividends among investors. The main purpose is to find the factors that lead individual investors to reveal their preference for either cash or stock dividends. The most important dividend theories are, employed to test the behavior of Pakistani individual investors towards dividends. The results reveal strong evidence that individual investors, in Pakistan want dividends either in the form of cash or stock dividend. They also have a strong preference for dividend even if the company has to pay dividend by borrowing funds.

Key words: Cash dividend, stock dividend, dividend theories, behavioral finance, investor perception.

1. INTRODUCTION

Dividend is a distribution, of a part of a company's profits, declared by the board of directors, to its shareholders. The most often quoted form is in terms of the currency amount each share receives (dividends per share). Dividends are, paid in the shape of cash or stock. Mostly invulnerable and financially stable companies offer dividend to their share holders. Normally high growth companies reinvest all of their profits and rarely offer dividend in-order, to sustain higher than average growth.

Many researchers are going on in the area of corporate dividend policy. Most of them create a relationship between the corporate dividends issue to the theories related to individual investor's behavior. There is no doubt, that individual investors, want dividends, but there has been no research work available finding why they want it. This research paper is, focused on filling the gap by pointing out the reasons why individual investors, demand dividend.

This study presents a survey based research regarding, the perception, of individual investors towards dividend. It is, based on the notion that there has been a strong liking for dividends among individual investors, here in Pakistan. It presents the key factors affecting the individual attention towards dividend. The only way of understanding the dividend perception is to find out human perceptions by asking for their opinion. Perception is the process of attaining awareness or understanding information. The investor's perception towards dividend means how investors in stocks, process the information about dividend and act accordingly.

A financial manager takes the decision to choose between paying dividends and repurchasing shares. Individual investor's behavior varies from the demand of cash dividend to stock dividend. This is the essence, of corporate dividend policy. This is evident from the works of Miller and Modigliani (1961) and Gordon (1961). Further, Shefrin and Statman (1984) also verify this line of thought.

The main objective of this study is to find what driving factors lead individual investors to point out their preferences for cash or stock dividend. To explore more about dividend perception this study conducted a questionnaire based survey involving individual investors of Karachi, Lahore and Islamabad Stock Exchange.

2. LITERATURE REVIEW

Several studies discuss dividend theories and individual preferences, about dividend. According to Miller and Modigliani (1961), dividend policy is irrelevant when there is no transaction cost; no government taxes dividend, no asymmetric information, as well as no agency problem. In most of the countries the dividend payment is taxed heavily as compared to profits on selling shares. So the dividend policy is a puzzle when we compare the irrelevance theory with higher taxes of dividend. They also suggest that, when taxes on income are more when compared with income from sale of shares, then companies should try to redesign their dividend policies in order, to make it acceptable to the shareholders.

In another research study, DeBondt and Thaler (1995) point that some firms prefer to pay cash dividends, however, some prefer to pay stock dividends. Due to the advantage of lower transaction cost, stock dividends can prove more beneficial. Dong, Robinson and Veld, (2005) pointed out that stock dividend is not beneficial for small investors. Fama and French (2001) indicated that there has been a significant decline in the proportion, of U.S. firms paying cash dividends from the year 1978 to 1999. Grullon and Michaely (2002) revealed that many firms have opted for repurchase of shares. These findings might be a response to the dividend puzzle.

Baker and Wurgler (2004) pointed out the catering effect and trends of dividends payments over time. They notice that for the period 1963-2000, there are four different trends that exist. In mid 1960s they find a positive dividend premium trend i.e. an increase in propensity to pay. The trend becomes negative through 1969. During the period 1970 to 1977 they again find a positive trend in dividend payment. Finally, during 1978 to 2000, this is the start of fourth trend of disappearing dividends. During this period there is a negative propensity to pay dividends. Dong et al. (2005) surveyed a Dutch panel of families in their research study; the focus is on matters of finance and consumption of dividend. They focus only on individual investors in their study. This research study also focuses on the individual investors behavior who hold shares of listed companies in the Stock Exchange; directly or indirectly through investment funds. In a research study conducted by Kumar (2006), he pointed out various factors explaining the difference in dividend payment behavior of Indian firms from the year 1994 to 2000. These include financial structure, investment opportunities, dividend history, earning trends and ownership structure.

Al-Malkawi (2007) in his research study used the panel data of publically traded firms of Amman Stock Exchange for examining determinants of dividend policy. Results recommended that payout ratio is significantly affected by the percentage of stocks held by insiders and state ownership while other factors like size of the firm and search for profitable stocks were found to be the major factors of dividend policy in Jordan. The results strongly supported the Agency Hypothesis and were broadly consistent with Pecking Order Hypothesis but inconsistent with Signaling Hypothesis. According to Anil and Sujjata (2008), Beta i.e., year to year variability in earnings and liquidity are the two determining factors of dividend payout in Indian information technology sector firms. From a Pakistani context, Ahmed and Attiya (2009) conducted a research study comprising a sample of 320 firms listed on KSE. They also focused on determinants of dividend payout and found that firms with stable and positive earnings are paying more dividends, secondly they also pointed out that ownership concentration and liquidity is positively related to dividend payment ratio and opportunities for growth and investments and size of the firms have a negative impact on dividend payments.

Dividend policy is one of the few areas of finance where primary research is conducted frequently. Some of the primary researches include Lintner (1956), Baker, Farrelly, Edelman (1985), and Brav, Graham, Harvey, Michaely (2004). However, all these studies focus on managers of companies. This research study focuses more on various theories relating, to dividend payments and tries to shed light on to what extent which theory is more important, from the perspective of individual investors.

3. METHODOLOGY

3.1 Instrument

The first survey that points out the determinants of individual investors perception towards dividend is, conducted by Dong, Robinson and Veld (2005). This research study refers to the attitude of Pakistani investor's attitude towards dividends with particular reference to the dividend theories developed. This research study is also important for the fact that no one has conducted research in this area. The questionnaire is adopted from the research study "Individual Investors perception towards dividend" by Maditinos et al. (2007).

The questionnaire consists of 34 items. The first four items are general in nature, and intend to get information about nature of investors. Items 5-26 refer to theories relating, to cash dividends. Items 27-30, are related, to the comparison of cash and stock dividends with regard to stock dividends as small stock splits, transaction costs and behavioral finance theories. The last section of the questionnaire points out some general demographic information of the respondents such as gender, age, monthly income and educational level.

3.2 Sample selection

The questionnaire was distributed among randomly selected investors from Karachi, Lahore and Islamabad Stock Exchange. The questionnaires were distributed among 300 individual investors. Out of these, 256 respondents returned the questionnaires. 56 questionnaires were found incomplete, 200 were completely filled (with a response rate of 66.67%) and have been used for analysis.

3.3 Procedure

In terms of analysis, the statistical package for social sciences program (SPSS) is used to record, examine and analyze the data gathered. All the items are analyzed individually and then compared with each other, and then categorized and prioritized factors are asked in the questionnaire.

4. RESULTS AND DISCUSSION

In order to measure the significant difference between males and females with regard to various dividend theories, independent sample t-test is used. Table 1 & 2 show the results of independent sample t t-test.

4.1 Results on Cash Dividend:

Table 1: Results on cash dividend between male & female respondents (Independent Sample T-Test, N=200)

Theory	Group	Mean	Std Dev	P-Value
Irrelevance Theory	Male	6.06	1.93	.104
	Female	5.09	2.70	
Transaction Costs	Male	6.43	1.26	.606
	Female	6.59	1.29	
Uncertainty Theory	Male	4.75	.99	.611
	Female	4.63	.68	
Accounting Manipulations	Male	6.46	1.42	.404
	Female	6.15	1.84	
Behavioral Finance	Male	5.89	1.58	.935
	Female	5.92	1.98	
Free Cash flow	Male	4.62	1.45	.282
	Female	5.00	1.38	
Agency Cost	Male	5.65	1.82	.518
	Female	5.93	1.52	
Signaling	Male	4.65	1.42	.310
	Female	5.02	1.73	
Choice between Cash div. and share buy-backs	Male	2.64	2.09	.903
	Female	2.70	1.81	
Taxes	Male	6.16	1.43	.560
	Female	5.68	1.94	

Table 1 refers to the cash and stock dividend questions with particular focus on confirmation of dividend theories.

With respect to irrelevance theory, the responses show that male (mean=6.06) and female (mean=5.09) respondents want cash dividend. The above table shows that p-value is .104, it means that there is no significance difference among males and females ($p > .05$). The result does not confirm the irrelevance theory by Miller and Modigliani (1961) and is in line with the results of Dong, Robinson and Veld (2005) and Brav et al. (2005).

Transaction cost is tested as the second theory. The results show that male (mean=6.43) and female (mean=6.59) have preference for cash dividend due to transaction cost. P-value of .606

also shows that there is no significance difference among males and females for preference for cash dividend due to transaction cost. The result is also in line with Dong, Robinson and Veld (2005).

According to uncertainty theory, individual investors, show preference for stocks that pay dividend because they are less risky. The results of the table no. 1 show that, individual investors, (males mean=4.75 and females mean=4.63) believe that high dividend yield companies are more risky. The result is in accordance, with the result of Dong, Robinson and Veld (2005).

The results of fourth theory suggest that dividend paying companies offer more certainty about company's future earnings. Both males (mean=6.46) and females (mean=6.15) agree to the statement. P-value=.404 ($p > .05$) also shows that there is no significant difference among males and females.

The results of fifth theory suggest that there is no significant difference ($p = .935$) between males (mean=5.89) and females (mean=5.92) with respect to behavioral finance theory.

The sixth theory was free cash flow theory. The survey results show that there is no significant difference ($p = .282$) between males and females.

The results of agency costs theory also suggest that there is no significant difference between males and females. Both have confirmed that they would like to receive cash dividend, if a company has to issue new shares or borrow funds for paying dividends.

Signaling theory is revalidated through this study. Individual investors believe that dividend payment serve as a signal for future performance of a company. There is no significant difference between male and female ($p = .310$) with regard to signaling theory.

As far as stock buyback is concerned, the individual investors find it extremely negative. Both means of males (2.64) and females (2.70) confirm the statement. The p-value (.903) also confirms that there is significant difference between male and female respondents with respect to stock buyback.

Finally both male and female respondents show a positive response to the taxation of dividends. P-values also show that there is no significant difference between males and females with respect to taxation of dividends.

4.2 Results on stock Dividend:

Table 2: Results on stock dividend Between Male & Female respondents (Independent Sample T-Test, (N=200))

Theory	Group	Mean	Std Dev	P-Value
Stock Dividend as small stock	Male	3.73	2.34	.228
	Female	3.04	2.45	

splits				
Transaction Cost	Male	2.60	2.41	.101
	Female	3.59	2.77	
Taxes	Male	2.28	2.22	.348
	Female	1.81	1.36	
Behavioral Finance	Male	6.28	1.41	.454
	Female	6.54	1.47	

Table 2 shows that both males and females believe that stock dividend is like a cash dividend. The result matches the result of Dong, Robinson, Veld (2005). P-value .228 also suggests that there is no significant difference between males and females with respect to believing that stock dividend is like a cash dividend.

Secondly, due to transaction cost both male (mean=2.60) and female (mean=3.59) have no preference for stock dividend over cash dividend. P-value .101 also suggests that there is no significant difference between males and females for preference for stock dividend over cash dividend.

Thirdly without keeping in mind the taxation affect both male (mean=2.28) and females (mean=1.81) have strong preference for cash dividend over stock dividend.

Finally, both male (mean=6.28) and females (mean=6.54) have strong preference to receive stock dividend in case their company has not enough cash to pay dividend.

Table 3: Measure of difference among age groups for dividend theories (ONE WAY ANOVA test, N=200)

Theory	Group	Mean	F-Stat	P-Value
Irrelevance Theory	18-25	5.00	3.173	.076
	26-35	5.65		
	36-50	7.00		
	50 & above	6.57		
Transaction Costs	18-25	6.47	4.02	.015

	26-35	6.75		
	36-50	7.00		
	50 & above	5.82		
	18-25	4.03	6.69	.000
Uncertainty Theory	26-35	4.76		
	36-50	5.00		
	50 & above	5.11		
	18-25	4.50	9.11	.000
Behavioral Finance	26-35	5.95		
	36-50	6.95		
	50 & above	6.58		
	18-25	6.26		
	26-35	5.14	4.35	.001
Agency Cost	36-50	5.28		
	50 & above	6.41		
	18-25	3.64	8.20	.000
Signaling	26-35	4.69		
	36-50	4.85		
	50 & above	5.58		
Choice between Cash div. and share buy-backs	18-25	2.21	2.44	.065
	26-35	2.89		

	36-50	1.00		
	50 & above	2.98		
	18-25	6.07	10.49	.000
	26-35	5.34		
Taxes	36-50	7.00		
	50 & above	7.07		

Table 3 shows results of ONE WAY ANOVA test among different age groups for dividend theories. Significant difference among various age groups exists for transaction cost theory ($p=.015$), uncertainty theory ($p=.000$), accounting manipulation theory ($p=.001$), behavioral finance theory ($p=.000$), agency cost theory ($p=.001$), signaling theory ($p=.000$) and taxes theory ($p=.000$). No significant difference exists among various age groups for irrelevance theory ($p=.076$), free cash flow theory ($p=.097$) and choice between cash dividend and share buy backs ($p=.065$).

5. CONCLUSION

Results of the research study show that majority of individual investors, show strong preference for cash dividend. Results also reveal that majority of individual investors, consume major portion of their dividend income and very few investors reinvest their dividend income.

Investigation of different dividend theories, reveals that majority of shareholders have strong preference for cash dividend. In case the company doesn't have enough cash to pay cash dividend, investors still have strong preference for stock dividend. They also show strong preference for cash or stock dividend even if company has to pay dividend by borrowing funds.

6. RECOMMENDATIONS, LIMITATIONS AND FUTURE RESEARCH

Investing in stocks is a complex procedure; it requires that individual investors have thorough knowledge and experience with regard to trading in shares. Investors must, be guided through rules and procedures, as well as be provided with proper training facilities conducted by management of concerned stock exchanges. I have tried to expand the knowledge of investors with respect to various dividend theories; this will broaden their knowledge base and will help in investing in shares.

This research is, conducted among limited number of individual investors, further work is suggested for larger population, and this will increase the generalizability. Secondly, besides the measured variables various other factors can affect the investor's perception towards cash or stock dividend. Future research can focus on social, economic, personality factors affecting the individual's preference for dividends.

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