



Dividend Policy and Share Price Volatility: A Study on Dhaka Stock Exchange

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Abstract

This study investigates the impact of dividend policy on stock price volatility based on 11 years' (from 2004 to 2014) data collected from 35 manufacturing companies listed in Dhaka Stock Exchange (DSE) of Bangladesh. Secondary data, collected from the archive of DSE and records of the companies, were used in this study. Correlation and multiple regression analysis were used to analyze the association between share price volatility and two main measurement variable of dividend policy (dividend yield and dividend payout). Primarily regression model was expanded by adding control variables including size, earning volatility, and debt. The findings of the study suggest that, among predictive variables, dividend yield and size of the firm have major impact on share price volatility, as the research found the significant inverse relationship of share price volatility with both these variables (dividend yield and size of the firm).

Keywords: Dividend Policy; Share Price Volatility; Dividend Yield; Dividend Payout; Earnings Volatility; Debt

1. Introduction

Dividend policy is a major financing decision which takes into account the payment to shareholders in return of their investments. It is an outstanding financial indicator of the firm and firms operating in a given industry. As such, the demand of the firm's share depends on the dividend policy managed by that firm (Masum, 2014). According to Baskin (1989), dividend policy is a direct cause of common stock price volatility. It is assumed that announcement of dividend is a significant factor regulating stock price movement and it gives a signal to investors about the company. Indeed, dividend policy involves the decision whether to pay out earnings or retain for reinvestment in the business (Vishwanath, 2007). Investors take into account how their total returns are divided between dividends and market price appreciation (Khan, 2009). As such, managers must choose the dividend policy that maximizes the wealth of shareholders and concentrate on the impact of their decision on stock price (Hashemijo et al., 2012) because an optimal dividend policy can balance between current dividends and future growth so as to maximize stock price of the firm (Brigham et al., 1999).

Although the association between share price and dividend policy is an extensively researched topic (as suggested by the above-mentioned research evidences), hardly any research addressing these phenomena can be found in the context of Bangladesh. This study focuses on the dividend policy and its effect on share price movement in Bangladesh with special reference to the manufacturing companies listed in the Dhaka Stock Exchange (DSE). The study is conducted with the aim of identifying the relationship of share price volatility with two main measures of dividend policy - (i) dividend yield and (ii) the payout ratio. This study is based on 11 years' (2004-2014) data collected from 35 manufacturing companies listed

in DSE. Firms, expect an optimal dividend policy which strikes a balance between return of shareholders and growth of a firm. Managers can control the stock price volatility and risk by dividend policy and distribution of dividend at the time of earning announcement which may be interpreted as signal about the stability of firm. Here, dividend policy can be used as a tool for controlling the stock price volatility. However, now, research for the relationship between dividend policy and stock price volatility is ongoing due to contradictory findings (Al-Hasan et al., 2013; Wodung, 2014; Dewasiri and Weerakoon, 2015).

In pursuit these objectives, this paper is organized as follows:

The following section unpacks different theories on dividend policy, the determinants of share price volatility and impact of dividend policy. The subsequent two sections unfold the objectives of the study in details and describe the methodology and models applied in this study. The results of data analysis are presented and analyzed in the section that precedes the final section where a conclusion is drawn to the study by stating some limitations and highlighting some prospective scholastic and empirical significance of the study.

2. Literature Review

In the late 1980s, many researchers examined the relationship between dividend policy and stock price volatility (Dewasiri and Weerakoon, 2015). To investigate the association between dividend policy and stock price volatility, Baskin (1989) used two variables (dividend yield and payout ratio) with four control variables (firm's size, growth, earnings volatility, and debt). This study collected data from 2344 US firms over a period of 1967-1986 and found negative correlation between stock price volatility and dividend yield. Moreover, this suggests that the correlation coefficient of share price volatility with this variable (dividend yield) is greater than the correlation coefficient (in terms of absolute value) with any other variables. Similar to Baskin's findings, Nazir et al. (2010) revealed that share price volatility has a significant negative relationship with dividend yield and dividend payout.

Hashemijoo et al. (2012) investigated the relationship between share price volatility and two main measures of dividend policy: Dividend yield and payout and control variables including size, earnings volatility, leverage, debt, and growth. In this study, a significant negative relationship of share price volatility was found with dividend yield, dividend payout, and size of the firm.

Nishat and Irfan (2004), on a study on the Karachi Stock Exchange, Pakistan, found that share price volatility is inversely related with both dividend yield and payout ratio, while it has got a positive relationship with the size of the firm and leverage. Another study (Habib et al., 2012) conducted on the share market of Pakistan reveals similar relationship of price volatility with payout ratio, but unlike the study of Nishat and Irfan (2004), it reveals positive relationship share price volatility with dividend yield. Even though the results of these studies are not robust enough as in case of developed markets, it is important in identifying the behavior of the emerging markets.

Hussainey et al. (2011) investigated the relationship between stock price volatility and two main measurement of dividend policy along with other variables such as size, growth, earnings volatility, and debt based on sample of publicly quoted companies in the UK for 10 years (1998 through 2007). This study found a positive association of dividend yield and a negative association of dividend payout ratio with stock price changes. In addition, the results of this study showed that debt level, size, firm's growth rate, and earnings explain stock price changes. Nazir et al. (2011) attempted to study the effect of dividend policy on stock price volatility of 75 financial firms listed in the Karachi Stock Exchange after controlling for earnings volatility, assets growth, firm size, and leverage for a continuous period of 5 years (2006-2010). The results of the study showed that there is a significant negative relationship between dividend yield and dividend payout with price volatility. The study indicated that dividend policy is an important tool in setting share prices. On the other hand, Sadiq et al. (2013) analyzed the stock price volatility by taking non-financial firms listed on Karachi Stock Exchange covering 35 firms from 2001 to 2011. The study concluded that price volatility has a negative relationship with dividend yield and earnings per share. It has identified a positive relationship of price volatility with size and growth in assets of firms. The study has also found that there is no relationship between price volatility and earnings volatility of firms in Pakistan.

Lashgari and Ahmadi (2014) attempted to examine the impact of dividend policy on share price volatility in Tehran Stock Exchange. The result indicated that dividend payout ratio has a significantly negative effect, but asset growth rate has a significantly positive effect on stock price volatility. This study also found that variables leverage, earnings volatility and company size on stock price volatility have no significant effect. Al-Shawawreh (2014) conducted a similar study with a sample of 53 companies listed in main market of Bursa Amman in Jordanian Stock Market from 2001 to 2013. The results of this study showed a significant negative relationship of dividend payout and a very weak positive relationship of dividend yield with share price volatility. Besides, a significant positive relationship between share price volatility and size is found, and dividend payout and stock dividend have the most impact on share price volatility among predictor variables.

Al-Hasan et al. (2013) attempted to evaluate the effect of dividend policy on market price of share in the context of Bangladesh with a sample of 28 companies for 2005-2009. The study found that the effect of dividend payout is more on market price than retention and concluded that the findings over the effect of dividend policy on market price support the relevant theory of dividend policy such as Walter's model and Gordon's model.

Duke et al. (2015) investigated the impact of dividend policy on share price valuation in Nigerian banks. The results showed that dividend yield had a significantly positive effect while retention ratio had a significantly negative effect on share price. The study suggested that banks should ensure that they have an optimal robust dividend policy in place. Regular update of shareholders' records should be made to avoid a deliberate diversion or undue retention of unclaimed dividend warrants. Government should establish a body that will help to deal with unclaimed dividends and also ensure that situations that give rise to such are minimized. In the same regard, Oyinola and Ajeigbe (2014) conducted a study on 22 companies listed on Nigerian Stock Exchange from 2009 to 2013. The findings revealed that both dividend payout and retained earnings are significantly relevant in the market price per share of the companies. The study suggested that Nigerian listed firms should adopt optimal trade-off between dividend payment and retained earnings that would increase the shareholders' wealth in terms of cash and/or stock dividend with capital appreciation, while Joshi (2012) examined the impact of dividends on stock price in the context of Nepal selecting 117 companies from banking sector and 46 from non-banking sector listed in Nepal Stock Exchange for fiscal year 2010/2011. This study showed that the impact of dividends is more pronounced than that of retained earnings. Dividend has a significant effect on market stock price in both banking and non-banking sectors.

With the purpose of investigating the influence of dividend policy on share price volatility, Ramadan (2013) studied 77 Jordanian industrial firms listed at Amman Stock Exchange for 12 years from 2000 to 2011. The results showed a significant negative effect of the dividend policy, dividend yield, and dividend payout on the share price volatility, indicating that as the Jordanian industrial firms increase their dividend yield and/or dividend payout, the stock prices tend to stability, as the price volatility fall, and hence, the share price risks fall. Besides, the results showed that the dividend policy has an impact on the price volatility and that the managers of the Jordanian industrial firms have the ability to affect their firm's share price by adapting dividend policy that suits their target investors. Moreover, the study suggested that duration effect theory and signaling theory are relevant in determining the share price volatility in the Jordanian Equity Market.

Hunjra et al. (2014) attempted to examine the effect of dividend yield, dividend payout ratio, earning per share, and return on equity and profit after tax on stock prices with a sample of 63 companies listed at Karachi Stock Exchange for 2006-2011. The results indicated that dividend yield and dividend payout ratio have significant impact on stock price. Dividend yield is negatively related, but the dividend payout ratio is positively related with stock price which means that these results are against dividend irrelevance theory. Profit after tax and earnings per share have a significant positive impact on stock price and return on equity which shows positive insignificant impact on stock price. Finally, this study showed new insights for policymakers to improve the performance of Karachi Stock Exchange.

Baah et al. (2014) studied the industry sector determinants of dividend policy and its effect on share prices of 12 companies listed on Ghana Stock Exchange (GSE) from 2006 to 2011. The findings

showed that the main determinants of dividend policy for listed companies of GSE are return on equity, profit after tax, and firm's size. However, there are varying factors that influence the dividend payout across the different sectors. Profit after-tax happens to be a key variable that is consistently considered by most sectors in paying their dividend. Most of the firms listed on GSE, however, showed statistically insignificant and weak relation between their dividend payout and share price.

3. Objectives and Hypothesis

The primary objective of this study is to examine the impact of dividend policy on share price volatility in DSE. Specifically, this study intends to investigate the following five issues:

- i. If there is any significant relationship between dividend yield and share price volatility
- ii. If there is any significant relationship between payout ratio and share price volatility
- iii. If there is any relationship between firm size and share price volatility
- iv. If there is any relationship between earnings volatility of the firm and share price volatility
- v. If there is any relationship between debt and price volatility.

4. Methodology

This study is based on secondary data collected from 35 manufacturing companies listed in DSE for 11 years ranging from 2004 to 2014. The firms are selected based on the availability and ease of accessing the required data. Data are derived from archive of DSE, the annual reports of companies listed on DSE, that consists of balance sheet, income statements, financial ratios and other relevant pieces of information for all publicly quoted companies.

4.1. Variables and Measures

The variables used in this analysis are derived from the work of Hashemijo et al. (2012) relating stock price, dividend, earnings, size and debt. The variables are as follows:

- i. Share price volatility expressed as *P. vol* and calculated as:

$$P. vol = \sqrt{\frac{\sum_{i=1}^{11} ((H_i - L_i) / (\frac{H_i + L_i}{2}))^2}{11}} \quad (\text{Formula 1})$$

Where

P. vol = Share price volatility

H_i = Highest stock price for year i

L_i = Lowest stock price for year i

i (from 1 to 11) indicates years from 2004 to 2014

- ii. Dividend yield expressed as *D. yield* and calculated as:

$$D. yield = \sum_{i=1}^{11} \left(\frac{D_i / MV_i}{11} \right) \quad (\text{Formula 2})$$

Where

D. yield = Dividend yield

D_i = The sum of annual cash dividend paid to common share holders in year i

MV_i = Market value of firm at the end of year i

i (from 1 to 11) indicates years from 2004 to 2014

iii. Payout ratio expressed as payout and calculated as:

$$\text{Payout} = \sum_{i=1}^{11} \frac{D_i/E_i}{11} \quad (\text{Formula 3})$$

Where

D_i = Cash dividend paid to common shareholders in year i

E_i = net income after tax for year i

i (from 1 to 11) indicates years from 2004 to 2014

iv. Firm size expressed as size and calculated as:

$$\text{Size} = \ln \left(\sum_{i=1}^{11} \text{MVi} / 11 \right) \quad (\text{Formula 4})$$

Where

MVi = The market value of firm at the end of year i

i (from 1 to 11) indicates years from 2004 to 2014

v. Earnings volatility expressed as E. vol and calculated as:

$$\text{E.Vol} = \sqrt{\frac{\sum_{i=1}^{11} (R_i - \bar{R})^2}{11}} \quad (\text{Formula 5})$$

Where

R_i = the ratio of operating income to total asset for year i

$$\bar{R} = \sum_{i=2004}^{2014} R_i / 11$$

i (from 1 to 11) indicates years from 2004 to 2014

vi. Long-term debt expressed as Debt and calculated as:

$$\text{Debt} = \sum_{i=1}^{11} \frac{LD_i / \text{ASSET}_i}{11} \quad (\text{Formula 6})$$

Where

LD_i = Long-term debt at the end of year i

ASSET_i = Total asset at the end of year i

i (from 1 to 11) indicates years from 2004 to 2014

4.2. Model specification

The relationship between stock price volatility and dividend policy has been analyzed using ordinary least squares regression (Multivariate). The regression model basically relates price volatility with the two main measures of dividend policy (dividend yield and dividend payout ratio). This first test model is given as:

$$P. \text{vol}_j = a * D. \text{yield}_j + b * \text{payout}_j + c + \epsilon_j \quad (\text{Formula 7})$$

Where

$P. vol_j$ = Share price volatility for firm j

$D. vol_j$ = Dividend yield for firm j

$Payout_j$ = Payout ratio for firm j

C_j = error

Here, the dependent variable, price volatility, is regressed against the independent variables, dividend yield and payout. In line with Baskin (1989) recommendation, a number of control variables are included to account for certain factors that might affect both dividend policy and price volatility. These control variables are firm size, earnings volatility, and long-term debt. The close relationship between dividend policy and price volatility may pose some problem as there are a number of factors that influence both dividend policy and price volatility (Hashemijo et al., 2012). To limit this problem, the control variables are included in the analysis. This modifies the model to take account of this control, giving the following regression equation:

$$P. vol_j = a * D. yield_j + b * payout_j + c * size_j + d * E. vol_j + e * Debt_j + C_j \quad (\text{Formula 8})$$

Where

$P. vol_j$ = Share price volatility for firm j

$D. vol_j$ = Dividend yield for firm j

$Payout_j$ = Payout ratio for firm j

$Size_j$ = Market value of firm j

$E. vol_j$ = Earnings volatility for firm j

$Debt_j$ = Growth in total asset for firm j

C_j = error

5. Analysis and Findings

This part of the paper presents the results of Pearson correlation to test the relationship between dividend policy and share price volatility, and it is acquired by taking an ordinary least squares multiple regression implemented by Habib et al. (2012) and Hashemijoo et al. (2012) where stock price volatility is regressed against selected independent variables such as firm dividend yield, payout ratio, size, earnings volatility, and long-term loan.

5.1. Correlation analysis

Correlation analysis is used to find whether price volatility, dividend yield, dividend payout ratio, firm size, earnings volatility, and long-term debt are correlated. Table 1 presents the result of correlation analysis among the variables:

Table 1 represents the correlation among variables. Table 1 indicates that price volatility and dividend yield are negatively correlated with value of -0.354 and statistically significant ($P < 0.05$). The value of correlation coefficient between price volatility and dividend yield is in line with Baskin, 1989, Habib et al., 2012, and Hashemijoo et al., 2012, results, while it is contrary to Allen and Rachim, 1996, findings.

Price volatility and dividend payout are positively correlated with the value of 0.016 but insignificant. It is consistent with Baskin, 1989, findings and Allen and Rachim, 1996, Habib et al., 2012, and Hashemijoo et al., 2012, results.

The results presented in Table 1 show that price volatility and size have a negative association which is consistent with our expectation. As large-sized firms are usually more diversified and small firms may have less public information, larger firms are expected to be less risky and have less

Table 1: Pearson correlation between variables

Variables	Price volatility	Dividend yield	Dividend payout	Size of the firm	Earning volatility	Long term debt
Price volatility	1					
Dividend yield	-0.354* (0.037)	1				
Dividend payout	0.016 (0.927)	0.022 (0.899)	1			
Size of the firm	-0.264 (0.125)	-0.488** (0.003)	0.033 (0.849)	1		
Earning volatility	0.114 (0.516)	0.057 (0.743)	-0.065 (0.711)	-0.069 (0.695)	1	
Long term debt	0.347* (0.041)	-0.236 (0.172)	-0.117 (0.502)	-0.038 (0.826)	-0.187 (0.281)	1

Figures in the parenthesis shows the significance level. *Correlation is significant at the 0.05 level (2-tailed). **Correlation is significant at the 0.01 level (2-tailed)

share price volatility. Price volatility and size are negatively correlated with the value of -0.264 but insignificant. It can also be seen from table that size and dividend payout has a correlation of 0.033 . This positive correlation implies that larger size firms may have more dividend payout.

Earnings volatility and price volatility are positively correlated ($r = 0.114$). This positive relationship between price volatility and earnings volatility is also consistent with expectation. The result presented in Table 1 shows that there is a positive relationship between dividend yield and earnings volatility ($r = 0.057$) which is in line with Sadiq et al., 2013, finding. Based on Table 1, earnings volatility and size are negatively correlated with value of -0.069 which is in line with Hashemijoo et al., 2012, results, and it implies that larger firms may have less volatility in their earnings. The correlation between price volatility and debt is 0.347 and significant. This result is also in line with expectation. The correlation between dividend yield and debt is negative ($r = -0.236$). It implies that companies with high debt may have less dividend payment.

In general, the pairwise correlations among the independent variables are low, suggesting that there is no multicollinearity among the variables. To summarize these results, dividend yield and dividend payout are positively correlated with the value of 0.022 . The correlation coefficient between dividend yield and debt is -0.236 . Between dividend yield and firm size, the coefficient is -0.488 , and between dividend yield and earnings volatility, the coefficient is 0.057 . Between payout ratio and debt, the correlation coefficient is -0.117 . Between payout ratio and size, the correlation coefficient is 0.033 , and between payout and earnings volatility, the coefficient is -0.065 . The coefficient between debt and size is -0.038 , while the coefficient between debt and earnings volatility is -0.187 . The coefficient between size and earnings volatility is -0.069 .

The correlation table also shows a low correlation between dividend yield and payout with values 0.022 ; this means that multicollinearity problem does not exist. The multicollinearity problem exists when the correlation between two independent variables is $\geq 70\%$ (Drury, 2008 cited in Al-Shawawreh, 2014). It can be concluded that the two variables were not strongly correlated, and this positive correlation indicates that any increase in the dividend yield variable causes a small increase in dividend payout ratio and vice versa. Negative correlation was found between dividend yield and size of the firms (-0.488). This coefficient is not large enough to cause any multicollinearity problem. This may be a good reason to believe that the situation aids the results of the regression results being in agreements with most expectations. Low correlation coefficient is only suggestive of the absence of multicollinearity.

5.2. Multicollinearity problem

High degrees of multicollinearity can result in both regression coefficients being inaccurately estimated and difficulties in separating the influence of the individual variables on the dependent variables. Any variables with a variance inflation factor (VIF) value above 10 or with a value below 0.10 of tolerance would have a correlation of >0.90 with other variables, indicative of the multicollinearity problem (Hair et al., 1998 cited in Al-Shawawreh, 2014).

Results in Table 2 shows that VIF for all independent variables ranged between 1.023 and 1.438, which are less than the limited valued (10) and tolerance for all independent variables ranged between 0.696 and 0.978, which are >0.10. This indicates that there was no high correlation among the independent variables (multicollinearity).

5.3. Regression

Multiple linear regression analysis is used to determine the relationship between dividend policy and share price volatility. The basic model used price volatility as the dependent variable against two independent variables, dividend yield and dividend payout ratio. Firm size, long-term debt, and earnings volatility are used as control variable. Table 3 shows the results of regression based on

$$P. vol_j = a * D. yield_j + b * payout_j + c + E_j$$

Table 3 represents the results of regression. In this stage, price volatility is regressed on dividend yield and dividend payout. The results of this regression show that price volatility and dividend yield have a negative association and statistically significant. It is exactly as hypothesized. The association between price volatility and dividend payout is positive, but it is not significant.

From Table 3, the P-value for the model was 0.117 which was >0.05, and hence, the research found that the relationship between share price volatility and dividend policy (measured by dividend yield and dividend payout ratio) was not significant at 5% significance level. R^2 was found to be 0.126, meaning that 12.60% variations in share price volatility were explained by changes in dividend policy. This means that the reliability of the model is low as 87.40% of variations remain unexplained by the model.

Table 2: Multicollinearity test

Variables	Tolerance	VIF
Dividend yield	0.696	1.438
Dividend payout	0.978	1.023
size	0.731	1.368
Earning volatility	0.951	1.051
Long term debt	0.867	1.154

VIF: Variance inflation factor

Table 3: Regression results: P. vol against D. yield and dividend payout

Model	Unstandardized coefficients		Standardized coefficients	t	Significance
	B	Standard error	Beta		
(Constant)	0.934	0.023		41.521	0.000
Dividend yield	-12.780	5.969	-0.354	-2.141	0.040
Dividend payout	0.002	0.016	0.024	0.144	0.886
R square			0.126		
F-stat			2.297		0.117

In the next stage, regression model is expanded by adding control variables as shown in Table 4, and it shows the results of regression based on,

$$P. vol_j = a * D. yield_j + b * payout_j + c * size_j + d * E. vol_j + e * Debt_j + \epsilon_j$$

With the addition of control variables (Size, E. vol, and Debt) to the regression model, the significant negative association between price volatility and dividend yield remains. Moreover, the positive association between price volatility and dividend payout remains but insignificant. As Table 4 shows, there is also a significant negative association between price volatility and size. However, long-term debt exhibits an insignificant positive correlation with share price volatility with $P = 0.131$.

F-test was used to test the significance of the whole model. The results depicted that the relationship between stock price volatility and all predictor variables was statistically significant at 5% level of significance. The coefficient of determination, R^2 , was found to be 0.438, meaning that 43.8% variations in share price volatility were explained by changes in predictor variables. The degree of variation in share price volatility due to dividend policy was statistically significant as the $P = 0.004$.

Inferences that can be drawn from the above analyses are summarized below:

Consistent with the literature, this study found the inverse relationship of share price volatility with dividend yield and size of the firm, which implies that, in DSE, share price volatility of the firms with higher dividend yield and larger size is expected to be low. Similar to most studies, this study found the positive relationship of share price volatility with earnings volatility and debt, which implies that, in DSE, share price volatility of the firms with high earnings volatility and larger proportion of debt is likely to be higher. However, although literature suggest dividend payout ratio as an important determinant of share price volatility, this study did not find any significant relationship between these factors, which implies that, in DSE, dividend payout ratio does not affect share price volatility.

About the association between and among the independent variables, this study revealed that size of the firm and dividend payout has positive correlation which implies that larger size firms may have more dividend payout. Positive correlation has also been found between earnings volatility and dividend yield which contradicts the findings of most studies.

The multicollinearity has been checked. The independent variables are not strongly correlated with each other because the value of VIF is less than the upper limit of 10. Moreover, by applying ordinary least square multiple regression, it was found that dividend yield has significantly negative association with price volatility, indicating that dividend yield has influence on share price volatility.

6. Conclusion

The study is conducted mainly to examine the impact of dividend policy on share price volatility with a focus on companies listed on the DSE. For this purpose, a sample of 35 non-financial firms

Table 4: Regression results: P. vol against D. yield, Payout, Size, E. vol and debt

Model	Unstandardized coefficients		Standardized coefficients	t	Significance
	B	Standard error	Beta		
(Constant)	1.788	0.288		6.201	0.000
Dividend yield	-20.399	6.024	-0.565	-3.386	0.002
Dividend payout	0.008	0.014	0.084	0.594	0.557
Size	-0.041	0.013	-0.523	-3.214	0.003
Earning volatility	0.718	0.644	0.159	1.114	0.274
Long term debt	0.211	0.135	0.233	1.555	0.131
R square			0.438		
F-stat			4.522		0.004

has been examined by applying multiple regressions for 11 years from 2004 to 2014. The primarily regression model is expanded by adding control variables including size, earnings volatility, and debt. The empirical results of this study showed mixed findings between the measures of dividend policy (dividend yield and payout ratio) and their impact on share price volatility, while dividend yield appeared negative and significant, payout ratio appeared positive and insignificant. Among the control variables included in the model, size of the firm has got significant negative impact on share price volatility. On the other hand, both Debt and Earning volatility have got positive but insignificant impact on share price volatility.

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