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RELATIONSHIP BETWEEN THE DIVIDEND PAYOUT AND FIRM'S PROFITABILITY: A STUDY IN THE OIL SECTOR OF PAKISTAN

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ABSTRACT
Many researchers have considered the issue of dividend policy over many other factors of profitability namely; profit margin, return on sales, return on assets, return on equity and return on investment however the motive of our study was to focus on the dividend payout ratio which is the one aspect of dividend policy over two main profitability ratios i.e. Return on Asset and Return on Equity therefore with the consideration of these factors this study derived the relationship between the dividend payout ratio and profitability nevertheless the impact of dividend payout ratio over return on asset (a component of profitability) is also derived. Moreover, the data of the listed oil sector companies of Pakistan is undertaken and the regression and correlation tests are applied on the variables to check the relationship and impact on each other besides the result showed that dividend payout ratio is the critical component which affects the performance of the firm since it is identified in our study with the R square of 0.18. Therefore, considering the result of this study it is said that the oil sector companies must pay attention to their dividend policies seeing as it affects the firm's performance.
Keywords: Dividend Payout, Return on Asset, Profitability, Return on Equity

1. INTRODUCTION

1.1 Background of the Study

Making a profit is one of the major aspects of successful companies. Companies can utilize this gain to redeem their liabilities, invest in potential projects, buy recent securities, or spread to shareholders. The dividend is the disbursement of profit to shareholders. The controversies that appear when a board of directors wants to spread profit to its shareholders contain the share of profit to be given as dividend to stockholders, either to spread gain as a cash dividend or cash be transferred to shareholders by reclaiming some shares and how flat and constant the dividend allocation should be. These problems are discussed in the dividend payout policy ack. The dividend includes dispersing a portion of a company's income to the shareholder to boom their wealth. The return to investors is fulfilled after government debt has been compensated. Return pay-out decreases the estimation of the held profit of an organization. The main source of internal financing for a company is the profit that is the part of the income that is kept to the side for investment (Jahan, 2019). A firm's profitability shows a firm's stability after the payment of its expenses and other charges (Shiranthi & Perera, 2020).

Dividend policy is a firm's choice in deciding the volume of income to be issuing in the shape of dividends and retained earnings for coming ventures. The value of dividends has been essentially confirmed in the stock market. A firm that always boosts dividend payment indicates a fair explanation that the firm is capable and has sufficient profit so, the firm has low chances of the threat of market ups and downs and economic downfall. If a dividend distribution ratio increases it means that profitability has a positive influence on it (Kusuma et al., 2018).

Financial performance is a primary indicator of how efficiently a firm can operate its assets from its initial level of business and makes a profit. Many investors have a concern about a company's financial performance. The financial performance is a fair picture of how effectively a firm operates revenues and uses its assets, obligations, and business activities of its shareholders (Shiranthi and Perera, 2020). Dividend payouts share benefit to shareholders alongside it gives information about the firm's current and future profitability. There is attention taking work based on the impacts that dividend payout and the firm's profitability have had consecutive returns. The dividend decision is valuable for the shareholders, but it is also important for potential investors. Before making decisions mostly stakeholders pay their consideration towards company performance and company policies (Shiranthi and Perera, 2020).

Most of the empirical studies indicate the result that growing dividend payments by a company is favored by investors on the contrary decline introduces to negative market response. Following the above assumption that the first motive of a firm is to boost shareholder wealth, before dividend payment it is acceptable to suppose that management would be interested in a positive, instead of negative market reaction (Biza-Khupe & Themba, 2016).

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1.2 Problem Statement

Investors invest in the company to earn a profit. The profit they earn is called a dividend. Companies pay a premium to its shareowner from their net income. Dividend payouts are the earning percentage that is paid to shareholders in the form of a dividend. The company pays to investors from its net income so, this dividend payment affects its profitability (Jahan, 2019). Many academic researchers were amazed to know the motive of the company and investors behind the payment of a dividend; The Company might announce a dividend to give profit to investors alongside attract to potential customers, on the contrary, investors are interested in a dividend that on a dividend they continue their investments (Mamaro & Tjano, 2019).

Researchers (Ajanthan, 2013; Amidu, 2007a; Howatt et al., 2009; Lie, 2005) have identified different results related to the results among dividend payout and company performance in different sectors. (Ajanthan, 2013; Amidu, 2007a)'s a contribution to research gives findings to the researchers that measuring dividend policy through profitability influence on firm performance. The consequence of the research shows the findings that there is a positive and significant relationship among ROA, ROE, growth in sales, and dividend policy. An additional study suggests the future adjustments in earning per share have a positive effect on alternation in dividends (Ajanthan, 2013). On the other side (Ajanthan, 2013) says that I don't have results that strongly indicate that firms that experiencing dividend payout have upgraded their performance.

Researchers have done a lot of work on dividend policy and firms achievement in the domain of progressive economics (Ajanthan, 2013). Can those findings be applicable in emerging countries (Ajanthan, 2013)? Researchers had studied the association between dividend allotment and the firm's profitability in Sri Lanka. Also, a study was conducted to analyze this relation among registered motels and restaurant businesses in Sri Lanka (Ajanthan, 2013). A study was inspected on dividend payout in the Oil and Gas line in Pakistan in which dividend payout was the dependent variable and the firm's profitability was the independent variable. Using secondary data research indicated the significant relationship of a firm's profitability with dividend payout (Tahir & Mushtaq, 2016).

This study aims to measure the relationship between dividend payout and firm profitability in the Oil Sector for the last 5 years (2014-2019) in Pakistan. In this study dividend payout is an independent variable and a firm's profitability is a dependent variable.

1.3. Research Questions

In the light of our study following questions are derived to understand the relationship between the firm's profitability and dividend payout ratio:

RQ: What is the impact of the dividend payout ratio on the profitability of the listed oil sector companies in Pakistan?

1.4. Research Objectives

The major objective of our study is to determine the affiliations among the variables included in this paper, for that below objectives are specified:

To determine the impact of dividend payout ratio on the profitability of the listed oil sector companies of Pakistan.

2. LITERATURE REVIEW

2.1 Dividend payout

The dividend policy decision is a financial management function that indicates the relative amount of the company's profit that would be shared to the shareholders as recovery on investment and percentage that will be received for the firm's reinvestment (Akani & Sweneme, 2016). It is a vital financial decision that the financial manager has to face (Akani & Sweneme, 2016; Amidu, 2007b). Profitability is the operating phenomenon of every profit-generating firm and forms short and long-run management planning and operational strategies. It is a subjective indicator of the input-output relationship of management and management efficiency in increasing investor ROI, ROA, ROC, and EPS. Firms' profitability can be estimated at the macro and micro levels (Akani & Sweneme, 2016). The alliance between dividend policy and firms' profitability has long been a debatable issue allying researchers in corporate finance. Various empirical studies have been done to solve this unsolved controversy between dividend payout and firms' profitability (Akani & Sweneme, 2016).

In Nigeria, many studies have considered the connection between dividend payout and the share price of the firm without focusing on firms' profitability. That's why this study will check the association between dividend payout and profitability of the Nigerian firms (Akani & Sweneme, 2016). The research design applied in this study is the quasi-experimental design that is applied to the test time series relationship. The data is gathered through the stock exchange factbook, and the time frame examines 1981-2014. Fifteen manufacturing companies were chosen among the population. Yearly time series data of the company were assembled to establish the variables. The integration between dividend policy decision and the profitability of this association though not very clear, might because of an increase in capital, knowledge, and the merit of the firm via a boom in profitability.

Multiple regression and SPSS are used for data analysis. The result shows the positive correlation among dividend payout ratio, retention ratio, dividend yield, earning per share, and return on investment. The T-statistic shows the result that EPS is positively associated with ROI but other variables in the model were insignificant. The f-statistic of 16.53 at the significance of 0.000 indicates the complete significance of the IV causing changes on the DV. The result indicates that dividend payout ratio, retention ratio, and dividend yield have a positive association with net profit margin but earning per share have a negative impact. The coefficient of correlation 2.05274 DPR, 0.53824 RR, -6.73141 DY, and .064114 EPS. The dividend payout ratio has a positive influence on ROI and net margin. The retention ratio has a positive influence on ROI and net margin. The dividend yield hurts ROI and net profit margin. EPS has a positive influence on ROI and the net profit margin of the manufacturing firm (Akani & Sweneme, 2016).

2.2 Dividend Payout and Profitability

Operating profit is one of the key aspects of profitable firms. Firms can utilize this profit to settle debt obligations spend in recent projects, buy fresh securities, and spread to shareholders. The dividend is the allocation of gain to shareholders. The issues that appear when the board of directors decides to allocate profit to its shareholders having a percentage of profit to be shared as a dividend to stockholders, even if to spread gain as a cash dividend or cash be given to shareholders by buying again shares and how flat and balanced the dividend sharing should be (Tahir & Mushtaq, 2016). These issues are shown in the dividend payout policy. It contains constant dividend payout indication to the shareholders the prosperous and comfortable future anticipation of the company; the dividend can be utilized by the company to seek the attention of investors who wish to have a constant return in the shape of dividend on their financing and stock price of the company relay upon the dividend payout decision. The decline of dividends by constant dividend-paying companies will have an unwanted influence on the company’s stock price. On the other hand, the increase in dividend and announcing an extra dividend will have a positive influence on the share price of these companies (Tahir & Mushtaq, 2016).

The content of this work inspects the profitability affecting dividend payout decisions in the oil and gas industry of Pakistan. The study applied secondary data to analyze the relationship between dividend payout and the firms’ profitability. Data is gathered from the published per annum reports of the oil and gas industry listed on the Karachi stock exchange. The population of this study is based on oil and gas corporations listed in KSE. The sample size of this research is based on 91 oil and gas companies recorded in KSE, but just 77 used for this study. This study contains the time series from 2008 to 2014 (Tahir & Mushtaq, 2016).

Dividend payout is the dependent variable in this research. The dividend payout of the oil and gas firms of Pakistan has been calculated using the dividend payout ratio (Tahir & Mushtaq, 2016). (Al-Kuwari, 2009; Amidu & Abor, 2006; Gill et al., 2010; Mirza et al., 2014; Musiega et al., 2013; Tahir & Mushtaq, 2016) have also calculated dividend payout using the dividend payout ratio. Profitability is an independent variable in this study. Profitability is calculated on ROA using the formula Net Income / Total Assets. (Mirza et al., 2014; Moon et al., 2015; Tahir & Mushtaq, 2016; Thanatawee, 2013) have also used this formula to calculate profitability.

The result shows a 38.26 dividend payout ratio of the oil and gas industry of Pakistan, which indicates that these companies on average share 38.26 percent of their income to shareholders as a dividend. The SD of dividend payout is 30.22 percent shows that companies are not paying a consistent dividend. The profitability indicates by ROA is 12.45 percent, indicating that the oil and gas companies of Pakistan make 12.45 percent income every year. Profitability has a high positive correlation with dividend payout. It shows that excessive profitability will lead to a high dividend payout. VIF is l.58 less than 4 so, data does not contain multicollinearity. Prob > chi2 0.5895 tells that at a 5% stage of significance indicates the acceptance of the null hypothesis because data is normally distributed. The regression result indicates that profitability has a positive and significant impact on the dividend payout decision of the oil and gas industry of Pakistan. It means when profitability will be raised then the dividend payout ratio would be raised (Tahir & Mushtaq, 2016).

2.3 Dividend Payout and Return on Asset

The dividend payment is the distribution of dividend payments to shareholders. Dividend shows the sharing of profit to their holders. The dividend also an advantage of a shareholder because of their risk. It is also an opinion of the management to set the share of the gain that gives the shareholder related to their investment. A dividend policy is a mini aspect that indicates the firm’s performance. Firms need to plan dividend policy to enhance performance (Hafeez et al., 2018).

This study indicates the influence of dividend policy on the firm’s performance from manufacturing firms in Pakistan. Different variables are used for analyzing the influence of dividend policy on a firm’s performance. DPOR, EPS, PER are applied as an independent variable and ROA, ROE is used as the dependent variable. ROA, ROE analyze firm performance. 15 manufacturing firms recorded in Pakistan Stock Exchange are used as a sample. Data gathered from the company’s yearly reports. The time period for this is four years (2014 to 2017) (Hafeez et al., 2018).

Researchers used distinctive approaches to analyze the data through descriptive, correlation, and regression. The analyst applied the mean, maximum, minimum, and SD to analyze the impact of dividend policy on firm performance. The mean ROA is 6.0134, the dividend payout ratio is 43.28, EPS is 15.77, and the price to earnings ratio is 13.34. The firm's ROA is significantly correlated to the dividend payout ratio, earning per share, and price to earnings ratio. The consequences of the research indicate the positive interaction between return on asset, dividend payout, earning per share, price to earnings ratio. The result of the study analyzes the positive relationship between dividend payout ratio and return on assets (Hafeez et al., 2018).

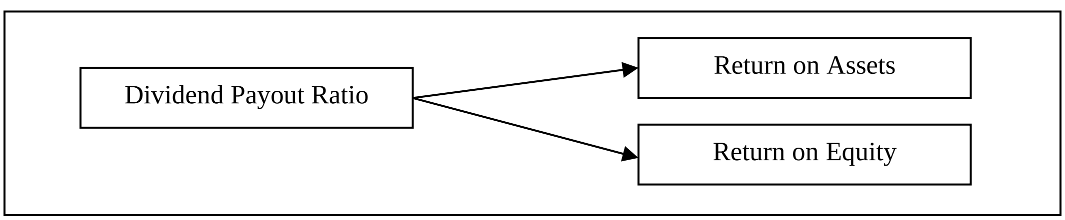
2.4. Dividend Payout and Return on Equity

A firm announces dividends when they earn a profit, although they do not spread all the gain to shareholders as the dividend. A profit which is not shared as the dividend is retained earnings. The attitude of the investor and stock market gives knowledge about dividend policy. When the dividend payment increases, it is the reason for the increase in the stock price of the firm and contra. The dividend payout policy has been researched in prior studies. Many theories indicate the result that the advancement in the dividend payout policy relay on the facts of the firm's profitability and future earnings. Numerous theories indicate that the dividend payment policies are co-related with the forecasted future profitability and earnings of the firm (Khan et al., 2019).

This study is related to the data that have not been considered complete, even though previous studies have existed. This work will enhance new problems and topics for discussion on the relationship between future forecasted earnings the dividend payout of the firm. 5 variables are used in this study. Firm performance is a dependent variable. Dividend payout, firm size, capital structure short term, capital structure long term, firm growth are the independent variable. Data have been collected through 40 companies in the cement sector of Pakistan. The data has been gathered only for 8 years from (2003-2010) from firms' yearly reports registered in KSE. In this paper, linear regression from SPSS is applied to study the relationship of the variables regarding firm performance. Equation $ROE = \beta_1 DP + \beta_2 CSS + \beta_3 CSL + \beta_4 FS + \beta_5 FG$ has used to measure the relationship among variables. The P-value of the dividend policy is 0.000. It indicates that dividend policy has a significant impact on ROE. The amount of R is 0.940. It demonstrates that ROE is 94% and it is correlated towards the DP, CSS, CSL, FS, and FG. The value of R square is 0.883 which indicates that independent variables show the variation of 88.3% in the dependent variable. In short, DP, CSS, CSL, FS, and FG are showing a positive relationship toward ROE (Khan et al., 2019).

3. CONCEPTUAL FRAMEWORK

Figure 3.1: Conceptual Framework



4. HYPOTHESIS

H1: There is a positive relationship between DPR and ROA.
H2: There is a positive relationship between DPR and ROE.
H3: There is a significant impact of DPO on ROA.

Above hypothesis are generated by studying various literature however the literature suggests many ratios of profitability i.e., profit margin, return on sales and return on investment. Besides our study focused on the Return on asset and Return on equity only because of the limitation of the time and the complexity of the model as including the other factors complex the model therefore, we took a simple model for our study.

5. METHODOLOGY

5.1 Data Resource

The data included in our study are secondary data in nature which is derived from the financial statements of the organizations i.e., Balance Sheet & Income Statement besides ratios are calculated based on these data. Moreover, the listed (PSX) nonfinancial oil sector company's data are included in this study.

5.2 Sampling Design

Sampling design is an overview of the whole population moreover; it includes the complete methods or process of the research which is adopted by the researcher. In addition to that our study consisted of a sample of 6 companies from the oil sector of Pakistan which is listed in Pakistan Stock Exchange (PSX).

5.3. Method of Analysis

The linear regression analysis method is used for the derivation of the result as our study includes only Independent Variable while there are two Dependent Variables. Furthermore, the correlation and descriptive statistics are also analyzed in our study besides E-Views software is used to analyze the secondary data; table 5.1 shows the variables along with their ratios which are studied in this research:

Table 5.1: Calculation of Dependent & Independent Variables

Dependent Variable	
Return on Asset (ROA)	Net Income / Total Assets
Return on Equity (ROE)	Net Income / Total Equity
Independent Variable	
Dividend Payout Ratio	Dividend Paid / Net Income

By considering the above variables linear regression is carried out to check the impact of dividend payout ratio on the Return on Assets and Return on Equity which we have taken as a profitability measure however to check the relationship among the crorrelation of the variables is executed. Nevertheless, following is the profitability model which is employed in this study:

Profitability = f (ROA & ROE)

It is considered necessary in our study that the dividend payout ratio is depended on Profitability Ratios that is Return on Asset and Return on Equity. Thus, the below model is derived to check the collision between dividend payout ratio and Profitability:

$ROA = \alpha + \beta\, DPR$

$ROE = \alpha + \beta\, DPR$

Whereas,

Dividend Payout Ratio	DPR
Return on Asset	ROA
Return on Equity	ROE

6. RESULT & ANALYSIS

6.1 Descriptive Statistics

Table 6.1: Descriptive Statistics

	DPO	ROA	ROE
Mean	0.366642	0.075297	0.235492
Median	0.332550	0.072450	0.210800
Maximum	1.170000	0.247300	2.094200
Minimum	-1.002000	-0.157200	-0.256600
Std. Dev.	0.442568	0.093272	0.374270
Skewness	-0.368244	-0.469434	3.461997
Kurtosis	3.866130	3.060507	18.23567
Jarque-Bera	1.938893	1.327703	420.1009
Probability	0.379293	0.514865	0.000000
Sum	13.19910	2.710700	8.477700
Sum Sq. Dev.	6.855337	0.304485	4.902736
Observations	36	36	36

Table 03 shows the standard deviation of both dependent and independent variable which states that dividend payout ratio (-0.368244) and return on asset (-0.469434) are negatively skewed which depicts that data is tailed towards the left side while return on equity (3.461997) is positively skewed which means data is tailed towards the right side. On the contrary, the kurtosis values are positive of each variable i.e., 3.866130, 3.060507 & 18.23567 respectively. This instigates that the allocation is peaked than the normal allocation and their end are also heavier than the normal allocation.

6.3 Correlation

Table 6.2: Correlation

	DPO	ROA	ROE
DPO	1.000000		
ROA	0.433057	1.000000	
ROE	0.094303	0.003975	1.000000

Table 6.2 represents the correlation among the variables which states that Dividend payout Ratio and Return on Asset has positive weak correlation with the value of 0.433057 while dividend payout ratio and return and equity also has a positive very weak correlation with the value of 0.094303. Nevertheless, the correlation between the return on asset and return on equity is also positive but weak with a value of 0.003975.

6.3 Regression Analysis

Table 6.3: Regression Analysis – ROA

Dependent Variable: ROA				
Method: Panel EGLS (Period random effects)				
Date: 07/28/20 Time: 20:53				
Sample: 2014 2019				
Periods included: 6				
Cross-sections included: 6				
Total panel (balanced) observations: 36				
Swamy and Arora estimator of component variances				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	0.041866	0.019058	2.196770	0.0350
DPO	0.091183	0.033003	2.762853	0.0092
Effects Specification				
			S.D.	**Rho**
Period random			0.007766	0.0080
Idiosyncratic random			0.086269	0.9920
Weighted Statistics				
R-squared	0.187659	**Mean dependent var**		0.073531
Adjusted R-squared	0.163766	**S.D. dependent var**		0.093002
S.E. of regression	0.085047	**Sum squared resid**		0.245921
F-statistic	7.854323	**Durbin-Watson stat**		1.755309
Prob(F-statistic)	0.008312			

Above table 6.3 shows the regression analysis of dividend payout ratio over return on an asset which indicates that there is a significant impact of dividend payout ratio over return on an asset with the value of 0.163766 of adjusted R square. Moreover, the value of the coefficient shows the slope of the data which instigates that the 1 percent change in the independent variable brings 0.041866 change independent variable.

6.4. Hypothesis Testing

Table 6.4: Hypothesis Testing

Hypothesis	**Results**	**Tools**
H_1 : There is a positive relationship between DPR and ROA.	Accepted	Correlation
H_2 : There is a positive relationship between DPR and ROE.	Accepted	Correlation
H_3 : There is a significant impact of DPO on ROA.	Accepted	Regression

7. CONCLUSION

The study analytically examined the relationship between dividend payout and firms' future profitability of oil companies listed on the Pakistan Stock Exchange. The major goal of the research is to endorse the influence of dividend payout ratio on the firms' performance of listed oil companies in Pakistan. Corresponding to the objective, the research has assessed one major question and three hypotheses. For evaluating, the study applied three methods regression analysis, descriptive statistics, and correlation analysis.

According to the consequence, there is a positive relationship between dividend payout and return on assets. That shows that the variations in dividend policy significantly influence on the company's profitability by the return on assets. The research has approved H1: there is a meaningful relationship between dividend payout ratio and the company's profitability (ROA).

As per the consequence, of the next hypothesis, the dividend payout ratio has a significant positive influence on the total debt to equity ratio. That signified that when the companies have excessive leverage, that time is favorable to spread dividends. It cannot influence the company's financial performance. The research has accepted the second hypothesis. Corresponding to the results of H3: DPO has a significant impact on ROA and the research has admitted it.

8. LIMITATIONS & FUTURE RESEARCH

Our study is limited to the one country that is Pakistan besides only selective listed companies of the oil sector are considered (6 companies) moreover, the data used in this study only includes the period from 2014 till 2019 which are 6 years, therefore, only 2 components of profitability are studied in this paper i.e., ROA & ROE. Considering that future research may include more components of profitability *(Gross Profit Margin, EBITDA Margin, Operating Profit Margin, Net Profit Margin, Cash Flow Margin & Return on Invested Capital)* and check their impact or relationship on dividend payout ratio.

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