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An analysis of the Corporate Dividend Policy in the Indian Banking Sector

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*Lakhwinder Kaur Dhillon & **Sukritee Raizada*

*Assistant Professor, Amity School of Business, Amity University

**Student, Amity Business School, Noida

Address for Correspondence: serviceheb@gmail.com

Abstract

Among the most important corporate finance strategies, not only from the company's point of view but also from the point of view of shareholders, consumers, employees, regulators and the public, is the Dividend Policy of the company. This is an extremely important decision regarding the performance and evaluation of a company. Every company has to decide if, and how much, money is to be paid to the shareholders. The most important aspect of dividend policy is deciding whether to pay a cash dividend, how high the dividend should be and how often it should be distributed among the shareholders. The dividend decision for every company in every sector of the economy is considered one of the most important decisions because they have to decide what part of their income they want to distribute and how much they would want to keep with themselves. Dividend policies in all economic fields are highly researched topics in the financial sector. However, there is still a controversial issue, namely, factors determining the company's dividend policy. The company's dividend decision in the economic field is the result of various considerations. These considerations vary with time and from industry to industry. Various factors have an impact on the distribution of dividends in cash. Some of them are; the profitability of the company, assets size, level of current liabilities, relations with suppliers, and liquidity position. This study targets the proportion of significance on the dividend policy of factors like liquidity and profitability in the Banking sector of India. In connection to the dividend payout ratio, the relationship between private and public banks is also under consideration. Further, on one hand, the relationship between the various factors of profitability and liquidity will be studied, and on the other hand, the effect on the dividend payout ratio will be evaluated. Data from 20 banks (10 private banks and 10 public banks) operating in India were sampled over a 10-year period from 2008 to 2017 to conduct the research. Statistical tools of correlation and linear regression have been used to examine the connection between the different variables.

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1.1 Introduction to Dividend Policy

The term "dividend" can be defined as a portion of the earnings of the company that the company distributes amongst its shareholders. This is the return to the owners of the shares of the company. Investors are interested in boosting return on their investment and maximizing possessions whereas on the other hand, companies require funds to support their long-term growth. When a company pays as much money as dividends, it has to resort to external resources, such as issuing bonds or new shares for commercial purposes and future expansion, which may lead to dilution of control. Therefore, the company's decision to pay dividends must be in the form of an even distribution of distributable profits and retained earnings.

As revealed in the existing literature, many factors affect the dividend policy of a firm. Some of them are returns in the form of profits, investment possibilities in hand, gaps attributed to the cost of retained earnings and external equity, cash flow status, shareholder preferences and legal restrictions.

Firms follow the policy of stable dividend or gradually rising dividends because some individuals depend on the dividend income earned through investments to meet the cost of living. Because either these expenses remain stable or increase gradually over time, the investors are more inclined towards. Invariable changes in dividend income may result into selling of some shares. Moreover, institutional investors often view a record of steady dividend payment as a highly desirable feature.

1.2 Objectives of Dividend Policy

The primary goal of a financial manager is to maximize shareholder value. On one hand, the payment of the dividend leads to a rise in the price of the shares, but on the other hand, it also leads to tightening of liquid funds for the financing of possible projects. There is an inverse relationship between dividend payments and retained earnings.

- **Wealth Maximization**

Dividend policy of any firm in any sector of the economy has a significant impact on the value of the firm. Thus, the optimum dividend policy should be selected keeping in mind the wealth maximization objective of the firm.

- **Future Projects**

Dividend policy is an extremely important financing decision and leads to massive outflow of cash which may decrease the availability of funds for an organization at a particular point of time. If a firm needs funds to invest in a new project, it may have to take the help of outside sources to raise the required funds due to non-availability of funds within the organization at the given time.

- **Stable Rate of Dividend**

Constant fluctuation in the rate of dividend adversely affects the market price of shares of that particular firm. Every firm must try to maintain a stable rate of dividend at all points of time. In order to maintain a stable rate of dividend, they must have enough funds with them at all points of time which can be used to pay dividends even when the firm incurs losses.

- **Degree of Control**

Issue of new shares to raise funds or external financing can lead to weakening of control of the existing shareholders. Therefore, a more conventional dividend policy should be adopted to ensure that the interest of the existing shareholders is not affected.

1.3 Types of Dividend Policy

There are various types of dividend policies that can be adopted by any firm. Some of them are as follows:-

- **Regular Dividend Policy**

Payment of dividend at the regular rate is known as Regular Dividend Policy. This policy is usually preferred by retired individuals, widows and economically weaker sections of the society who prefer to have a fixed income.

A regular dividend policy has many advantages. Some of them are mentioned below:-

1. It helps to generate goodwill of the company.
2. It instils credence into the shareholders.
3. Such policy helps in long-term financing as the firm would the amount of money they would be able to retain with themselves.
4. Stable rate of dividend helps in stabilizing the market price of shares.
5. Many shareholders consider income from dividends as their regular source of funds that can be used to meet their everyday expenses.
6. If earnings are retained and are not distributed on a regular basis, the shareholders may be required to pay a hefty amount of tax in the year the accumulated dividends of the company are distributed.

However, regular dividend policy can adopted only by companies that have regular incomes and not by companies whose incomes keep fluctuating regularly.

- **Stable Dividend Policy**

The term "dividend stability" refers to the steadiness or absence of fluctuations in the dividend flow. Specifically, this means regularly distributing a certain minimum dividend.

A firm can establish a stable dividend policy by opting for any of the following methods:-

1. **Constant Dividend Per Share**

A few companies conduct a policy of paying a fixed dividend per share regardless of the amount of income every year. Such companies generally create a "dividend reserve" so that they can pay the fixed dividend even in the year when profits are insufficient or when losses exist. A consistent dividend per share policy is best for companies whose earnings are expected to remain stable over several years.

2. **Constant Pay-out Ratio**

The constant payout rate means paying a fixed percentage of the net income in the form of dividends per year. The amount of the dividend in such a policy varies in direct proportion to the profits of the company. The constant payment policy is favored by the companies because it is associated with their ability to pay dividends.

3. **Stable Rupee Dividend Plus Extra Dividend**

Some companies have a policy of distributing a constant dividend per share plus an additional dividend in years of high earnings. Such a policy is best for companies that have fluctuating returns year after year.

Variables taken into consideration for the study:-

There are numerous variables impacting the profit strategy as examined in the writing above. In this investigation, the reliant variable is the dividend payout ratio (DPR) and the autonomous factors are liquidity and profitability. The organizations with greater liquidity usually opt to pay dividend when contrasted with the organizations with a liquidity crunch. Two of the normal liquidity measures in the banking sector have been connected. Every proportion estimates liquidity from a particular angle and each measure expected to have its own effect on the dividend payout ratio.

- Loans to Asset Ratio (LAR) = Loans and advances or investments in Indian banks divided by total assets.
- Loans to Deposits Ratio (LDR) = Loans and advances or investments divided by customers' deposits

The second factor is the profitability of the bank. Past specialists have discovered profitability as a standout amongst the most vital determinants of dividend payout strategy. Be that as it may, the outcomes on relationship of the two factors are mixed. According to the pecking order theory, the organizations will

want to depend more on their internal funds or retained earnings, therefore the organizations will have a propensity of paying less profit and thus high level of retained earnings. Thus, the profitable firms will favor lower dividend. What's more, two regular proportions of profitability have been directed:

- Return on Equity (ROE) = Net income divided by the total equity of the bank.
- Earnings per Share (EPS) = Net income divided by the number of outstanding common shares.

In light of the above dialog, a linear regression model will be created to test the expressed speculations.

DPR = *f* (Liquidity, Profitability.) (1)

DPR = *f* (LAR, LDR, ROE, EPS) (2)

LITERATURE REVIEW

George and Kumudha (2006) in their study of dividend policy in relation to Lintner's model, actual results seem to play an important role in the dividend policy decision. The results clearly show that the dividends for the current year's shares are positively linked to the dividend per share and the dividend per share of the previous year (offset dividend) with a correlation coefficient of 0.654 and 0.657 respectively. In the Indian context, some studies have analyzed the behaviour of company dividends.

B S Bodla, Karam Pal and Jasvir S Sura (2007) reviewed the applicability of Lintner's dividend policy in the banking sector of India. The outcomes recommend that the principle determinants of the present profit are conceded profit and current income of both open and private sector banks.

Azhagaiah and Sabaripriya (2008) analyzed the impact of dividends on shareholder value and demonstrated that shareholder wealth is strongly influenced by five variables: sales growth, improved profit margins, investment decisions, capital structure decisions, and capital costs. Dividend payment has a significant impact on the shareholders' equity of organic chemical companies, and shareholders' equity is not affected by the distribution of dividends.

Amitabh Gupta (2010) examined various factors that influence a company's dividend decision, using a two-step multivariate process. First factor analysis was performed on the data to extract important factors from different variables, then a multiple regression was performed with such factors. The results of the factor analysis showed that leverage, liquidity, profitability, growth and ownership structure were the main factors. The regression of these factors showed that leverage and liquidity are the determinants of dividend policy for Indian banks.

Saima Rizvi (2011) conducted an investigation to examine the factors that influence the dividend payout ratio of Indian banks by using statistical correlation and regression techniques to examine the connection between key factors. The results of the case show a positive and significant correlation between earnings per share and the payout ratio. The equity beta has been shown to have a negative but significant

relationship with the dividend payout ratio in the banking sector. The results also showed a non-significant relationship with the cash flow from operating activities and the debt ratio.

Olandipupo and Okafor (2011) focus on parties that control shareholders' wealth maximization and how it affects company performance. There is a positive correlation between firm size and undistributed profits, the impact of which is statistically significant in shareholder funds, and dividend payout is negatively correlated with shareholder wealth. However, income and retained earnings are more important than the distribution of dividends in controlling shareholder value.

Devaki and Kamalaveni (2012) analyzed the impact of shareholding pattern of the Indian corporate hotels. Fixed impact firm model estimation uncovered that there was a positive relationship between lagged dividend, income, debt-equity ratio, revenues, measure, age of the firm and institutional shareholding.

Onwumereet al. (2012) tried to examine the relationships between the financial structure of companies and the goal of companies to maximize shareholder wealth using three indicators of value maximization: net profit margin, dividend per share and liquidity ratio. This study found that the Outsider Fund was certain and had no noteworthy effect on the profit per share and the liquidity ratio; The Outsiders fund had a negative and significant impact on the net profit margin.

Atiyet (2012) result demonstrated that growth, profitability, monetary obligation and size of the firm had noteworthy effect on investors' wealth.

Chidinmaet al. (2013) found that earnings per share and market price per share had significant impact on shareholder’s wealth; a high dividend payout increases the market value of shares and thus, the shareholders’ value.

Salman (2013) study showed that dividend per share, earning per share and lagged market price per share had a significant positive relationship with shareholders wealth.

Kumaresan (2014) focused on the banking industry's top ten companies from 2008 to 2012 and found that there is a positive correlation between equity return, dividend payout per share and dividend payout rate and shareholder wealth of selected companies. Banking and research also Proof of negative correlation between retention rate and shareholder wealth

Dr. Souvik Banerjee and Dr. K.T. Rangamani (2016) conducted a research wherein they analysed the data of 40 banking sector companies in India for a period of 5 years and revealed that there is no noteworthy contrast in the Dividend Pay-Out Ratio of public and private sector banks in India.

RESEARCH METHODOLOGY

RESEARCH OBJECTIVES

- To test the stability of dividend pay-out ratio in the Indian banking sector
- To examine the relationship between liquidity and dividend pay-out ratio in the Indian banking sector
- To examine the relationship between profitability and dividend pay-out ratio in the Indian banking sector
- To examine the relationship between public and private sector banks in connection to the dividend pay-out ratio.

HYPOTHESIS

Hypothesis 1: There is a significant relationship between liquidity and the dividend payout ratio.

Hypothesis 2: There is a significant relationship between profitability and the dividend payout ratio.

Hypothesis 3: There is no difference between public and private sector banks as far as dividend payout ratio is concerned

RESEARCH DESIGN

The study is exploratory research in nature that is done to analyse the dividend policy in the Indian Banking Sector and to identify the relationship between the different measures of liquidity and profitability on one hand and the dividend pay-out ratio on the other hand in the Indian banking sector. This study is based on secondary data of the banks collected from the software ProwessIQ for a period of 10 years from 2008 to 2017.

POPULATION AND SAMPLING

Our sample size is the data of 20 banks (10 private and 10 public sector banks) listed in different stock exchanges in India. The sample period undertaken for study is from 2008 to 2017. The period of 10 years usually covers a business cycle. Therefore, the period chosen covers a complete business cycle i.e. both recessionary and booming phases of the Indian banking sector.

SAMPLING TECHNIQUE/PROCEDURE

Convenient sampling has been used as the banks whose data was available for this period has only been used for this study.

RESEARCH INSTRUMENT/TOOLS

Statistical correlation and linear regression have been performed using SPSS software to examine the relationship between different variables. Dividend pay-out ratio has been taken as the dependent variable whereas liquidity and profitability ratios have been taken as independent variables.

DATA COLLECTION

This study makes use of secondary data and is focused on the Indian banking sector. All the information has been collected from the software ProwessIQ, CMIE (Centre for monitoring Indian economy) reports and the annual reports of the selected banks.

METHODOLOGY

Variables have been selected on the basis of past studies.

Dependent Variable – Dividend pay-out ratio

Independent Variable – Profitability ratios (earning per share and return on equity) & liquidity ratios (loan to asset ratio and loan to deposit ratio)

LIMITATION OF THE STUDY

There are many other factors that affect the dividend policy of banks but they have not been taken into consideration. Only the data of 20 banks (10 private and 10 public sector banks) has been used in this study as the data of other banks was not available for the period of study and some of them shut down after a few years only

CHAPTER 4
DATA ANALYSIS AND FINDINGS

Table 1: Descriptive Statistics

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
ROE	200	-28	38	15.06	10.082	101.655
EPS	200	-83	215	33.34	38.636	1492.768
LAR	200	0	1	.98	.157	.024
LDR	200	0	2	.99	.224	.050
Dividend Payout Ratio	200	0	38	16.74	9.691	93.914
Valid N (listwise)	200					

INTERPRETATION:

Table 1 presents the descriptive statistics for all the variables included in the research to examine the dividend pay-out policy of the Indian banking sector for 2008 to 2017. The table reports the mean, maximum, minimum, standard deviation, coefficient of variation and the number of observations for each table.

The table shows that there is significant variation among the variables. The average standard dividend pay-out ratio is 16.8% and the average profitability per share is 33% which means that the firms distributed almost 50% of their net profits as dividends. The standard deviation of the dividend pay-out ratio for the selected period was 9.7% which means that the dividend pay-out was not highly dispersed.

Test for Multicollinearity

Multicollinearity refers to the situation in which the independent variables are highly correlated. When independent variables are multi collinear, there is overlap or sharing of predictive power. This may create a problem that none of the regression model fits the data well but none of the independent variables has a significant impact in predicting the dependent variable. To ensure that there was no problem of multicollinearity problem in the study Variance Inflation Factor (VIF) was done. The results of the test are available in table 5 below. Those independent variables with the values of VIF greater than 10 indicate possible problem of multicollinearity.

The mean VIF was found to be 1.1 which is much lower than the threshold of 10. The VIF for individual variables was found to be very low. This showed that the independent variables included in the study were not substantially correlated with each other.

Table 2: Correlation Analysis

Coefficient Correlations[a]

Model			LDR	LAR	ROE	EPS
1	Correlations	LDR	1.000	.008	.030	-.026
		LAR	.008	1.000	.010	-.021
		ROE	.030	.010	1.000	-.393
		EPS	-.026	-.021	-.393	1.000
	Covariance	LDR	8.072	.089	.006	-.001
		LAR	.089	16.513	.003	-.002
		ROE	.006	.003	.005	.000
		EPS	-.001	-.002	.000	.000

a. Dependent Variable: Dividend Payout Ratio

INTERPRETATION:
Correlation is a statistical technique that can demonstrate whether and how firmly combination of factors are connected. It surveys how well the connection between two factors can be portrayed. On the off chance that there are no rehashed information esteems, an ideal Spearman correlation of +1 or −1 happens when every one of the factors is an ideal monotone capacity of the other. Table 2 exhibits a low coefficient correlation among the diverse factors which demonstrates that every current variable have persuasive effect on the dividend payout ratio.

Table 3: ANOVA Table

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2998.591	4	749.648	9.317	.000[b]
	Residual	15690.364	195	80.463		
	Total	18688.955	199			

a. Dependent Variable: Dividend Payout Ratio
b. Predictors: (Constant), LDR, LAR, ROE, EPS

Table 4: Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.401[a]	.160	.143	8.970	.160	9.317	4	195	.000

a. Predictors: (Constant), LDR, LAR, ROE, EPS

Table 5: Model Coefficients

Coefficient Correlations[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-10.776	5.020		-2.147	.033		
	ROE	.091	.069	.094	1.324	.187	.845	1.183
	EPS	.033	.018	.131	1.832	.068	.867	1.183
	LAR	13.462	4.064	.217	3.313	.001	.689	1.000
	LDR	12.044	2.841	.278	4.239	.000	.746	1.001

INTERPRETATION:

The regression analysis has been led utilizing the SPSS to research the effect of the chosen factors on the dividend payout ratio. The regression results are displayed in table 3, table 4, and table 5 beneath. The model is a vigorous model and factually noteworthy with F = 9.32 and estimation of R-square = 0.16 which demonstrates that the model clarifies 16% of the minor departure from the dividend payout ratio.

There is a profoundly positive and exceptionally noteworthy connection between loan to deposit ratio and dividend payout ratio (0.00) and furthermore between loan to asset ratio and the dividend payout ratio (0.001). Thusly, we can acknowledge theory 1 that there is a critical connection among liquidity and the dividend payout ratio. This finding demonstrates that liquidity is a noteworthy determinant factor of the dividend strategy.

One of the fascinating outcomes is that there is immaterial and negative connection between the return on equity (0.187) and earning per share (0.068), i.e., profitability ratios and the dividend payout ratio of the chosen banks. This outcome repudiates with numerous investigations because of the way that every one of the banks create same scope of profits and fluctuates in their liquidity position; henceforth the profitability isn't a determinant factor as on account of liquidity. In view of this outcome, speculation 2 will be rejected in light of the fact that there is no huge connection among profitability and the dividend payout ratio.

It is clear that benefit has no critical association with the dividend payout ratio.

The results of the regression model demonstrate that the dividend payout ratio is emphatically influenced by the two liquidity factors are essentially related however earning per share is positive yet immaterial. The return on equity are not altogether identified with the dividend ratio and negatively correlated.

Table 6: Independent t-test to compare dividend pay-out ratio of private and public sector banks

Independent Samples Test

	Levene's Test for Equality of Variances		t-test for Equality of Means						
	F	Sig.	T	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
								Lower	Upper
Equal variances assumed	3.916	.049	-1.217	198	.225	-1.770	1.454	-4.637	1.097
Equal variances not assumed			-1.217	196.47	.225	-1.770	1.454	-4.637	1.097

INTERPRETATION:

Independent t-test is a statistical tool used to determine whether there is significant difference between the means of two unrelated groups. Here, it has been used to compare the dividend pay-out ratios of public and private sector banks in India. Table 6 shows that the p value is 0.225 which is way above the acceptable p value of 0.005. So, we failed to reject the null hypothesis number 3. Thus, it can be concluded that there is no difference between the dividend policies of public and private sector banks in India for the concerned period.

Careful evaluation of the correlation and regression analysis results as shown in the above tables has provided us with the following findings:-

- **Stability of Dividends**

There is stability of dividends in the Indian banking sector as the standard deviation of the dividend pay-out ratio for the selected period was 9.7% which means that the dividend pay-out was not highly dispersed. This shows that the dividends are distributed regularly amongst the shareholders by the banks.

- **Liquidity**

Liquidity of the firm has been recognized as a noteworthy determinant factor of the dividend strategy. Regression analysis demonstrated that there is a noteworthy connection among liquidity and dividend payout ratio of the firm as there exists an exceedingly positive and critical connection between loan to

deposit ratio and dividend payout ratio (0.00) and furthermore between loan to asset ratio and the dividend payout ratio (0.001).

- **Profitability**

Profitability has been found to have an insignificant relationship with the dividend pay-out ratio. This result contradicts many studies because all the banks produce same scope of benefits and only differ in their liquidity position. The results showed that there exists an insignificant and negative relationship between the return on equity (0.187) and earning per share (0.068) i.e. profitability ratios and the dividend payout ratio of the selected banks.

- **Dividend policies of public and private sector banks**

Independent t-test has been used to compare the dividend payout ratios of public and private sector banks in India. The results of the independent t-test showed that there is no difference between the dividend policies of public and private sector banks in India for the concerned period.

CONCLUSION

- The banking system plays a very important role in the economy of the nation. The health of the economy is closely linked to the soundness of the banking system. As a rule, the company spends part of its profits on the shareholders. The part of the profit distributed to the shareholders is called dividend. The dividend policy determines how much of a company's profits will be paid to shareholders and how much will be withheld. The return on a shareholder's participation includes the dividends received and the capital gain or loss during the duration of the action. As a result, a dividend is an important part of the shareholder's return.
- The principle objective of the study was to exlore the impact of liquidity and profitability on the dividend payout ratio in the Indian banking sector for a period of 10 years from 2008 to 2017 by taking into account the data of 20 banks (10 public and 10 private sector banks).
- Regression analysis showed that liquidity is a noteworthy factor in determining the dividend policy of the banks as there exists a prominant relationship between both the liquidity ratios and the dividend pay-out ratio of the banks.

- Regression analysis also showed that profitability does not have any impact on the dividend policy of the banks as there is no significant relationship between the profitability ratio and the dividend pay-out ratios of the banks in India.
- The results of the independent t-test reflected that there is no noteworthy relationship between the dividend policies of public and private sector banks in the Indian banking sector. Both public and private sector banks follow similar dividend policies in India.
- There is stability of dividends in the Indian banking sector as the standard deviation of the dividend pay-out ratio for the selected period was 9.7% which means that the dividend pay-out was not highly dispersed. This shows that the dividends are distributed regularly amongst the shareholders by the banks.
- The results of the study are similar to the previous studies conducted by Aivazian, Gatchev and Spindt (2007), Kuwari (2009) and Baker and Wurgler (2004).
- The study was initially planned to include all the banks in India but many banks had to be excluded from the study due to unavailability of required data for the concerned period of time and many banks shut down only after a few years.

In summary, it is clear from the study that the dividend policy has a positive effect on the performance of banks. It is undeniable that strict compliance with the dividend policy by the banks would produce better results. It is therefore up to the company's management to define an ideal dividend policy that is most appealing to shareholders, adding value to them because of their sacrifices.

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