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EFFECTIVENESS OF SIGNALING THEORY IN PAKISTAN- TESTING THE RELATIONSHIP BETWEEN CURRENT DIVIDEND AND FUTURE PROFITS

Abstract:

Effectiveness of Signaling Theory in Pakistan- testing the relationship between current dividend and future profits Author: Misbah Iqbal Institute of Business Management Abstract The importance of dividend policy has always been a topic of discussion amongst academicians. Many authors continue to come up with different findings from their studies on the relevance of dividend policy on company's performance. Where there are researchers and academicians who suggest no significance of dividend policy, there are others who propose that higher dividend payouts signal towards higher profits in the future years. This research sought to establish the relationship between dividend payout and firm performance among twenty six listed firms on the Karachi Stock Exchange. For this reason, twenty six companies with the highest dividend payout ratio were selected from the KSE-100 index. Data was collected for ten years, from year 2002-2012 for all ten companies and a regression was run between Dividend Payout ratio and the Profit Margin at first. Since signaling theory states about current dividend signaling about future profits, therefore, profit margin of t+1 was considered for regression. The findings state that Dividend Payout Ratio does not have any significant impact on the earnings of the firm at least in Pakistan. The relationship was tested in different ways, taking various aspects of profitability, but the results were somewhat the same. Though signaling theory (high dividend indicates high future profits) has proved to be significant in a few developed economies, its significance on the companies listed in the Karachi Stock Exchange is invalid. Key words: Dividends, Firm's performance, Dividend Payout ratio, profit margin, signaling theory

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Dividend payout, dividend policy, company's performance, profit margin

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