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Firm's Growth and Share Price Volatility: Evidence from Pakistan

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ABSTRACT

Purpose: This research aims to determine how the growth of non-financial dividend-paying companies affects stock prices. This study investigates the impact of growth of the firm on stock prices using different statistical tools and models.

Design and Methodology: A decade of research will be conducted from 2011 to 2020. Dividend announcements, gearing ratios, firm size, and profitability ratios—all growth indicators—are significant drivers of stock price volatility, according to the findings of this study.

Findings: The results support Lintner's and Gorden's "Bird in Hand theory". Companies can earn the trust of long-term investors by maintaining a consistent dividend policy and growth rate. Investors may find more excellent value in the stocks of companies that consistently report significant dividend increases and have a high profitability ratio. Companies that announce high dividends, gearing ratios, and profits typically have promising futures and rising earnings. The study's findings suggest that, from a shareholder's standpoint, shareholders should prefer stocks of companies that pay a high and stable dividend, are large, and generate significant profits.

Implications: Findings are providing information to investors that companies' stock prices are so sensitive to dividend volatility and low profitability ratios because these factors directly impact those metrics.

Key Words: Firm's Growth, Share Prices, Dividend, Gearing ratio, Size, Profitability ratio.

1. Introduction

This study's main goal was to ascertain whether or not the expansion of dividend-paying non-financial companies impacted their stock prices. All businesses' overarching themes and objectives are to increase profits for stockholders and expand the business (Cheffins, 2020). Shareholder wealth and the Company's development are influenced by dividend payments, gearing ratio, company size,

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and profits. The market value of a company's shares rises when favorable dividend payout ratios, gearing ratios, asset values, and profitability ratios are maintained (Grennan, 2019; Rane & AnjanaRaju, 2018). Stockholders will feel appreciated and be more likely to hold onto their shares if the company consistently increases dividends (Haidar, 2023). Companies that retain a portion of their profits for future growth are more likely to succeed in the long run (Okpara, 2011). (Black, Schulze, & Unger, 2020) asserts that it is incredibly challenging to comprehend the dividend picture because it resembles a complex puzzle with a complicated solution.

While numerous economies have conducted extensive research on the dynamics of dividend announcements, gearing ratios, firm size, and profitability ratios, developing countries like Pakistan have shown relatively little research on these subjects (Ahmed &Javed, 2009). (Nazir, 2010). How much of the share price's fluctuation can be attributed to the company's expansion? Numerous researchers and their theories have addressed this question. Two main concepts address the issue of how a company's growth affects its stock price.

According to Miller and Modigliani's "dividend irrelevance theory," the announcement of a company's dividend does not affect the price of its stock and, consequently, the wealth of its shareholders (Jaros & Bartosova, 2015). (Miller, Wright, Breton-Miller, & Scholes, 2015) later confirmed M&M's dividend policy findings and research. The second concept believed to be true is that dividend announcements impact stock prices.

Lintiner and Gordin presented a remarkable proposition and argued that skepticism lends credibility to the theory. Due to the equity market volatility, Gordon proposed the "Bird in the Hand theory," which suggests that investors prefer dividends to share price increases.

Researchers have also debated and clarified the significance of a country's tax system to its economy. Pakistan's tax structure differs significantly from developed nations like the United States and emerging economies like India. Prior to June 30, 2010, Pakistan did not tax capital gains. Consequently, during the time above period, shareholders of non-financial companies were exempt from capital gains tax on the sale of their shares. However, they were required to pay a 10% withholding tax on dividend income. On June 30, 2010, the Finance Act of 2010 amended Section 37 of the Income Tax Ordinance of 2001 to read as follows:

A security holder will be charged capital gains tax at the rates detailed in the First Schedule if they decide to sell their security after holding it for less than a year on or after July 1, 2010. This clause covers vouchers issued by telecommunications companies in the new section's clause 2. Investors who hold a Modaraba Certification and holders of instruments with redeemable capital are also subject to this rule. Gains mentioned in this subsection must be analyzed independently of other sources of income by Clause 3. The 2010 Revised Income Tax Ordinance's Section 66 is the source of these provisions.

The research gap indicates that many countries and eras have studied this topic. However, Pakistan needs to coordinate more studies in this area. The information about the sample companies for the specified period is entered into a regression model after conducting the necessary tests as

part of the strategy's series of steps. The mathematical and statistical analysis was completed utilizing Gretlplus EViews.

1.2 Problem Statement

Stocks prices of companies are pretentious to Firm's Growth which is determined by the Dividend payout ratio, gearing ratio, value of assets, and profitability ratio. The literature on the existing sector assists the point of tough bonds in Firm's Growth and share prices (Mbulawa, Okurut, Ntsosa, & Sinha, 2020; Taleb, 2019). Still, it is unclear how much effect is caused by the share prices due to Firm's growth, especially in Pakistan.

1.3 Research Questions

i. Do non-financial dividend-paying companies that are listed on PSX keep stable dividend announcements, gearing ratio, and profitability ratios?
ii. Does the Firm's Growth of non-financial companies listed on PSX influence share price?

1.4 Aims and Objectives

i. To perceive/evaluate the influence of Firm's Growth on the share price of sample companies that are registered with PSX from the period 2011 to 2020.
ii. To scrutinize the determinants of Firm's Growth like Dividend announcements, Gearing ratio, size of the firm and profitability ratio.

1.5 Significance of study

Prior to 2010. in Pakistan, no taxes were there on capitals gains. Therefore investor's were negligent regarding the dividend announcements, gearing ratio, and profitability ratio of a firm, as a higher advantage in the shape of capital gains could be achieved. But after the tax application on capital gains and then becoming higher as compared to the tax imposed on dividends, the Firm's growth acted as a significant reason regarding the determination of share prices (Wachowitz and Hornne, 2011).

2. Literature Review

In this section, relevant literature and previous research are discussed. This section sheds light on a large body of prior research organized and conducted in multiple locations and periods and the theories those researchers subsequently provided.
According to economists and researchers like (Farooq, Saoud, & Agnaou, 2012; Iqbal, Ahmed, & Shafi, 2014) and (Siegel, 2016), the company's growth is not the only factor influencing stock price

fluctuations. In addition to this, additional vital factors influence the direction of share prices. (Safitri, Fuady, Wahyudi, Mawardi, & Utomo, 2020) hypothesized that the value of a company's stock would increase proportionally with its profits. According to the findings of Murekefu and Ouma (2012), share price and company growth are directly correlated. Contrary to this, new and previous research on Chinese dividend policy regulation is focusing on the impact of this regulation on corporate dividend payment (An, 2012; Wei, Li, & Li, 2014; Liu, Tan, & Li, 2016), having less attention being given to its impact on corporate agency cost. According to research by Husainey and Mgbamme (2011), the announcement of a high dividend can cause the share price to fluctuate wildly. The study also found that high profitability ratios, asset values, gearing ratios, and dividend-paying ratios indicate a firm's commitment to its growth, which is reflected in the stability of its share prices. The stock price volatility in addition to being influenced by the dividend payout ratio (DPR) of a company is also influenced by the financial performance of the company itself (Gusni, 2017).(Nurchaqiqi & Suryarini, 2018; Skinner & Soltes, 2011) argues that companies with good financial performance will be more attractive to investors.

Few researchers have examined the signalling hypothesis to determine the relationship between dividends and profits at growing companies (Raza, Ramakrishnan, Gillani, & Gillani, 2020; Tekin & Polat, 2021). These researchers' studies and findings supported Gordon and Lintner's dividend relevance theory. Exhaustive testing has validated the foundational work of the researchers. In today's complex economy, the impact of a company's growth and dividend announcements is significant. Tax code and industry changes will profoundly impact the dividend market (Ahmed &Javed, 2009). In light of the reasons above for differences in the taxation system, it became essential to comprehend the dividend payment behavior of firms in Pakistan's economy. This is because, prior to June 2010, there was no capital gains tax in Pakistan. (Balli, Agyemang, Gregory-Allen, & Balli, 2022) is widely regarded as an expert on the dividend payout ratio, having conducted extensive research on the subject and published numerous studies and works that accurately depict dividend behavior in the American economy. Despite numerous studies on dividend announcements' effects and dividend policy evolution across time and economies, a more transparent comprehension of the dividend conundrum remains elusive (Khan & Ahmad, 2017). As a result, there is a mosaic of viewpoints regarding the factors that influence a company's decision to pay dividends and the effect of various dividend policies on the price of a stock.

Based on the information content theory proposed by Kumar and Sujit (2018) and the findings of SYED, ZAINIR, ISA, and KATPER (2018), it has been observed that businesses persist in distributing dividends despite the likelihood of future profits being lower than current profits. The driving factor behind this policy is the preservation of stockholder support.

Based on the agency cost argument proposed by Jenson and Meckling, it is posited that management cannot enhance shareholder wealth. Venkata (1922) expanded upon the research conducted by Litzenberger and Ramaswamy by delineating three fundamental factors that contribute to investors' inclination toward investing in companies that distribute dividends. In the

first instance, the taxation of long-term capital gains is deferred until the point at which the stock is divested. Investors benefit from the fact that they are not obligated to pay taxes on their payments immediately. Consequently, proprietors can postpone their tax liabilities. Shareholders perceive value in companies retaining profits rather than distributing them to the government. In the event of an investor's demise before the conclusion of the fiscal year, it is essential to note that their capital gains shall remain exempt from taxation. The successors of deceased investors can potentially mitigate their capital gains tax liability by divesting their remaining shares at the original purchase priceSarwar, Kutan, Ming, & Husnain (2020) furnished irrelevance theory of Miller and Modigliani, declaring that a firm's dividend announcements and growth make no bond with companies' stock prices. In highly advanced countries, the findings/results in diverse economies for different periods, like in the UK (Munawar, 2019) as well as in Ireland (McCluskiey, 2006) assisted the discovery of M&M. In the developing countries, researchers furthermore deduced that detection/results of MM are accurate up to high range. Even though variables used in this thesis were used by researchers in past conducted research studies, the period, the sectors, the sampling, and the economy used in this thesis modify the results more than other results that were the conclusion of the previous studies.

2.1 Hypotheses

Based on the theory and past literature, we test the following null and alternative hypotheses.
Ho: Firm's Growth does not influence share prices.
H1: Firm's Growth has an impact on share prices.

3. METHODOLOGY

This portion enlightens that methodologies worked out in the research analysis are examined. The accessibility of data has been made a base for selecting the required sample and the period. The connection between stock price volatility and Firm's growth has been analysed using OLS. The regression model developed basically relates share price volatility with main dividend announcements, gearing ratio, size of firm and profitability ratio. Descriptive statistics, correlation and Common effect model were used to know about the association between Firm's growth and share price volatility.

3.1 Data Collection and Sample Period

This research study collected, employed, and examined data from a sample of sixty manufacturing companies in Pakistan. The companies' representation on the Pakistan Stock Exchange indicates their significance within the country's manufacturing sector. To achieve this objective, the research employed the convenience sampling method. The primary data source for the analysis was derived from reputable secondary sources, such as the Pakistan Stock Exchange

(PSX), the State Bank of Pakistan (SBP), and the companies' Annual Reports. The investigation encompasses a decade-long period, commencing in 2011 and concluding in 2020, thereby affording a substantial duration for the comprehensive examination of the collected data.

3.2 Model

$$SP= \alpha+\beta DivA+\beta GgR+\beta Sz+\beta PyR +\mu$$

SP denotes Share price Volatilty, DivA denotes the dividend announcement, GgR denotes the gearing ratio, Sz denotes the size of the firm, PyR denotes the profitability ratio.

3.3 Variables

The study used the "Firm's Growth" as the independent variable and " Share Price volatility" as the dependent variable.

3.3.1 Share Price Volatility (SP)

The term "share price" is an abbreviation used to refer to the annualized average closing price of equities traded on the stock exchange. The compound rate of return serves as a valuable metric for assessing the level of volatility exhibited by stock market returns.

3.3.2 Dividend Announcement (DivA):

DivA denotes the percent of firm's income which is divided in stockholders. The major portion the firm divides, the higher is the payout ratio. Michaiel S. Rozef (2010) in his research work used dividend announcements.

DivA = total dividend / total earnings * 100

3.3.3 Gearing Ratio (GgR):

GgR denotes the financial ratio and is used for comparing theowner's equity to borrowed funds. Situmm (2014) took in his analysis.

GgR = total debts / total equities

3.3.4 Size (Sz):

Total Assets aretakenfor estimationofthe company's size. Romann (2015) took firm'ssize in his studies.

Sz = total assets

3.3.5 Profitability Ratio (PyR):

It is financial ratio and is used to estimate the profitability on firms' assets after all the taxes as well as expenses are being paid off. Murniatei (2011) took the profitability ratio as a variable for his analysis.

PyR = net profit after tax / total assets

4. Data Analysis

During this session, we examined and discuss information obtained from a diverse range of illustrative businesses. The temporal scope of the dateset encompasses the years 2011 to 2020. Various analytical techniques are employed to ascertain the most suitable model for the study's objectives, including descriptive statistics, correlation analysis, panel data regression models, and hypothesis tests. The findings of the analysis and experimentation are thoroughly presented and described.

4.1 Descriptive Statistics

Table 4.1: Descriptive statistics

	Comp_Return	DivA	GgR	PyR	Sz
Mean	0.190391	3.120948	1.878047	0.107521	6.956528
Median	0.184297	3.182797	1.881739	0.093856	6.916965
Maximum	1.198164	4.787464	2.792767	0.285176	8.419417
Minimum	-0.687305	1.611500	1.027071	-0.060623	5.644298
Std. Dev.	0.442953	0.657626	0.401482	0.072001	0.644382
Skewness	0.195492	-0.115274	-0.049928	0.472626	0.290372
Kurtosis	3.065277	2.935374	2.163686	2.744220	2.871034
Jarque-Bera Prob.	0.374544	0.698863	0.111871	0.200497	0.109501

Table 4.1 presents the calculations employed for determining the mean, mode, standard deviation, skewness, and kurtosis of the compound return variables: DivA, GgR, PyR, and Sz. According to the interpretative values, it can be observed that the data exhibits a normal distribution.

4.2 Correlation

Table 4.2: Correlations

	Comp_Return	DivA	GgR	PyR	Sz
Comp_Return	1.000000	-0.120796	0.048715	0.147170	0.013498

DivA	-0.120796	1.000000	-0.080503	0.052413	0.000555
GgR	0.048715	-0.080503	1.000000	-0.44043	0.237273
PyR	0.147170	0.052413	-0.440420	1.000000	0.125719
Sz	0.013498	0.000555	0.237273	0.125719	1.000000

The results in table 4.2 reveal that:

The correlation between Comp Return and DivA is -0.120796. Comp Return and GgR have a positive correlation (0.048715). PyR and Comp Return have a positive correlation of 0.147170. Comp Return is more likely to be positive than Sz by 0.013498. Some independent variables have both positive and negative correlations.

4.3 Regression Model of the study

Table 4.3. Common Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.223976	0.305462	0.733238	0.4641
DivA	-0.081162	0.038270	-2.120820	0.0349
GgR	0.166206	0.073822	2.251465	0.0252
PyR	1.391572	0.402248	3.459491	0.0007
Sz	-0.034795	0.041540	-0.837636	0.4030
R-squared	0.054500	Durbin-Watson stats		2.036523
Adj R-square	0.041680			
F- statistic	4.251006			
Prob'(F- statistic)	0.002325			

4.4 Model specification

The criteria for the selection of significant model in the common Effect Model and Fixed Effect Model: F-value was calculated with the help of a formula. The outcome is 0.824which is less than 2 and the results of the Common effect Model are interpreted.

$$F = \frac{\left(R^2_{FE} - R^2_{CC}\right)/(N-1)}{\left(1 - R^2_{FE}\right)/(NT - N - k)}$$

In models incorporating a fixed effect, the coefficient of determination is conventionally represented as R2FE, while in models incorporating a common effect, it is denoted as R2CC. In this context, the variable N denotes the aggregate quantity of units, T symbolizes the overall duration of

the study, and K signifies the total count of independent variables. The F-statistic discriminates between the common-effect and fixed-effect models, rendering it a valuable tool for model selection.

5. Discussion and Explanation of Common Effect Model results

Table 4.3 summarises data from 2011 to 2020. Overall Impact Model regression was used on its panel data. DivPR has a statistically significant effect on Comp Return, as indicated by the probability of 0.0349 and the value of -2.1208220. GgR has a statistically significant influence on Comp Return, as shown by t-Statistic of GgR = 2.251465 and probability = 0.0252. The t-Statistic of PyR=3.459491 and probability of 0.007 indicate that PyR and Comp Return have a significant relationship. Sz has no discernible influence on Comp Return, according to the t-statistic and probability (-0.837636 and 0.4030, respectively). Statistical tests with less than 5% significance support the model's overall value (F-statistic = 4.251006, Durbin-Watson statistic = 2.036523, Prob(F-statistic) = 0.002325).

5.1 Implications of the study

This study will guide and inform future investigations. Extending the research period beyond ten years could produce more reliable results. In addition, a comparative future survey could include Pakistan and other developing nations. Over time, the economy could undergo a significant transformation. Therefore, this study and its model may provide a solid foundation for future research if the capital gains tax regime and the dividend taxation system undergo substantial changes.

5.2 Limitations and Recommendations

Stock prices were the dependent variable, whereas dividend announcements, gearing ratios, profitability ratios, and company sizes were the independent variables. Additional factors, such as the dividend cover ratio and the retention ratio, impact a company's growth in addition to those mentioned above. Essential questions are unanswered as a result of these exclusions. The manufacturing sector is the only one covered by the study. No samples that accurately represent the retail industry have been gathered to date. Banks and other financial institutions are excluded from the sample to avoid bias, and only dividend-paying companies from outside the financial sector are included.

The findings of this study suggest that companies should implement dividend policies designed to attract domestic and foreign investors. When dependable dividends are declared, share prices typically increase. Nonetheless, if one exists, investors will forego the dividend in favor of an alternative profit distribution method. This means that the company's Growth can no longer be used as a selling point for its stock.

Policymakers should seek to increase Firm Growth to benefit both the company's bottom line and its shareholders' wealth. The responsibility of market managers is to implement a capital gains tax policy that benefits the company and its shareholders.

6. Conclusions

According to the study's findings, a company's growth rate significantly impacts its stock price. From this, it can be concluded that the alternative hypothesis, "Firm's Growth influences share prices," is true, whereas the null hypothesis, "Firm's Growth does not affect share prices," is false. The dividend relevance theory proposed by Lintner and Gorden facilitates the above terminations. This study concludes that dividend announcements, profitability, and company size all impact stock prices, representing businesses' growth.

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