
The Impact of Dividend Policy on Kuwaiti Insurance Companies Share Prices

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Abstract

This study aims to examine the effect of dividend policy on the market value of common stocks of insurance companies listed at Kuwait stock exchange over the period 2009-2017. The study is motivated by the unsolved issue on dividend policy in financial management literature. The study uses share prices as dependent variable and dividend yield, dividend payout ratio, earnings per share, book value per share, and market price to book value ratio as independent variables. The results of the regression model revealed that dividend yield and dividend payout ratio had a statically significant negative effect on the share prices while earnings per share, book value per share, and market price to book value ratio had a statistically significant positive effect on the share price. The results of this study supports Miller and Modigliani (1961) dividend irrelevance theory.

Key Words: *Dividend policy, Insurance companies, Kuwait stock exchange, The Bird in the Hand Theory, Dividend Irrelevance Theory, Share price.*

1. Introduction

Dividend policy and its effect on share prices has always been a controversial issue among researchers. Black (1976) summarized that argument by stating that “The harder we look at the dividend picture, it seems like a puzzle with pieces that don’t fit together”. Dividend policy is a term that describes the management decision to whether or not to pay dividends and if they do, how much of their net profit is allocated to their shareholders. Arnold (2008) described dividend

policy as the decision of what proportion of earnings should be distributed to the company's shareholders. While Gordon (1959) referred to it as the dividing of company earnings into dividend payment to shareholders and reinvestment into new opportunities. Dividends can take many forms, it can be in the form of cash dividends or share bonuses.

Dividend policy is crucial for all parties that are associated with the company. From the management stand, keeping the profits of previous years can help them finance their future projects internally and reduce their dependence on costly external funding's but on the other had not paying any dividends might result in losing some of their investors particularly those investors that seek dividend generating stocks. Khan (2012) concluded that selecting an appropriate dividend policy is a crucial decision for the management because variability to invest in future projects largely depends on the amount of dividends payout to their shareholders. Investors look at dividends as a source of income and also uses it as a gauge to measure and assess the financial soundness of the company from an investment point of view. According to Gupta et al. (2011) many shareholders prefer to receive regular dividends rather than irregular cash payments while some prefer that their reward should be reinvested in new project for increase in capital gains.

The effect of dividend policy on the company share price was intensively studies in the literature, while some researchers believe that market price of an equity is a representation of the present value of estimated cash dividends that can be generated by the equity (Gordon, 1959), others believe that dividend payout is irrelevant to evaluating the worth of equity and earnings are more relevant to the share value (Miller and Modigliani, 1961). Although there have been various studies conducted in the finance literature regarding the validity of both theories, no final result has been reached so far.

Researchers have developed many theoretical models describing the factors that managers should consider when making dividend policy decisions (Huda and Farah, 2011). The main theories include;

- 1- The Signaling Theory (Lintner, 1956) where it states that increase in the dividend payouts of the earnings provides a good sign to the markets about company earnings in the future.
- 2- The Bird in the Hand Theory (Gordon, 1963) the assumption in this theory is that dividends are less risky and more certain than capital gain. Amidu (2007) concluded that investors prefer dividends over capital gain because they are less risky and that companies should set a high payout ratio and offer high dividend yield to maximize their share prices. Elton and Gruber (1970) show that investors' have different preferences towards the dividends and that dividend policy affects the share price in the stock market. Gordon (1959) argument is that the motive to pay dividends is to increase share market prices of the companies.
- 3- Dividend Irrelevance Theory (Miller and Modigliani, 1961) where the theory is based on the assumption that reinvesting the net profit to perform better growth would lead to an increase of the capital earnings for investors through increasing the share prices. They argued that the value of the company is determined by its investment policy and its profit and not by its dividends. Similarly, Black and Scholes (1973) also agreed on the irrelevance of dividend policy.

Numerous studies were conducted to investigate the effect of dividend policy on share prices. Ali et al. (2015) used the data of 45 non-financial companies listed on Karachi Stock Prices in Pakistan over the period 2001-2012. The results of the study showed that dividend payout ratio had a significant positive relationship with share prices which supports the bird in hand theory that suggested that shareholders give preference to a cash dividends over uncertain cash of capital gains. Ansar et al. (2015) examined the relationship between share prices and dividend policy using the data of 30 firms from textile, cement and chemical sector quoted at Karachi stock exchange in Pakistan over the period 2007-2011. They concluded that dividend had a positive relationship with share prices. Joshi (2012) examined the impact of dividends on stock price of 163 companies (both banking and non-banking sector) which are listed in Nepal Stock Exchange for fiscal year 2010/11. Their study revealed that, dividend had a significant effect on market price in both banking and non-banking sector.

In contrast, studies by Baskin (1989) and Allen and Rachim (1996) using the data of Australian stock market found no relationship between the stock prices and dividend yield. Jakata and Nyamugure (2014) also employed data from selected firms on the Zimbabwean stock exchange (ZSE) over the period 2003-2011. They did not find any relation between dividend policy and share prices which supports Miller and Modigliani (1961) dividend irrelevance theory.

2. Methodology

The aim of this study is to examine the dividend policy effect on the share prices of insurance companies listed at Kuwait stock exchange over the period 2009-2017. A panel data is used to evaluate that relation where the share price is the dependent variable and dividend yield, earning per share, dividend payout ratio, book value, and market to book ratio are the independent variables. The assumption is as follow;

$$SP = f(DY, EPS, DPR, BV, MTB)$$

Which can be translated into the following equation;

$$SP = \alpha + \beta_1 DY + \beta_2 EPS + \beta_3 DPR + \beta_4 BV + \beta_5 MTB + \varepsilon \quad (1)$$

Where the variables are shown in table 1 as follow;

Table 1. Variables Description

Variable	Symbol	Description
Share Price	SP	Market share price
Dividend Yield	DY	Dividend per share divided by share price
Earnings Per Share	EPS	Net profit divided by number of shares
Dividend payout ratio	DPR	Dividend per share divided by earning per share
Book Value	BV	Total shareholders' equity divided by number of outstanding shares
Market to book ratio	MTB	Market share price divided by share book value
Error Term	ε	

3. Data and Empirical Results

This research is based on the data of four conventional insurance companies listed at Kuwait stock market over the period 2009-2017. The results of the research are based on their financial reports that were downloaded from Kuwait stock exchange and Kuwaiti institute of banking studies websites.

Diagnostic tests are conducted to support the validity of the regression results. The model used in this research is based on financial ratios, and according to Wadhwa (2019) normality has been proved to be absent when the pattern of ratios was analyzed. In order to examine the normality of the data, examination of skewness (symmetry of the distribution) and kurtosis (sharpness of the peak of a frequency-distribution curve) are required. According to Klein (1998) who stated that for data to be normally distributed, skewness value should be less than ± 3 and kurtosis should not exceed ± 10 . By looking at the descriptive analysis in table 2, it can be seen that the data is normally distributed. The table also shows that the average share price of the companies under study was 0.384 Kuwaiti dinar (1 KD = \$3.33) while the book value of the shares was KD 0.358 indicating that shares are traded in a premium of 7.26%. The table also reveals that insurance companies in Kuwait pay around 28.7% of their earnings in cash dividends and prefer to keep most of its profits for future projects and to reduce their dependence on external funding's.

Table 2. Descriptive Analysis

	<i>SP</i>	<i>DY</i>	<i>EPS</i>	<i>DPR</i>	<i>BV</i>	<i>MTB</i>
Mean	0.384	0.054	0.031	0.287	0.358	1.038
Standard Error	0.031	0.004	0.004	0.196	0.018	0.063
Kurtosis	-0.541	1.508	0.038	30.121	-1.412	-0.405
Skewness	0.091	-1.073	-0.501	-5.289	0.041	-0.009
Count	36	36	36	36	36	36

The results of the regression analysis is presented in table 3. The variables included in the model were able to explain 97.99% of the variation in share prices and it can be labeled as a “good fit” since the model was able to explain more than 50% of the variance in share prices and also have a significance *F* (Prob) that is less than 0.01. The results also showed that dividend yield and dividend payout ratio had a statistically significant negative effect on the share prices which indicates that investors are risk takers and they prefer expected capital gains over secured dividends. The results also revealed that share prices are mostly affected by the earning per share over the rest of the variables since it has the highest coefficient among all variables. This would indicate that investors are more lean toward Miller and Modigliani (1961) dividend irrelevance theory than they are toward Gordon (1963) bird in the hand theory. Share book value and market price to book value ratio also showed statistically significant positive relation with share prices.

Table 3. OLS Regression output

R Square	0.9828
Adjusted R Square	0.9799

	<i>Coefficient</i>	<i>t Stat</i>	<i>P-Value</i>
Significance F	1.71E-25		
Observations	36		
Intercept	-0.1999***	-7.5873	1.84E-08
DY	-0.8644***	-3.8793	0.000532
EPS	1.7127***	4.3590	0.000141
DPR	-0.0076*	-1.7666	0.08747
BV	0.7900***	9.0650	4.27E-10
MTB	0.2854***	21.7403	6.46E-20

*, **, *** represent the confidence level at 90%, 95% and 99% respectively

4. Conclusion

This study was set to examine the effect of Kuwaiti insurance companies' dividend policy on their share prices. The study was conducted using panel data of four conventional insurance companies that are listed at Kuwait stock exchange over the period 2009-2017. The results of the regression model revealed that dividend yield and dividend payout ratio had a statically significant negative effect on the share prices while earnings per share, book value per share, and market price to book value ratio had a statistically significant positive effect on the share price. The results of this study supports Miller and Modigliani (1961) dividend irrelevance theory. While the results on this research applies to the shares of the insurance sector in Kuwait stock exchange, that does not mean by any way that other sectors should yield the same results.

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