

Effect of Dividend Policy on Market Price of Banking Industry in Bangladesh

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ABSTRACT

Stock price volatility is considered one of the most crucial issues in finance, and numerous studies have been conducted to investigate the determining factors in share price fluctuations, with varied results. This paper seeks to examine the sensitivity of stock prices within the banking sector to alterations in dividend policy, while also assessing the influence of this policy on key financial indicators such as the retention ratio (RR), earnings per share (EPS), and return on equity (ROE). A sample of 10 private commercial banks listed on the Dhaka Stock Exchange (DSE) was analyzed over the period from 2013 to 2022. The ordinary least squares regression model was employed in the study using panel data. The findings indicate that stock dividends significantly affect market prices, while EPS and ROE also show a significant positive association with market prices (MP). These results can be very informative for policymakers in making informed dividend decisions.

Keywords: Cash Dividend, Market Price, Retention Ratio, ROE, and Stock Dividend

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INTRODUCTION

The banking industry is the backbone of the financial ecosystem in Bangladesh, serving as a channel for financial intermediation and contributing significantly to economic growth. Over the last couple of decades, the industry has seen phenomenal growth on the back of increasing financial literacy, as stated by Hasan et al. (2021), rising disposable incomes, as mentioned by Biswas (2024), and government initiatives, as discussed by Noor et al. (2022), toward financial inclusion. Dividends are a vital part of shareholder returns, which constitute that part of the company's profits distributed to the shareholders. Dividend policy is a corporate decision on the proportion of its profits the company intends to retain for future growth and the proportion to distribute as dividends. The banking industry in Bangladesh is resilient and adaptable; it reflects the nation's commitment to economic progress. Over time, it has grown into a hub where fiscal policies, market trends, and regulatory frameworks converge. This sector's growth chronicles the greater economic growth of Bangladesh and serves to show just how financial institutions function as linchpins in the country's quest for prosperity. One hot topic of interest in this vibrant arena is the interactive relationship that exists between dividends and stock prices. Dividends paid by banking institutions reflect their financial health and strategic decisions, which have far-reaching implications for the equity markets. The interplay between dividends and stock

prices becomes a lens through which one can discern not only the financial health of individual banks but also gain valuable insights into broader economic patterns and investor sentiments. Unraveling these complexities is not an academic exercise in itself; it is more about decoding the pulse of functioning economic mechanisms.

The impact of dividend policy on stock prices has been very well debated among academics and practitioners. Although some authors believe that high dividend pay-out means financial stability and promising growth prospects, resulting in the increase of share prices, such as Rajan (2024), Tran (2024), and Lou (2024), there are those who believe the opposite—that this will negatively influence future growth rates because less funds will be left for reinvestment. Examples are AlAliet. al., (2024), Mahirunet. al., (2023), and Shah et. al., (2020). This debate highlights the intricate and multifaceted connection between dividend policy and share prices. In the case of Bangladesh's banking industry, researches on the effect of dividend policy on stock prices have not been adequately addressed. This study aims to address the gap in the existing literature by examining the effect of dividend policy on share prices in Bangladesh's banking sector.

OBJECTIVE OF THE STUDY

The primary objective is to explore how stock prices in the banking sector respond to changes in dividend policy and to evaluate the effect of such policy on important financial metrics (RR, EPS, and ROE).

LITERATURE REVIEW

The landscape of financial research has been significantly shaped by studies into the dividend policies and their impact on share prices; they form a cornerstone in the literature on finance. Foundational work by early authors such as Lintner (1956) asked critical questions about how managerial decisions shape the size, timing, and structure of dividend payments, which invited extensive theoretical and empirical discussion. This led to the development of diverging perspectives, with Miller and Modigliani's (1961) Dividend Irrelevance theory arguing that dividend policies have no bearing on share prices in perfect markets, while Gordon's (1963) Dividend Relevance theory posited that dividend policies directly influence firm valuation and market prices. Over the years, these theories have been extended and tested globally by various researchers, including Black and Scholes (1974), Baker, Powell (2002), and Myers and Frank (2004), among others, with mixed results.

Empirical studies have also continued to mirror this divide. On the one hand some researchers, such as Allen and Rahim (1996) and Baskin (1989), found no or negligible relation between dividend policies and share prices, thus supporting the irrelevance school of thought. More recent studies, such as those by Nidar and Maraya (2021) and Seyedimany (2023), provide evidence that dividend announcements, particularly in emerging markets, do not consistently yield significant stock price reactions. These findings suggest that market inefficiencies, investor behaviors, and contextual factors might dilute the signaling effect of dividends. Conversely, certain studies support the relevance theory, such as the

study of Halife and Karroum (2023) on the Istanbul Stock Exchange and the findings of Singh and Nautiyal (2024) in the Indian market, which give reason to the signaling effect of dividends in communicating positive corporate performance.

For instance, region-specific studies such as those in South Africa by Kasozi&Ngwenya, 2023, and Pakistan by Jatoui, 2024, indicate contextual nuances in which firm characteristics, like size, profitability, and growth opportunities, affect dividend decisions and, consequently, their influence on share prices. In the same line, Louziri and Oubal (2022) noticed that firm age and growth prospects significantly affect dividend policies in Morocco. However, despite these insights, consensus on a universal theory remains elusive.

Regarding Bangladesh, the discussion of dividend policies and stock prices is relatively limited compared to the number of studies conducted on the issue globally. Most available studies, such as those by Provaty & Siddique, (2021); Hossin & Ahmed, (2020), identified a substantial connection between dividend policies and share prices. However, findings often contradict each other due to differences in models, variables, and methodological approaches. While the impact of sector-specific effects-for example, in banking or in the non-financial sector-continues to attract broad research attention worldwide, this dimension has not received the due attention in Bangladesh.

This suggests further, careful probing of the dividend policy dynamic in Bangladesh, particularly the banking sector, as it could be used to give very key signals of financial health for an increasingly developing yet unpredictable market. Future research could provide deeper insights into the relationship between dividend policy and share prices is mediated by factors in specific industries or investor behavior within Bangladesh's unique financial ecosystem. Such a study might compare findings with global trends to show if the observed pattern aligns with or runs counter to the international context.

METHODOLOGY OF THE STUDY

The paper studies the commercial banks listed on the DSE, where the data has been primarily sourced from secondary resources: annual reports, and the DSE database, for the period ranging from 2013 to 2022. Newly listed banks were excluded because of their insufficient data, thus narrowing it down to 10 banks with a consistent history of dividend payouts. A wide review of various domestic and international literatures was conducted to identify the research variables.

Operational Variables and Measurement: Operational variables in this study are defined and measured as follows:

Market Price (MP): It represents the average of the highest and lowest share prices within a specific month. However, researchers have widely used price volatility instead of the market price to see the impact of dividend policy as can be seen in studies by Rashid & Rahman 2009; Hussainey et al., 2011.

Cash Dividend: Cash dividend declared and distributed to the shareholders per share in the company annual reports.

Stock Dividend: Numbers of stock dividend issued per share according to company reports
Earnings per Share (EPS): Net income divided by the average number of outstanding shares.

RR or Retention Ratio: The net income retained after dividends are paid, computed as the difference between dividends and net income divided by net income. This is a neglected ratio in past studies but shows a positive association with stock prices (Pani, 2008).

Return on Equity (ROE): Net income divided by the average shareholders' equity (Kutaningtyas, et. al., 2024; Thenmozhi, 2000)

HYPOTHESES OF THE STUDY: The hypotheses are structured as follows:

H_{o1} : Dividend policy does not have a statistically significant impact on the market price.

H_{o2} : Return on Equity (ROE) does not significantly influence the market price.

H_{o3} : Earnings per Share (EPS) has no statistically significant effect on the market price.

Technique of Data Analysis: In its pursuit to unravel the intricate financial dynamics, the study embraces a robust and comprehensive approach to data analysis. Central to this analytical effort is the application of multiple regression analysis, a sophisticated statistical technique designed to discern and quantify the relationships among various financial variables. In essence, the adoption of multiple regression analysis elevates the study's analytical rigor, allowing for a sophisticated exploration of the complex interplay among financial variables. This approach is well-suited to uncovering patterns, trends, and insights that enhance the understanding of financial dynamics within the study's scope

Technique of Testing Hypothesis: To evaluate the formulated hypotheses, the study employs statistical hypothesis testing. Specifically, it utilizes hypothesis tests associated with regression analysis, such as testing individual coefficients. This study employs a sophisticated regression model to meticulously analyse the intricate relationships among key financial variables. The regression model is expressed as:

$$MP = \alpha + \beta_1 DP + \beta_2 RR + \beta_3 ROE + \beta_4 EPS$$

Where, α = Constant; $\beta_1, \beta_2, \beta_3, \beta_4$ are beta coefficients (slopes) for independent variables.

RESULTS AND DISCUSSION

Table 1 presents descriptive statistics, showcasing the mean and standard deviation of various variables. The mean, representing the average of the data, highlights noteworthy trends. Notably, the mean of Market Price surpasses that of other variables, indicating its prominence. Conversely, Cash Dividend exhibits the lowest mean, reflective of the banking industry's inclination towards stock dividends over cash dividends. Standard Deviation, revealing the degree of variation in the data, offers insights into the data's dispersion. The highest standard deviation, observed in Market Prices (167.76), signals significant variability in the banking industry's market valuations in Bangladesh. In contrast, the lowest standard deviation (0.053) in Return on Equity indicates a comparatively stable pattern in this metric. This diversity in standard deviations underscores the dynamic nature of the financial metrics

under scrutiny, providing a nuanced understanding of the variability inherent in the banking industry's performance during the specified period. Top of Form

Table 1: Descriptive Statistics

Variables	X	σ	Minimum	Maximum
MP	67.97	167.77	6.03	1390.96
EPS	3.22	2.23	0.53	15.1
ROE	0.13	0.053	0.02	0.4
RR	0.79	0.18	-0.5	1
CD	0.09	0.13	0	0.7
SD	0.12	0.13	0	0.8
TD	0.13	0.13	0	0.65

Source: Author's calculation

Table 2 presents the Pearson Correlation, scrutinized at 1% and 5% levels of significance, offering insights into the relationships among various financial indicators in the banking sector of Bangladesh. Notably, Market Prices exhibit a significant correlation with EPS, Return on Equity, and Retention Ratio at both 1% and 5% significance levels. EPS demonstrates significant relationships with Market Price, ROE, and Cash Dividend at the 1% significance level. Furthermore, Cash Dividend and Stock Dividend exhibit an insignificant relationship with Market Price. However, Cash Dividend has strong associations with EPS and ROE at the 1% and 5% levels of significance, respectively. On the other hand, Stock Dividend is only significantly associated with ROE at the 1% level. The inverse association of Retention Ratio with Stock Price indicates that shareholders are dividend oriented, and when banks retain earnings for internal purposes, the stock prices decline. The presented results provide the complicated view of dynamic dependencies in the banking financial data with many interesting and meaningful dependences within these correlation series.

Table 2: Pearson Correlations

Variables	MP	EPS	ROE	RR	CD	SD
MP	1					
EPS	0.293**	1				
ROE	0.203*	0.662**	1			
RR	-0.108*	-0.295**	0.283**	1		
CD	0.069	0.368**	0.167*	-0.706**	1	
SD	0.084	0.054	0.235**	-0.715**	0.009	1

Source: Source: Calculated by the authors (2024)

Table 3 presents the correlation between share price and variables such as dividend policy, ROE, retention ratio, and EPS. The result from the analysis, with a correlation coefficient of 0.436, is significant. From the above result, it is observed that dividends explain 19.2% of the variation in share price, which means the impact is small. The model is well fitted, with F-statistics significant at a 1% level, hence proving that EPS, BVPS, and CFPS are strong determinants of share price. This leads to the rejection of the null hypothesis- H_{01} that there is a significant influence of independent variables on the market price.

Table 3: Regression Result

Dependent Variable: Market Price (MP)				
Variables	Coef.	SE	t-stat.	P value
C	-7.655	35.629	-2.15	0.830
EPS	23.727	8.708	2.725	0.007**
ROE	152.524	552.092	3.27	0.034**
RR	4.081349	329.532	0.01	0.990
CD	-59.232	115.255	-0.514	0.608
SD	92.254	109.316	0.844	0.040**
<i>R</i>	0.436			
<i>R</i> ²	0.192			
Adjusted <i>R</i> ²	0.174			
F Statistic	11.391**			0.000

Source: Source: Calculated by the authors (2024)

The significance of the independent variables was tested individually in the study. The significance levels are represented by the denotations of *, or ** at 1%, and 5%, respectively. From Table 3, there is an indication of a positive and significant relationship between EPS, stock dividends (SD), and share prices, with the most influential being EPS, as confirmed by the studies of Khan et al. (2011) and Adesola & Okwong (2009). The ROE also positively influences the share prices, as good management of shareholders' funds enhances returns, and this is in agreement with studies conducted by Khan et al. (2011) and Raballe & Hedensted (2008). On the other hand, cash dividends and retention ratio are insignificant in influencing the market price. These findings provide a better understanding of how dividend policy and financial performance measures influence stock prices.

CONCLUSION

The discussion surrounding the relationship between dividends and market prices has been an ongoing one. The paper has focused on how dividend policy affects the market price of the banking sector. The findings support the relevance theory since it was

established that dividends impact shareholders' wealth. It is evident that stock dividends affect market price, but there are also other variables that contribute just as much, such as EPS and ROE. In conclusion, the study not only contributes empirical insights to the specific context of the Banking industry in Bangladesh but also advances the on-going discourse on dividend policies in the broader field of finance. It challenges researchers, policymakers, and industry practitioners to reevaluate their assumptions and adopt a more nuanced and context-specific approach to dividend decisions, thereby shaping the trajectory of financial strategies in the Bangladeshi business landscape.

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