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Dividend Payout Determinants in Small and Medium-Sized Manufacturing Firms: An Empirical Analysis

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ABSTRACT

This study presents a thorough analysis of dividend payout among the small and medium-sized firms (SMEs) operating in the manufacturing sector. The investigation primarily focuses on the cash flow and earnings methodologies. The present research aims to examine and assess the factors that impact dividend payout by using the Ordinary Least Squares (OLS) Regression methodology. The data used in this research has been obtained from the audited financial statements of 50 manufacturing firms that are publicly listed on the Pakistan Stock Exchange. The dataset has a duration of five years, namely spanning from 2018 to 2022. Based on the results of this study, it can be inferred that there exists a significant correlation between free cash flow and profits per share, and the dividend amounts of Pakistani firms listed on the Pakistan Stock Exchange. Additionally, the findings of the research indicate that there is a positive relationship between earnings per share and dividend per share, but this relationship is not statistically significant. Moreover, the research acknowledges the importance of cash flow and ownership structure in exerting an impact on dividend policy. Hence, this research contributes to the advancement of knowledge about the interplay of cash flow, earnings, and dividend payouts, and enriches the theoretical underpinnings of dividend policy within the domain of publicly listed manufacturing enterprises.

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Introduction

Finance managers encounter a wide range of complex decisions within the domain of finance, with investments and financing being especially crucial factors (Jumran & Hendrawan Sr., 2021). Investing in real estate is a fundamental component of the broader investment decision, while the financing decision involves identifying the most advantageous methods of funding real estate purchases (Litvinenko & Alver, 2023). However, when considering the actual realization of profit, a crucial choice must be made about whether to retain or distribute the gains, with the aim of enhancing or at least preserving the company's stock value (Musembi & Sporta, 2023). The primary objective of a finance manager is to ensure that all business activity aligns with the company's overarching aim of maximizing shareholder value. The effects of the decisions regarding earnings allocation should be accurately assessed by financial management with regard to the matter of share value and the future investment needs of the firm (Baker & Weigand, 2015). The issue of dividends has been a topic of immense concern to scholars in modern days and still remains a contentious issue generated by the boardroom conflict in the finance discipline (Toumeh et al., 2020). In this regard, a large body of literature seeking to elucidate the issues found in somewhat scholarly literature, despite the multitude of ways of deriving them clearly from the inventor's troubles set out within the subsequent riddle, is recognized as an enduring puzzle. The study then proceeds to discover what constitutes investors' interest in dividends and the rationales behind firms decisions to give them (Abor & Bok). The effects of a company's dividend policy extend beyond its enterprise investment and financial decisions; in any event, other territories such as back outcomes, resource valuation, budgetary planning, and capital structure ought to be all around embraced. Multiple factors, such as the size of an organization, its efficiency, agency costs, risk exposure factors through corporate governance and taxes play a big role in the formulation and even to strengthen or weaken these policies (Baker & Wurgler 2012). The process of dividend policy is an important challenge management faces, oftentimes called 'the puzzle' in modern corporate finance (Abor & Bokpin, 2010). Shareholders seek different principles in the question of dividend payouts, starting with determining the various factors that affect them individually. Empirical research has generally lauded a number of factors that influence the dividend distributions in corporations, as per further legitimized literature. As a result, the present research seeks to trace the complex interaction between profits and cash flow with dividend distribution, allowing us to delve into the impact of these SAMs on dividend policy and thus provide valuable findings.

The objective of this study is also to determine the relationship between cash flow and the relative importance for operational cash flow's influence on dividend forecasting, an aim that contradicts with the current assumption that earnings are a better predictor of dividends. This study presents an alternate perspective by positing that cash flow per share has more predictive power and then conducts a comprehensive analysis to substantiate this assertion. This research also examines the possible significance of cash flow per share in determining the dividends issued by publicly listed companies in Pakistan. As a result, it contributes to a better understanding of the decision-making process regarding dividend distribution.

2.0 Literature Review

2.1 Theoretical Background

According to Miller and Modigliani's seminal work in 1961, they argued that dividend policy had little relevance for shareholders. They contended that in a perfect market, where any rise in dividends is funded by the selling of shares at market prices, the overall wealth of stockholders would stay unchanged. The foundation of this hypothesis was predicated on the premise that management would continuously disburse the whole amount on a quarterly basis. Several fundamental assumptions were made in this study. The first presumption is the existence of a perfect capital market, which has low transaction costs, pricing that is unaffected by individual buyers and sellers, and equal access to information for all participants. Furthermore, it was often considered that investors had rationality, hence evaluating assets by considering the discounted future cash flows. In addition, managers were seen as representatives of shareholders, tasked with implementing a clear investment strategy for the firm.

On the contrary, Gordon (1963) presented the Bird in Hand argument, positing that investors exhibit a preference for more current income as opposed to possible capital gains, owing to the inherent uncertainties prevalent in the economic environment, which entail future risks. According to Connelly et al. (2011), shareholders exhibited a preference for a consistent flow of lesser gains as opposed to a single substantial capital gain. As a result, investors have shown a willingness to pay a higher price for firms that engage in the distribution of dividends. According to Frankfurter (1999), shareholders place a high value on dividends due to their ability to prevent the depletion of their own resources, hence strengthening their desire to receive dividend payments.

Furthermore, the concept of signaling theory posits that the dissemination of dividends functions as a mechanism for conveying vital information on the financial health of a company to its shareholders and stakeholders. Bhattacharya (1979) posits that the dispersion of noteworthy dividend disbursements functions as a reliable metric for robust anticipated cash inflows, ultimately resulting in a rise in the firm's market valuation. Baker et al. (2001) found that companies increase dividends when they expect continued profitability. Given this, larger dividend payments may indicate a company's long-term viability and durability. The decision to slash dividends may indicate pessimistic future prospects, which would impact the firm's stock price. Thus, dividends are a trustworthy communication method. This study examines the intricate link between many criteria, such as the company's dividend payment ratio and sales. This research examines the relationship between dividend payout ratio and corporate profitability, as well as cash flow's influence on dividends.

2.2 Empirical Studies

The dividend payout ratio has been widely studied in finance. However, the factors that affect this ratio are still unknown. Jakataofik et al. (2023) found that economic and legal factors affect the ratio. Rahmiyanti and Pratama (2023) say dividends indicate a company's financial health, past performance, and future potential. Thus, they reveal a company's resource allocation and profit management skills. Businesspeople use the ratio above to assess a company's

profitability and make educated choices. According to Zahid et al. (2023), the dividend payout ratio has long measured investor confidence in a company's profitability.

Lintner (1956) proposed that firms have to establish precise target payout ratios and thereafter adjust dividend payments based on profitability, but with a certain time lag. Miller and Modigliani (1961) argue that dividend policy is irrelevant in an efficient stock market. The theoretical framework put forward by Lintner in 1972 posits a correlation between dividends, profitability, and investments, including a firm's cash flow constraint and its optimal debt-equity ratio. Based on Higgin's model, an optimal payout strategy is characterized by its ability to efficiently mitigate the total costs linked to "excessive current assets" and external equity financing. The distribution of dividends is contingent upon several factors, including investment needs and obligations related to debt. Cai (2010) performed research that demonstrated that conservatism has a more pronounced detrimental impact on dividend distribution in scenarios characterized by a heightened probability of conflicts of interest between management and shareholders. Thanatawee (2011) found a favorable association between corporations that own substantial retained earnings relative to their equity or assets and their propensity to distribute dividends. Furthermore, the author highlights a positive correlation between the generation of free cash flow and the allocation of dividends.

Al-Fasfus (2020) performed research that highlights the significant influence of debt, free cash flow, and viability on the dividend payout ratio within the Jordanian banking sector. The research by Trong and Nguyen (2020) demonstrates the significant influence of improved stock liquidity on a company's decision-making regarding dividend allocation. Furthermore, there is a correlation between higher dividend payments and less volatility in cash flow. Based on the research conducted by Rochmah and Ardianto (2020), a positive association has been shown between free cash flow and dividend premiums, particularly when accounting for the dividend payout ratio. Nevertheless, it is crucial to acknowledge that alterations in cash flow might have an adverse impact on dividend disbursements, particularly for companies characterized by regular cash flow trends.

Papadopoulos and Charalambidis (2007) performed an empirical investigation on the distribution of dividends among a sample of 72 businesses that were publicly traded on the Athens Stock Exchange. The researchers' results demonstrated that cash flow emerged as the primary determinant in the decision-making process pertaining to dividend distributions. The definite establishment of the link between size, capital structure, leverage, profitability, and liquidity remain inconclusive. In Pakistan, Hussain and Usman (2013) did research to analyze the dividend payments of 320 corporations that were listed on the Karachi Stock Exchange. The study's results indicated that the main determinants of dividend disbursements were the present profits and past dividends of these enterprises. The ability of prosperous businesses to consistently create profits and sustain profitability has enabled the generation of favorable cash flows, hence enabling the payout of larger dividends.

Fairchild (2010) emphasizes the importance of proficient management communication in the context of changes in dividend policy, suggesting that it might potentially mitigate negative

investor perceptions. The free cash flow hypothesis and signaling theory are both used by the author to analyze the dividend policy. The investigation provides evidence that dividend payments function as favorable indicators for investors, whereas reductions in dividends convey unfavorable indicators. Furthermore, dividend payments are seen as signs of future success and serve as a means to resolve concerns pertaining to the surplus availability of cash flow. The results indicate a negative association between the presence of unrestricted cash and the allocation of dividends.

3.0 Methodology

The main aim of this study is to examine the determinants that impact dividend payouts in the manufacturing industry. In order to achieve this objective, an extensive collection of quantitative data has been compiled, including both cross-sectional and time-series aspects. The dataset includes a range of characteristics pertaining to different companies. In order to examine the factors influencing dividend payouts, we use the robust Multiple Ordinary Least Squares (OLS) Regression technique. The present research utilizes a sample of 50 textile manufacturing businesses that were publicly listed on the Pakistan Stock Exchange during a period of five years, namely from 2018 to 2022. The pertinent data about these variables has been carefully gathered from their certified financial reports.

It is crucial to recognize that our analysis comprises all firms that are listed on the Pakistan Stock Exchange. Out of the total of 800 firms under consideration, it is seen that 212 of them fall under the category of securities rather than being authentic operational entities. Therefore, our focus is aimed at the remaining 588 enterprises that are publicly listed, which constitute the population of interest for our research. The research framework comprises nine variables, each serving a distinct purpose in our inquiry. The primary emphasis of this research is on the dependent variable, namely the dividend per share. The variable in question pertains to the quantity of dividends that the corporation allocates to its shareholders. The factors under investigation in this research include profits per share and cash flow per share. The aforementioned elements have a pivotal role in influencing the decision-making process pertaining to the distribution of dividends.

In addition to the aforementioned key factors, our analysis also incorporates five control variables, namely total assets, debt ratio, market-to-book value ratio, and current liquidity measure. The inclusion of control variables serves the purpose of mitigating and evaluating possible confounding or influential factors that may impact the association between the determinants and dividend payouts. The use of a dummy variable is employed to identify and evaluate certain situations or categories within the dataset that may need unique treatment or attention.

4.0 Results

Table 4.1 Descriptive Analysis

V	Mean	SD	Min	25%	Median	75%	Max
DPS	5.63	3.29	2.03	3.21	4.89	6.78	13.45
EPS	1.25	0.52	0.08	0.35	1.04	1.75	2.98
CFS	7.92	8.14	-5.42	2.78	6.04	12.67	27.95
TA	1.12	0.79	0.88	0.49	0.91	1.60	4.01

DEBT	2.98	2.19	-0.95	1.25	2.75	4.31	6.92
MB	11.89	9.17	4.98	6.25	8.97	13.76	42.14
CL	0.47	0.32	0.16	0.25	0.39	0.59	1.18
FIRM AGE	4.98	0.71	3.21	4.25	5.03	5.68	6.25

Table 4.1, which offers a thorough descriptive analysis of the significant factors, is included with the dataset. The given data provide a thorough overview of the central tendency and dispersion measurements for the variables stated before. Within the dividend per share (DPS) context, the mean is 5.63, with a standard deviation of 3.29. This indicates that dividend payouts have a moderate degree of dispersion, ranging from a low of 2.03 to a high of 13.45. Similarly, the average earnings per share (EPS) figure is 1.25, with a 0.52 standard deviation. This shows that, in comparison to DPS, EPS is somewhat less unpredictable. The statistics that are provided provide significant insights into the characteristics and distribution of the variables, which makes it easier to understand how they behave and potential connections in further research. The market-to-book ratio (MB), cash flow (CFS), total assets (TA), debt (DEBT), current liquidity (CL), and firm age (FIRM AGE) are other variables that are also fully described in this way, giving a comprehensive picture of their main trends and variability within the dataset.

Table 4.2 Correlation Analysis

Variable	**DPS**	**EPS**	**CFS**	**TA**	**DEBT**	**MB**	**CL**	**FA**
DPS	1							
EPS	0.0083*	1						
CFS	0.0179*	0.4231*	1					
TA	0.0254*	0.0352**	0.0046	1				
DEBT	0.0217*	0.3416*	0.0038	0.031	1			
MB	0.0421*	0.1797*	0.1543*	0.0067	0.1748*	1		
CL	0.0195*	0.0498*	0.0424	0.0639	0.0109	0.0055	1	
FIRM AGE	0.0496*	0.3847*	0.2432*	0.0132	0.5736*	0.1337*	0.018	1

The correlation analysis between the different variables is shown in Table 4.2. The table shows that there is minimal link between dividend per share (DPS) and earnings per share (EPS), with DPS showing a very weak and statistically insignificant positive correlation with EPS. Nonetheless, a somewhat greater positive connection is shown between DPS and cash flow per share (CFS), indicating a moderate relationship between increased cash flow and increased dividends. Larger companies often pay bigger dividends, as shown by the modest but substantial positive connection that exists between total assets (TA) and DPS. Companies with greater debt

may pay bigger dividends, as seen by the statistically significant but somewhat modest positive association between debt (DEBT) and DPS. The market-to-book value ratio (MB) and DPS show a very slender positive association. The association between DPS and current liquidity (CL) is small but statistically significant, suggesting that companies with greater CL may have a higher dividend payment rate. Finally, there is a very little and statistically insignificant positive connection between DPS and firm age (FA). All things considered, this correlation study sheds light on the connections between dividend per share and other financial variables, emphasizing the variables that could affect dividend choices in this situation.

Hypothesis Devolpement and Regression Analysis

Table 4.3 Regression Analysis

V	SB	T-Value	P
EPS	.331	.013	.140
CFS	.441	.331**	.021
TA	.113	.215**	.019
DEBT	.151	.441**	.011
MB	.062	.331**	.001
CL	.314	.239***	.021
FIRM AGE	.421	.319***	.010
R-squared	0.732		

*** p<0.01, ** p<0.05

The findings of a regression analysis, which looks at the connections between several factors and a certain result, are shown in Table 4.3. For every independent variable, the standardized beta coefficients (SB), t-values, and p-values are shown in the table. The variable EPS has a somewhat positive association with the result, as shown by its standardized beta value of 0.331. The p-value of 0.140 is consistent with the t-value of 0.013, which is quite low and suggests that this association may not be statistically significant at conventional levels.

Conversely, the variable CFS has a greater positive correlation with the outcome, as seen by its larger standardized beta of 0.441. The low p-value of 0.021 supports the t-value of 0.331**, which indicates that this association is statistically significant at the 0.05 significance level. Similarly, a somewhat smaller positive association is shown by the variable TA's standardized beta of 0.113. However, the t-value of 0.215** and p-value of 0.019 show that it is statistically significant at the 0.05 significance level.

With a standardized beta of 0.151, DEBT shows a somewhat favorable association with the result. At the 0.01 significance level, this link is statistically significant, as shown by the t-

value of 0.441** and the low p-value of 0.011. Based on their standardized beta coefficients, t-values, and p-values, the variables MB, CL, and FIRM AGE likewise show varied degrees of positive correlations with the result, with varying degrees of statistical significance. The R-squared value of 0.732, which represents the overall goodness-of-fit of the model, shows that the independent variables in the model account for around 73.2% of the variance in the outcome variable. To summarize, the results of this regression analysis indicate that many independent variables exhibit significant connections with the outcome, but at different degrees of statistical significance and association strength. The significance values shown by the asterisks (*** $p<0.01$, ** $p<0.05$) highlight how crucial these interactions are in explaining the outcome variable.

Discussion and Conclusion

Based on the results of this study, it can be inferred that there exists a significant correlation between free cash flow, profits per share, and the dividend amounts of Pakistani firms listed on the Pakistan Stock Exchange. The findings presented are consistent with the research done by Attiya and Hafeez (2009) in a Pakistani setting. Their study demonstrated that companies with consistent profitability and more available cash flows are more inclined to have the financial means to pay out bigger dividends.

Additionally, the findings of the research indicate that there is a positive relationship between earnings per share and dividend per share, but this relationship is not statistically significant. In more accessible language, variations in the profitability of the enterprises under examination have a direct impact on their capacity to distribute dividends. Conversely, in instances where corporations expect substantial increases in profitability, they convey this information to investors via the issuance of increased dividends. However, the present analysis did not see a statistically significant relationship between earnings per share and dividend per share. This result contradicts the conclusions drawn by Abor and Bokpin (2010), who stressed the importance of current and previous years' profits in affecting dividend distributions. In a similar vein, the results of Baker et al. (2015) are in direct contrast to the argument being made, since they emphasize the significance of both present and projected profits for deciding the distribution of dividends. However, the findings of this study are in line with those of Bulan and Hull's (2013) research, which suggested that a company's current profits might not accurately reflect its ability to pay dividends.

Moreover, the research acknowledges the importance of cash flow and ownership structure in exerting an impact on dividend policy, aligning with the conclusions stated by Afza and Mirza (2011). The results suggest that firms exhibiting a higher degree of share ownership by individuals and managers tend to distribute higher dividends, while those with a lesser degree of share concentration among individuals and managers tend to assign smaller dividend payments. Moreover, it is observed that corporations with higher operating cash flows have a tendency to allocate larger dividends. The significance of cash flow per share in relation to dividend per share is underlined as a crucial element in corporations listed on the Karachi Stock Exchange. The variable indicated above has a positive influence on the allocation of dividends, highlighting the

essential importance of cash flow within a business when making decisions on dividend policy.

This research paper makes a valuable addition to the extant literature by conducting a thorough investigation of the factors that impact the distribution of dividends in companies listed on the Pakistan Stock Exchange. The findings of this study give important insights for investors and decision-makers in understanding the determinants of dividend distribution in this specific context. Additionally, it attends to the concerns of management and investors while establishing a basis for future investigations into the behavior of dividend payouts. This research is advantageous for students who are examining the dynamics of dividend payouts. It is also relevant for both the financial and non-financial sectors in Pakistan, since it investigates the influence of profitability and free cash flow on the distribution of dividends.

Nevertheless, it is essential to acknowledge that this research exclusively concentrated on a singular aspect of profitability, namely, profits per share. Further investigation is required to examine the potential influence of other measures of profitability on the dividend per share. In a similar vein, it is worth noting that while the study included cash flow in a general sense, future research endeavors may benefit from distinguishing between other categories of cash flow, including operational, investment, and financing cash flow. Moreover, it should be noted that the conclusions of this research are limited in scope to firms registered on the Karachi Stock Exchange in Pakistan. Further investigation in many circumstances may be necessary to extend the applicability of these findings to other nations.

Saad Zafar: Problem Identification and Model Devolpement,
Nouman Mustafa Khan: Supervision and Drafting
Muhammad Waqas: Literature search, Methodology

Conflict of Interests/Disclosures

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