American Journal of Economics, Finance and Management
Vol. 2, No. 4, 2016, pp. 28-34
http://www.aiscience.org/journal/ajefm
ISSN: 2381-6864 (Print); ISSN: 2381-6902 (Online)

Impact of Dividend Policy on Firm Performance: An Empirical Evidence From Pakistan Stock Exchange

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Abstract

The basic objective of this study is to examine either the dividend policy makes an influence on the firm performance in Pakistan. Data which is used for research collected from the reports of firms which are listed from 2010-2015. OLS technique was used to check the regression analysis. Findings show that there is a positive relation between return on assets, dividend policy, and growth in sales. Mostly the results of the research make similarity with the previous research. Results show that dividend payout ratio and leverage have significant negative relation with the return on equity. The Basic purpose of study is to investigate how the dividend policy affects the performance of the firms which are listed in the Pakistan stock exchange.

Keywords

Dividend, Pakistan, Share, Prices, Policy

Received: May 28, 2016 / Accepted: June 1, 2016 / Published online: July 8, 2016

1. Introduction

Pakistan's capital market and advance corporate finance facing issues from the actions of dividend policy. It is the very disputable issue in the field of advance corporate finance, but they are still keeping its prominent place. Different studies have already been done by different researchers and provided the practical evidences and theories regarding the determinants of dividend policy. But the main issue is still there and unresolved. We still do not have any strong arguments for the dividend behavior of firms. We are yet to cover the factors that derive the dividend policy decision and the way these factors interact.

The attraction of dividend policy has increased over the last few decades. Globally, people think that Dividend policy has strong impact on the firm performance. Pakistan as being a developing economy is not responding into these developments. Risks and uncertainty are always associated with an investment which cannot be predicted exactly, except up to certain limits. A lot of information, not only associated with the performance of the company, but also the information such as the economic situation and the political conditions in a country which an investor needs to know to reduce the risks intensity and uncertainty that possibly can happen. Information about the company's performance is normally received from the financial reports. Investors easily understand the company's performance and its ability to raise profits. On Annual General Meetings meeting company declared amount of profit that will be distributed among shareholder as income gain.

Finance revolves around four main decision and the dividend distribution decision is key decision among those. The other decision includes financing, investment, and working capital management. Companies such as (JAFFE, WESTERFIELD, & ROSS, 2002) argued that dividend decision is of great

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importance because it predicts the amount of fundstransfered to investors and retained earnings of firm for further investment. Dividend policy also delivers information for stakeholders about the company's performance. The main objective of investors for investing their savings is to gain income or return on them. A Dividend is a common source of income for risk averse investors in such settings; when a company operates in a highly competitive era and have to maintain its quality and performance to maintain its status quo. This decision has become the matter of great importance that what amount of the portion should be kept with retained earned and what portion will be transferred to shareholders to maintain the attractiveness of firm.

The corporate dividend plans varies over time but also across the different countries, especially between industrialized, unindustrialized and evolving Capital markets. Dividend policy directly affects a company's cost of investment. Jones, Willett, and Glen (1995) discovered that dividend plans and ratios are different in different economy. They describe that dividend disbursement ratios are about two thirds of developing countries than that of developed countries. Ramcharran (2001) also report curtailed dividend yields for emerging economy.

The reason of conducting this research is to further improve the dividend debate with regards of evolving market because Pakistan is going to enter into the emerging markets soon. A lot of researchers have given attentively to the private sector and also in developed countries like in the Germany, European Union, United States and Brazil etc. Now a day the focus is to find the determinants which decide the dividend policies in the less developed or in emerging markets. It means that the picture is incomplete, especially with regard to the capital market of Pakistan. It is clear at all in the case of Pakistan's capital market dividend policy shows a different picture than from the developed countries capital market.

The Purpose of the study is to investigate the impact of Dividend policy on firms performance listed in Pakistan stock exchange.

2. Literature Review

This section will focus on a company performance and purposed dividend plans, Many decades have been spend by researchers but all failed to disclosure the reasons that on which bases a company decided its dividend policy in one country and same company why decided another dividend plan for that econ0my after some years (Peggs et al., 2011). The literature of finance is pampered with a lot debate issued but this issue has gained a lot of importance from few years. (Asif, Rasool, & Kamal, 2011). Agyei and Marfo-Yiadom (2011) discovered some impotant factors that describes the reason for the payment of dividend amount, existing and former years'sprofits, changes in the earnings, the progress rate of earnings and previous dividend policies. Cairns et al. (2007) perceived that it is not necessary for firms to declare dividends for common stockholders, but they never change their policy even in the years when they should never pay to common stocks, but the firms desire is to meet their stackholders' expectation to build a good image to attract other investors and to show the firm stable position to the general public. A lot time and money is spend by professional and academic instiutions to discover the main and key dterminents and behaviors of firms in the selection of dividened but failed to idebtify any thumb rule (Uwuigbe, Jafaru, & Ajayi, 2012).

Dividends are rewards which are disseminate to shareholders for the time and risks undertaken in doing investment with a firm. These distributions are typically after the tax and mandatory payments incase of creditor of firm and they showesa curtail of cash assets (Kazman et al., 1998). Amidu (2007) discussed dividend policy impact on firm performance and measurement of afrmprofitability. The research displayed a confident and significant corelationship between return on assets, progress in sales,equity, and dividend policy. Dividend payment to stockholders are made on the guiding path describe by the dividend policy (Lie, 2005). Frankfurter and Lane (1992) was the first research paper that step forward to explain that under specific assumptions (perfect market and balanced behavior), the worth of a firm is an independent factor and all other decisions like decision for investment and payment of dividend are depended, firm with good value can adopt a different policy while a firm with less value have to adopt a more active policy so its audience never considered it saturate.

Financial performance means how good is the position of a firm, and how efficiently a firm is using its assets to earn more revenues and enlarge its operations (Copisarow, 2000). Different techniques are used to measure the financial performance. Revenue from operational activites, total units sold and market share of a firm can be an indicator of performance. According to Demsetz and Lehn (1985) financial ratios calculated by using financial statements are a good way to evaluate financial performance. Liquidity is the most important ratios used to measure a firm's ability to encounter financial.

Velnampy (2006) studied the companies's financial position and relationship was studied by taking 25 companies listed in Sri Lanka'stock exchange as a sample to explain the association between profitability ratio and financial worth of a firm by using the Altman Original Bankruptcy Forecasting Model. Research tells that only 4 firms will bankrupt in nearby future. He also found that, earning/total assets ratio, market value of total equity/book value of debt ratio and sales/total assets in times are the most significant ratios in determining the financial position of the quoted companies. Velnampy (2013) in his research of "corporate/business governance and corporate performance" sample was taken of 28 manufacturing firm, the data was used of 2007 – 2011indicate that there is no correlation between corporate performance and policies adopted by that firm. Regression model exposed that ROE is not affected by the corporate governance and ROA explain that measures of a corporate are not linked with performance procedures. Nimalathasan (2009) scrutinized the link between organizational progress and of Commercial bank's profitability in Sri Lanka over last 10 years. They understand that, there is a positive relationship between sales and profitability ratios excluding operating profit, ROI (return on equity) and depositor ratio is negatively interrelated with profitability ratios excluding operating profit and ROE. Similarly, advances ratio is also adversely connected with the ratio of return on average shareholder's equity.

Net earnings is another way to mearure financial performance it tells what is allocated into two portions, first one is retained earnings and second one is dividends section. The purpose of retained earnings is to reinvest it in another project and to maintain a pool of long-term reserves. The dividend amount is normally distributed among the shareholders to increase their capitaland to fulfill the purpose for what their shareholder invest their money and time in a particular firm. The trend of Stock Exchange of Pakistan is highly depended on the dividend policy announced by corporate which infact stimulate the market.

A sensible argument in the favor of dividends consists of transaction cost. A risk averse investor usually wants to takea income gain from his/her security which he or she holds has a an option to buy shares that will paydividened in near future and cash them for divideneds, or to buy dividened which will never pay dividened but he/she can gain capital gain from those shares. The transaction costs for the smaller investor is comparetabily less in cashing the income gain because they perform smaller transaction than a big investor who purchase in bulk and transaction cost also increase in this case (Grullon & Michaely, 2002) Gordon theory of "Bird in Hand" (1961, 1962) claims that shareholders with no longer relation demands a great dividend policy. They favor a dividend nowthan aextremelyambiguous situation about capital gain due to doubtful future investment. Practical implication fail thismodel if we apply it the in a perfect market withsuppositionof investors who behave according to concepts of rational conduct (Bhattacharya, 1988) However, the creativethinking of (Clifford & Preston, 1961) is motionlessly often sited.

Farrar and Selwen (1967) suppose that investors gain satisfactory amount from the income which is after tax. Ina context of partial equilibrium, investors have two choices. Individuals decide according to their situation whether to receive dividends or earn amount as capital gains. The logical behind this concept is that when shareholder feels that over all they will earn less after the payment of tax on the dividend earned from the shares they hold,as compared to after tax amount of capital gain then they decided to go with the option of no dividend. For example if the tax rate is high on capital gains than tax rate implied on income from dividend then investors choice would like to be the company who has abundance reserve in retain earnings. Litzenberger and Ramaswamy (1979) presented tax Preference theory and said that investors need companies who has abundance reserve in retain earnings and thus deliveryields in the form of capital gains which are less tax rather than dividendswhih are highly tax dividened. In other words, a firm value of share increase when they pay less dividened their expenditure becomes less and their investment and sixe grow fster which over influence its share price.

The information about dividends or with regarde to signaling theory,despite the misrepresentation of investment decisions to show capital gains will incurred in near future, some timespay dividends to signal their future brightness that firm is progressing by leaps and bounds. Here intuition is grounded on the information irregularity between executives (insiders) and outsider stockholder(common inveator), when managers have special information about thethefuture policies of a firm that is not provided to outsiders. Managers gain incentive by communicatin this information to the general public in their interst. Bhattacharya (1979) Miller and Rock (1985) argued non equality of information availability between key managers and common shareholders may indicate a signaling part for dividend. They tell dividend payments information in a clear manner. The most vital component in their model is that companies must pay funds habitually. Dividends announcement is considered as good news in response the share price responds favourably and vice-versa. Good reputed firms normally send indications to the market by announcing dividend policy and poor reputed firms cannot copy this behavior because of high cost associated with it (for e.g. external financing cost, or tax fine on dividends, alteration of investment decisions

(Brennan, 1970) further studied Farrar and Selwyn's findings by seeing how the prices of shares affected by dissimilar dividend plans. He supposed that the prices of shares would responein manner that shareholder of company will receive same rate regardless of dividend policy. In the model of Brennan, participants of the stock market would need the identical after tax yield from the shares even in case of unlike dividend policy. This means that if a company select an outgoing policy of high dividend, and if investors have to reimburse greater taxes as a consequence, the corporation's stock will have less price in return to sustain the equal after tax rate of yield that shareholders want.

A vital reason for the payment of dividends is that it is generally considered that firms who pay return to their shareholder are truthful and less question to accounting fraud. Harackiewicz, Barron, Pintrich, Elliot, and Thrash (2002) argues: "Embrace stocks that pay healthy dividends. A bird in the hand is better than two in the bush. Healthy dividend payments also indicate that companies are generating real earnings rather than cooking the books". The paststated Wall Street Journal article also describe: "Dividends are paid by companies that grow earnings over a longer period of time. [Buying dividend paying stocks] is a way of getting into growth through the book door, in a lower-risk way." This spat is strictly connected to the uncertainty perseverance argument. Shefrin and Statman (1984) bulid a dividend theory grounded on the point that, even amount received in form of cash is the same, it can even create a variation for the investor, that form which source cash comes from dividends or from capital gains. Behavioral theory is the base for this model. Investor are risk averse and they are not in hurry to gain income from other sources that why they demand dividend. such type of investor focus on savings rather than on spending too much. They never need to inclient their capital and, so, they merely let themselves to consume existing returns as dividends. The conclusion described by(Shefrin & Statman, 1984) is particularly robust for old (retired) investors, as they have slight or no labor earnings and depend on more heavily on income earned from their securities. They mention this as the life cycle of a human behavior. This study indicates few similarity with (Parnes, 1961)study. Nonetheless, the Gordon's theory is built on uncertainty in the direction ofupcoming dividends, though the theory of Shefrin and Statman (1984) is built on investors who select to use incomes from dividends rather than capital gains.

Free cash flow is the cash flow that remains after all positive net present value (NPV) projects are undertaken. (Shenoy & Vafeas) managersgoalis to enlarge the scope of the firm, and therefore may accept negative NPV projects rather than paying dividends. Managers perceive a big firm to be extraadmired and they suppose to earn extrareward than they would earn in a small firm. This is clearly not in thefavor of the current shareholders. Garman and Kohlhagen (1983) argues giving dividends can lessen a possible overinvestment difficulty, since they curtail the quantity of free cash flow. This study is difficult to imply in the setting of our research. The main cause is that it is difficult to send the notion of a negative Net Present Value for project to investors individually who are not aware of finance theory. The only one possible way to test this theory is through linking free cash flow to set markets down or economic downwords. The main assumption of this theory is less growth opportunities under these circumstances. Even in the case if the firm have not free cash flow, dividend can still be very productive for shareholders for the purpose to control the overinvestment problem.

3. Research Methodology

This study examines either dividend policy have an influence on the firm's performance. A sample of different firms has been taken that are listed in PSE over the recent last six years (2010-2015). The data were collected from the annual reports of listed companies which was available in PSE. The PSE data include information like Balance Sheet, Income Statements, Financial ratios and other information which is relevant for all public companies. The data are readily available on Compact Disks (CDs) from the year 2010 to date.

This study applications are accounting measure of performance, such as (ROA) Return on Assets and Return on (ROE) Equity as the dependent variables. So, as a robustness check, this study also uses TOBIN'S q even as a proxy for market based measures ratio. The q describes the ratio of the market value of assets to book value of assets.

The expository variables include dividend policy and the payout ratio, which can be calculated as dividend per share divided by earnings per share. Furthermore, this study has different other control variables that might have an influence on the value of firm rather than dividend policy. Logarithm of total assets is used as a proxy of a firm size to manage the size of the firm's among sample firms. The firm's leverage is computed as the total debt ratio divided by the book value of assets. Jensen and Meckling (1976) explain that debt is a regiment mechanism that relieves agency problems between shareholders and management. The firm's value also affected by the firms future investment opportunities.

Following are the names of variables and their proxies by which variables are measured

ROA-Net income/Total Assets

ROE-Net income/Total equity

Policy-Ratio of market value of assets to book value of assets

Pay-Dividend per share divided earning per share

Size-Log of total assets

LEV-Ratio of total debt to total assets

Growth-Growth in sales for firm

4. Empirical Results

4.1. Descriptive Statistics

Table 1 gives a brief summary of descriptive statistics of variables. The mean value of ROA is 0.112. However the average value of ROE was 0.134. The average value of dividend policy was 0.7123. These results indicate that more than 70 % of companies which are listed on the Pakistan stock exchange pay their dividend during the year. The firm debt to equity ratio is 72.31%. The average growth rate of sales is 22 %.

Table 1. Descriptive Statistics of Companies.

	Mean	Std.deviation	Maximum	Minimum	Median
ROA	0.1124	0.1234	0.4862	-1.2020	0.0834
ROE	0.1345	0.2164	2.3103	-0.5369	0.1104
TOBIN'Sq	2.1973	0.6431	0.3212	-1.3440	0.7818
POLICY	0.7123	0.5432	2.5231	1	1.0
PAY	0.2321	0.3918	2.6154	0	0.2264
SIZE	1,500,000	6,500,000	6,900,000	555	84,100
LEV	0.7231	0.5231	6.8439	0.0084	0.4431
GROWTH	0.2214	0.3216	0.3451	-0.3481	0.1081

4.2. Regression Results

According to regression results R-square explains that on the basis of independent variable variation is explained in the dependent variable. According to the results there is a significant positive relation in the ROA and dividend policy, this relation indicates that when companies pay their dividend it influence the firm's profitability. These results are consistent with signaling theory. These findings are also consistent with the empirical evidence of the researcher. The findings indicate that there is a significant negative relationship between dividend payout and firm profitability. This negative relation means that when companies pay dividend, it effects the retained earning which reduces the firms internal earnings. The proxy which is used to measure this is dividend per share divided by earnings per share.

Table 2 indicates that how other firm's level characteristics influence the company earnings. The results indicate that size coefficient and leverage coefficients are insignificant for the penal data.

The Finding suggests that size and leverage of then entire firm listed on the Pakistan stock exchange do not have a relation with return on assets. There is a significant positive relation between Growth and return on assets which means that when growth opportunities available for the firm increases, return on assets also increased. This is also consistent with the empirical evidence of previous authors.

Table 2. Regression Model Results (Dependent Variable: ROA).

Variable	Coefficient	Std. Error	Prob.
C	0.034809	0.023156	0.0000
Policy	0.138329	0.012380	0.0000
Pay	-0.168018	0.029432	0.0004
Size	-3.23E-15	7.65E-15	0.3281
Leverage	-0.012113	0.013841	0.5689
Growth	0.123421	0.001321	0.0086
R-square	0.763920		
Adjusted. R-square	0.581750		

In table 3 we regress the dependent variable Return on equity on the five independent variables. Results show that dividend payout ratio and leverage have significant negative relation with the return on equity. Remaining all the variables gives the same results.

In the table 4 Tobin's q gives different results that are against the above findings. According to table 4 there is negative correlation between dividend policy, the firm's size and firm's market value. Dividend payout ratio, leverage and growth have a negative impact on the firm market value. According to results Coeffients of variables are not significant which means that there are some other variables that determine the share value of firms listed in the Pakistan stock exchange.

Table 3. Regression Model Results (Dependent Variable: ROE).

Variable	Coefficient	Std. Error	Prob.
C	0.073958	0.034213	0.0731
Policy	0.362139	0.52383	0.0000
Pay	-0.120346	0.04638	0.0003
Size	3.98E-14	2.56E-14	0.2580
Lev.	-0.103891	0.018563	0.6658
Growth	0.213462	0.047819	0.5782
R-square	0.582301		
Adj. R-square	0.498305		
Prob (F-statistic)	0.0000		

Table 4. Regression Model Results (Dependent Variable: TOBIN'Sq).

Variable	Coefficient	Std. Error	Prob.
C	0.807934	0.132931	0.0000
Policy	-0.023483	0.173481	0.8494
Pay	0.312373	0.154325	0.2834
Size	-1.43E-13	1.83E-13	0.1869
Lev.	0.051032	0.071738	0.4738
Growth	0.138588	0.163210	0.4968
R-square	0.513256		
Adj. R-square	0.421316		
Prob (F-statistic)	0.0000		

5. Conclusion

The main purpose of the study is to investigate the Corporate dividend policies of companies listed in the Pakistan stock exchange. Data is collected from the annual reports of companies listed in PSE in the most recent years. OLS, which is a technique of panel data analysis is used to investigate panel data. Findings show that there is a positive relation between return on assets, dividend policy, and growth in sales. Therefore, this study supports the relevant theories of dividend policy.

Findings show that there is a negative relation between return on assets and dividend payout ratio, and leverage. The results are according to empirical literature. In order to check out the robustness of the findings the study also investigates the two another equations. Results show that dividend payout ratio and leverage have significant negative relation with the return on equity. Remaining all the variables gives the same results as in case of ROA.

The dependent variable TOBIN'Sq that gives different results. According to this regression dividend policy and firm size have a negative impact on the firm's value. On the other hand, dividend payout ratio, leverage and growth have a positive impact on firm,s value. According to results all variable coefficients with respect to TOBIN'Sq are insignificant. This study has a few limitations.

Firstly, Our sample size is too small. Secondly, this study only uses OLS to estimate the penal data. Future research can use the multiple method. Future research can include new variables to investigate the dividend policy decision.

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