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The Role of Dividend Policy in Shaping Market Value of Shares: Evidence from Colombo Stock Exchange

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ABSTRACT

Purpose: This study investigates the role of dividend policy in determining the impact of dividend policy on the stock prices of the non-financial companies listed on the Colombo Stock Exchange in Sri Lanka during the period from 2017 to 2021, using panel data analysis. The research aims to explore the varies aspects of dividend policy that affect market prices in the Sri Lankan context.

Design/Methodology/Approach: A sample of 90 non-financial firms, resulting in 450 observations, was selected for this study. To analyze the relationship between the independent variables namely dividend per share, dividend payout ratio and dividend yield and the dependent variable of market price per share, the study used pooled OLS, fixed and random effect models. After chow, Hausman, and LM tests, fixed effect model is selected as the best model for the study.

Findings: These results indicate a positive and significant relationship between dividend per share, dividend payout ratio and share price supporting signaling theory, and dividend relevance theory. Conversely, the study finds a significant negative relationship between dividend yield and stock prices, suggesting that higher dividend yields may limit a firm's growth prospects by reducing reinvestment opportunities.

Originality: This study contributes to the literature by applying panel data techniques to assess the influence of dividend policy on stock prices in an emerging market like Sri Lanka. It provides empirical evidence to support the relevance of dividend policy in shaping market perceptions and stock valuation.

Theoretical and Policy Implications: The findings offer insights for academicians, corporate managers, investors, and policymakers. By understanding the importance of dividend policy and its impact on the market value of shares, stakeholders can make more informed decisions related to dividend distribution, market strategies, and corporate growth planning.

Research limitations/ Future research directions: Future research could extend this study by exploring the effects of dividend policy on stock prices during pre and post financial crisis periods or by examining the moderating role of other financial variables such as leverage and earnings growth.

KEYWORDS

Dividend per share, Dividend payout ratio, Dividend policy, Dividend yield, Market share price, Colombo Stock Exchange

JEL CLASSIFICATION

G1, G32, G35, O16

I. Introduction

Dividend decisions are a key aspect of Corporate Finance. Stockholders are normally concerned with the potential returns on their investments and the risks associated with those stocks. Shareholders earn returns through capital gains and dividends. Therefore, a company should adopt a suitable dividend policy to ensure investors receive a fair return on their investment (Busro et al., 2023). A consistent increase in dividends is often seen as a sign of strong financial stability (Chang et al., 2024). Dividends reflect the company's

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financial performance and serve as a key factor in evaluating its overall value (Abeysinghe & Kariyawasam, 2023; Satt & Iatridis, 2023).

Over time, various theories and models have been developed by researchers to guide organizations in making optimal dividend decisions. This began with Modigliani and Miller (1961), who proposed that the dividend policy does not impact the company's value. On the other hand, literature suggests that dividend relevance theory highlights the importance of distributing dividends to shareholders, as this increases the share value (Lintner, 1956; Gordon, 1959; Walter, 1963). Consequently, many studies have been carried out to understand the relationship between the share price of the company and dividend policy (Tran, 2024; Wirama et al., 2024).

Dividend decisions can be driven by various factors, such as attracting new investors, rewarding current ones, or maintaining a steady cash flow (Herath & Dissanayake, 2021). The literature shows that dividend policy can impact share prices positively or negatively, depending on the company's strategies. Higher dividend payouts might boost share prices in the short run due to increased returns for the investors. Meanwhile, this may decrease the company's reserves, affecting the long-term sustainability. Conversely, when a company pays lower or no dividends, it may hurt short-term share prices, but investors could benefit from long-term price appreciation, as reserves are used for company growth (Busro et al., 2023).

The literature revealed that dividend policies could be in the form of controlled or residuals where a company may decide to manage the dividend payout or other relevant ratios steadily over the period to signal investors and to gain a favorable response from the investors, while other companies may decide not to distribute and maintain an internal reserve to invest in profitable projects in future (Abeysinghe & Kariyawasam, 2023). This brings the research puzzle of whether the dividend policies have any impact on the share prices of the firms.

Further, the key debate revolves around determining the optimal dividend policy that influences the share price of the company and returns for the shareholders. Stock investors can get returns mainly via dividends and capital appreciation (Usman et al., 2021). The question arises of deciding what proportion of earnings will be distributed among shareholders while retaining the remaining earnings with the firm for growth purposes. Despite the numerous studies that have been conducted to select the most suitable optimum policy, there is no universally accepted model in the literature (Tharanga et al., 2024).

In the Sri Lankan context, although several studies have explained the impact of dividend policy using panel data (Abeysinghe & Kariyawasam, 2023). Few have examined how multiple aspects of dividend policy, namely dividend per share, payout ratio, and yield, simultaneously influence market value, particularly within non-financial companies. Additionally, the study excludes data after 2021 due to the economic crisis, which disrupted financial stability and led many firms to reduce or halt dividend payments. Including this period would distort the analysis, as it does not reflect typical market behaviour The findings will benefit various stakeholders as understanding the impact of dividend policies on the market value of shares is crucial for investors looking to optimize their portfolios, companies focusing on enhancing market value, and academics exploring this area further.

The remainder of this paper is organized as follows. Section 2 reviews the extant literature and develops hypotheses with supporting rationale. Section 3 presents the research methodology, and section 4 reports empirical findings and discusses results. Finally, section 5 concludes and outlines avenues for future research.

II. Literature Review and Hypotheses Development

The importance of considering dividend policy on Corporate Finance related decisions is analysed by different academics and since the outcomes were not consistent with one another, more researchers still try to figure out the exact relationship between dividend policy of the company and share prices. There are numerous studies on theoretical frameworks and empirical evidence.

Theoretical Framework

Dividend Irrelevance Theory

Modigliani and Miller (1961) proposed that a company's dividend policy is irrelevant to the market price of the shares. According to their theory, the market value of the share depends solely on the company's profitability and not on how earnings are distributed. Paying dividends does not impact share price or the cost of capital, as any increase in risk from higher debt is offset by higher returns. Further, they argued that investors are indifferent between dividends and capital gains. Their theory states that if a firm does not pay dividends, the equivalent value is reflected in future share prices as capital gains. If a firm's performance falls short of expectations, investors can sell their shares or benefit from share repurchases. Although criticized for unrealistic assumptions, this theory laid a strong foundation in finance.

Dividend Relevance Theory

The relevance theory suggests that dividend policy significantly impacts the market value of the share and the company value. Lintner (1956) argued that companies prefer stable or smooth dividends over time, while Gordon (1959) and Walter (1963) stated that dividend policy directly affects a firm's value and cannot be separated from its investment policy. They provided evidence that in imperfect capital markets, dividends impact share prices positively. Gordon's model shows that increasing dividends can raise share prices.

Bird in Hand Theory

Gordon (1962) introduced the bird in hand theory, suggesting investors prefer certain dividends over uncertain future earnings. He argued that lower dividend payouts and higher earnings retention increase the cost of equity due to greater risk, leading to lower share prices. Gordon (1959, 1962) showed that increasing dividends raises share prices and lowers the discount rate.

Signaling Theory

In response to Modigliani and Miller (1961), Asquith & Mullins (1983) found that dividend announcements raise share prices. Ross (1977) showed that firms that increase dividends see share prices rise, while firms that reduce or omit dividends experience a decline.

Tax Efficiency Theory

The tax efficiency theory posits that investors may prefer capital gains over dividends due to favorable tax treatment. In many jurisdictions, capital gains are taxed at a lower rate than dividends, making retained earnings and share price appreciation more attractive. As a result, firms that retain profits rather than pay them out may be viewed more favorably by certain investor segments (Brennan, 1970).

Empirical Evidence

Dividend policy describes how a listed organization distributes its earnings to its shareholders. Company management has the privilege to decide how much to distribute among shareholders and, at the same time, how much to retain for future expansion purposes. Studies mentioned that the firms which are still in the growing phase would like to keep the return, and the matured companies which produce a stable growth rate will distribute their profit to shareholders (Subramaniam & Devi, 2010).

There is no specific set of rules or regulatory requirements to have a particular amount or percentage distributed to company owners in Sri Lanka or even globally. Lintner (1962) mentioned that the company changes its dividend payout ratios based on the earnings levels. Investors normally consider a company's dividend policy as one of the factors when building investment portfolios (Ozuomba Chidinma et al., 2013; Ojeme et al., 2015). However, Modigliani and Miller (1961) found that dividend policies are irrelevant when deciding on the market value of the share.

Investors earn returns from both capital appreciation of the invested stocks and dividends. Normal investors, mainly those who are risk risk-averse, want to get some of their income at least from dividends because these are considered a stable source of income compared to stock price changes, which are normally volatile and determined by the demand and supply of the company, along with business, industrial and economic risk levels. However, companies must bear more financial burdens to have consistency in dividend payments.

There are numerous studies that focus on analyzing the relationships between the dividend policies of companies and their financial performances (Iqbal et al., 2014) and in most of the analysis, to measure the dividend policies, they have used Dividend Pay Out ratios (DPO), Dividend Yields (DY), and Dividend Per Share (DPS) (Yogendrarajah et al., 2022); Baker & Weigand, 2015; Iqbal, Waseem & Asad, 2014). In addition, Raed (2020) explained different methods available to allocate the earnings to the investors, namely Stable Dividend Policy, Progressive Dividend Policy, Regular and Irregular Dividend Policy, Scrip Dividends, Noncash Dividends, Share Splits and Reversal Splits, Bond Distributions, and Quality Distributions. There are most studies which concluded a positive relationship between dividend policy and shareholder wealth. (Okeke et al., 2021; Chiedu Christian & Justina, 2020; Farrukh et al., 2017; Ozuomba et al., 2016; Ansar et al., 2015).

Further, Nambukara-Gamage & Peries (2019) also concluded that there is a positive moderate relationship between shareholder wealth and dividend policy, which had arrived based on The Australian retail industry for the period of 2012-2017, and they revealed that the results were consistent with the dividend relevance, signalling and bird in the hand theories. Not only that, a study carried out by Farrukh et al. (2017) found that there is a positive relationship between shareholder wealth and dividend policy and their findings also supported dividend relevance theory, signalling effect theory, bird in hand theory and clientele-effect theory. The firms may send a signal to the investors that they are financially stable by paying dividend continuously and having a growth in it (Daniel et al., 2018).

This is further supported by Gul et al. (2012) in which they concluded that there is a significant relationship between shareholder wealth and the dividend policies of firms, and they further pointed out that the Market Book value ratio of dividend-paying companies is likely to be higher than non-dividend paying companies' ratios. Further, Wanjohi (2017) also did a study in the Kenyan market to understand the relationships between different companies' dividend policies and the impact on shareholder returns and concluded that regular dividend-paying companies had a significant positive impact on shareholder's wealth while the firms that do not pay dividend had less impact on shareholder wealth. However, there are some studies that have revealed different results. Omodero and Amah (2017) findings supported the dividend irrelevance theory based on Nigerian firms in which EPS and Net asset per share had a significant positive impact on the MPS while DPS had no impact on MPS. Therefore, they arrived at the conclusion as paying dividend is not always an indication of share price increases.

To measure the shareholders' wealth, Market share prices are used by different researchers. (Farrukh et al, 2017; De Wet & Mpinda, 2013). However, in some instances, EPS was considered a proxy to value the shareholders' wealth (Chiedu Christian & Justina, 2020). Further, to value the share of a company, different variables such as dividend distribution, dividend yield, EPS, and inflation are considered.

The existing research produced a variety of results, which show the combination of positive or no relationship between dividend payments of the company and shareholder wealth. Therefore, there is a need to analyze the impact of dividend policy on share price of the company.

Hypotheses Development

Dividend policy plays an important role in shaping shareholder perceptions and firm valuation, particularly in emerging markets where investor protection and disclosure standards are evolving. The ongoing debate over the impact of dividend policy on market value has conflicting theoretical perspectives and mixed empirical findings. One central theory supported by Ross (1977) is signaling theory, which suggests that dividends act as a signal of firm stability and future earnings prospects. Firms that consistently issue or increase dividends are perceived as financially sound, reducing information asymmetry and instilling investor confidence (Asquith & Mullins, 1983). Empirical studies consistently show that dividend per share positively influences stock prices. Farrukh et al. (2017) observed a strong positive relationship between DPS and shareholder wealth in the Pakistani manufacturing sector, while Gul et al. (2012) concluded that higher DPS is associated with a better market to book ratio. In Sri Lanka, Charith and Davydenko (2021) demonstrated that dividend initiations positively affect share prices in the manufacturing industry. Chang et al. (2024) also confirm this relationship in the Japanese context, noting that management's forecasting ability enhances the predictive power of dividend changes. These findings support the first hypothesis (Ha) that DPS has a significant and positive impact on market price.

The dividend payout ratio serves as another indicator of management's outlook on earnings sustainability. Classical models by Lintner (1956) and Gordon (1959) suggest that firms adopt stable payout policies to minimize investor uncertainty. A higher payout ratio reflects confidence in consistent future earnings, especially when firms prioritize shareholder returns over internal reinvestment. This aligns with the relevance theory of dividends. Bernard Alajekwu et al. (2020) find that DPO significantly affects firm valuation in both financial and non-financial sectors. Similarly, Baker and Weigand (2015) show that dividend-paying firms experience stronger valuation multiples during earnings announcements. In emerging markets, investors often rely on DPO as a performance benchmark due to weaker corporate governance mechanisms. In Sri Lanka, Abeysinghe and Kariyawasam (2023) highlight that payout ratios are positively correlated with market performances among non-financial firms. Therefore, the second hypothesis (Hb) is proposed that DPO has a significant and positive effect on share price.

However, the impact of dividend yield (DY) is more complex and potentially negative. According to Gordon's (1962) bird in hand theory, risk averse investors prefer stable dividend income to uncertain capital gains. Yet, excessively high yields may suggest that a firm has few profitable reinvestment opportunities, implying limited growth potential. Brennan's (1970) tax preference theory further complicates this relationship, indicating that investors may prefer capital gains due to favorable tax treatment in some jurisdictions. Empirical studies by Wirama et al. (2024) and Raed (2020) demonstrate that high dividend yields are sometimes associated with declining share prices, especially in low growth sectors. In Nigeria,

Okeke et al. (2021) find that firms with high DY underperform due to reinvestment constraints. Omodero and Amah (2017) similarly report no significant effect of DY on stock price, supporting the view of dividend irrelevance. Within Sri Lanka, Herath and Dissanayake (2021) observe that high dividend yields among banking stocks negatively impact market value due to growth limitations. Hence, the third hypothesis (Hc) posits that DY has a significant and negative effect on share prices. Hence, based on classical and modern dividend theories as well as consistent empirical findings from both developed and emerging markets, this study proposes the following hypotheses.

H_a: *Dividend Per Share (DPS) has a significant positive impact on the share price.*

H_b: *Dividend Payout Ratio (DPO) has a significant positive impact on the share price.*

H_c: *Dividend Yield (DY) has a significant negative impact on the share price.*

Conceptualization

The following conceptual model is developed from the insights drawn from the literature review.

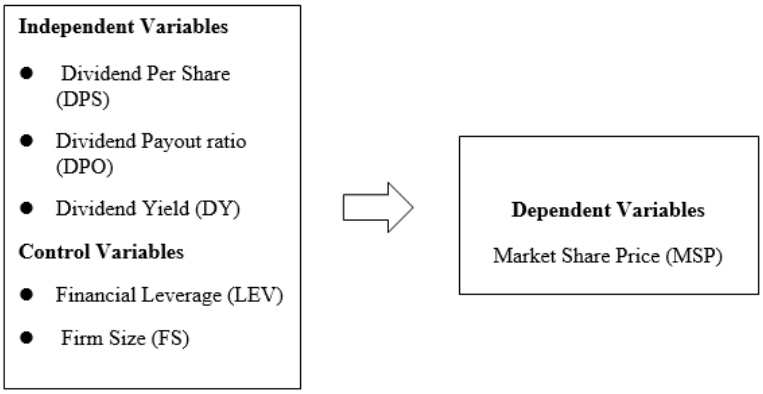

Figure 1. Conceptual Framework

Operationalization

Table 1. Summary Statistics of the Variables

Variables	Acronyms	Measurement	Authors
Independent variables/Explanatory variables			
Dividend Per Share	DPS	Total dividend paid / Number of ordinary shares	Farrukh et. Al., (2017) Charith & Davydenko (2021)
Dividend payout ratio	DPO	Dividend per share / Earnings per share	Bernard Alajekwu et al. (2020)
Dividend yield ratio	DY	Dividend per share / Average market price per share	AlAli (2019)
Dependent/Explained variables			
Market price per share	MPS	Ln (Average market price per share)	Farrukh et.al., (2017) Charith & Davydenko (2021)
Control variables			
Leverage	LEV	Total debt / Total assets	Hashemijoo & Younesi (2012)
Firm Size	FS	Ln (Total Sales)	

III. Methodology

This study is based on philosophical foundations that are explored through ontological, epistemological and axiological assumptions. This takes an objectivist viewpoint, emphasizing that a universal truth exists concerning the influence of dividend policy on the stock prices of non-financial firms listed on the Colombo Stock Exchange (CSE) in Sri Lanka. This conclusion can be reached through panel regression analysis, utilizing pooled OLS, fixed and random effect models. The research follows a value-neutral, detached position of the researcher, aligning with axiological assumptions. Therefore, this study follows the positivist paradigm, utilizes a deductive methodology and examines how dividend policy affects market share prices.

For analysis purposes, non-financial companies which are listed on the Colombo Stock Exchange are considered. Out of 225 non-financial companies, 90 companies are selected on a stratified random basis for the analysis purposes after eliminating the companies which don't have sufficient information such as dividend payment and companies which are listed recently. Industry-wise categories are taken into consideration to make homogeneous strata. There are 20 sub divided industrial groups given by CSE. However, since 3 are related to financial related segments, the remaining 17 subcategories are taken for analysis. Thereafter, from each stratum, random companies are picked while giving more quota/proportion to the strata which have a greater number of listed companies. The study examines a five-year period from 2017 to 2021. As it employs a quantitative approach, the necessary data is gathered from secondary sources, specifically the financial statements of the companies and the Colombo Stock Exchange.

This study takes Market Price per Share (MPS) as dependent variable to measure Market value of the share. To represent the company's dividend policy as an independent variable, Dividend Per Share (DPS), Dividend Payout Ratio (DPO), and Dividend Yield (DY) are included in the study. Additionally, Firm Size (FS) and Leverage (LEV) are considered to account for control variables.

Initially, the selected sample data are assessed for normality through a Normality Test. Following this, a multicollinearity test is performed to evaluate the relationships among the explanatory variables, and a correlation analysis is accompanied by a further exploration of these relationships. Additionally, a Unit Root Test is carried out to evaluate the stationarity of the data. To test the hypotheses, the study applies pooled OLS, fixed effect, and random effect models. Finally, the Breusch-pagan Lagrange multiplier test, chow test, and Hausman test are conducted to identify the most appropriate model for the analysis.

Model Specifications

The following common equation is used to investigate the relationship between the dividend policy and the market value of the share of listed non-financial companies in Sri Lanka.

$$MPS_{it} = \beta 0 + \beta 1\ DPS_{it} + \beta 2\ DPO_{it} + \beta 3\ DY_{it} + \beta 4\ FS_{it} + \beta 5\ LEV_{it} + u_{it} + \varepsilon_{it} \quad (1)$$

Where:

MPS_{it} = Market Price per Share of firm i at time t

DPS_{it} = Dividend per Share of firm i at time t

DPO_{it} = Dividend Payout Ratio of firm i at time t

DY_{it}= Dividend Yield of firm i at time t

FS_{it} = Firm Size of firm i at time t

LEV_{it} = Financial Leverage of firm i at time t

$\beta 0$ = intercept coefficient of firm i at time t

$\beta 1$, $\beta 2$, $\beta 3$, $\beta 4$, $\beta 5$= row vectors of slope coefficient of regressors

$\varepsilon_i t$ = Stochastic error term of firm i at time t

u_{it} = Error term of firm i at time t.

IV. Findings and Discussion

Descriptive statistics

The following Table 2 provides descriptive statistics for a sample of 450 observations, summarizing key variables of the study.

Table 2. Summary Statistics of the variables

Variable	Obs	Mean	Std. Dev.	Min	Max
DPS	450	4.593644	9.489457	0.000000	55.00000
DPO	450	0.614214	4.256926	0.255319	75.00000
DY	450	0.038258	0.079437	0.000000	1.333333
MPS	450	1.689299	0.658406	0.397940	3.653213
FS	450	9.776417	0.630993	8.098159	11.68164
LEV	450	0.363163	0.247892	0.000310	0.967487

DPS has an average of 4.59 with a high standard deviation of 9.49, indicating considerable variation among selected firms of the study, with values ranging from 0 to 55. The high standard deviation of DPS indicates considerable variation in dividend policies among firms, which may stem from differences in firm size, profitability, lifecycle stages, or industry-specific practices. DPO has an average of 0.61 but a wide range (0.26 to 75), reflecting significant differences in how firms distribute their earnings. DY shows a mean of 0.038, with low dispersion (standard deviation of 0.079). MPS averages 1.69. Control variable FS has a mean of 9.78, showing relatively low variation. Lastly, another control variable, LEV, has a mean of 0.36, suggesting moderate use of debt financing with values ranging from almost 0 to 0.97.

Normality test

The results of the residuals' normality test are presented in Table 3 below.

Table 3. Summary Statistics of the Jarque – Bera normality test

Statistic of Jarque- Bera test	3.245
Chi-squared (χ^2)	5.745
p-value	0.0564

Since the p-value 0.0564 is greater than 0.05, there is insufficient evidence to conclude that the residuals deviate significantly from normality. Therefore, the residuals are normally distributed, which supports the validity of the statistical methods applied in the study.

Correlation Analysis

Table 4. Correlation table

Correlation Probability	DPS	DPR	DY	FS	FL	MPS
DPS	1.000000 -----					
DPO	0.013684 0.7722	1.000000 -----				
DY	0.131018 0.0054	-0.027839 0.5558	1.000000 -----			
FS	0.019177 0.6850	-0.041748 0.3770	0.026703 0.5721	1.000000 -----		
LEV	-0.041307 0.3820	-0.012348 0.7939	-0.040541 0.3909	-0.478500 0.0000	1.000000 -----	
MPS	0.640366 0.0000	0.080604 0.0877	-0.051643 0.2743	0.017526 0.7108	-0.080860 0.0867	1.000000 -----

The results indicate a significant positive relationship between DPS and MPS (0.64, p = 0.0000), while other variables show weaker correlations. Next, the Variance Inflation Factor (VIF) test is carried out to measure the extent of multicollinearity among independent variables.

Multicollinearity Test

The following Table 5 shows the multicollinearity assessment of the variables.

Table 5. VIF – Variance Inflation Factor

Explanatory and Control variables	VIF	1/VIF
DPS	1.019107	0.98125
DPO	1.004180	0.99584
DY	1.019733	0.98065
FS	1.300846	0.76873
LEV	1.301444	0.76838
Mean VIF	1.13	

A VIF value below 10 typically indicates that multicollinearity is not an issue. In this study, all values are below 1.5, indicating that there is no significant multicollinearity among the variables. Hence, it allows us to estimate the individual effects of each variable taken for the study.

Unit Root Test

Table 6 presents the Levin-Lin-Chu unit root test.

Table 6. Unit Root Test

Variables	Zero level t statistics	Probabilities	Conclusion
DPS	-7.795826	0.0000	DPS is stationery at zero level
DPO	-3.470995	0.0092	DPO is stationery at zero level
DY	-13.56395	0.0000	DY is stationery at zero level
FS	-6.122830	0.0000	FS is stationery at zero level
LEV	-11.13879	0.0000	LEV is stationery at zero level
MPS	-6.809934	0.0000	MPS is stationery at zero level

The Levin-Lin-Chu unit root test is conducted to assess stationarity, and the results indicate that all variables in the study are stationary at the zero level.

Regression Analysis

Table 7 shows the results of Pooled OLS, Fixed effect, and random effects models.

Table 7. Regression analysis

Variables	Pooled OLS	Fixed Effect	Random Effect
C	1.715328 (0.0000)	1.313948 (0.1175)	1.533746 (0.0053)
DPS	0.045452 (0.0000)	0.021064 (0.00000)	0.029750 (0.0000)
DPO	0.010216 (0.0648)	0.011924 (0.0001)	0.011682 (0.0002)
DY	-1.142563 (0.0001)	-0.564770 (0.0070)	-0.721983 (0.0004)
FS	-0.019836 (0.5957)	0.030052 (0.7277)	0.004035 (0.9427)
LEV	-0.002691 (0.0906)	0.000733 (0.5860)	0.000108 (0.9262)
F- Statistics	68.96389 (0.000000)	29.18401 (0.000000)	23.10476 (0.000000)

R- squared	0.437134	0.885421	0.206468

Pooled OLS is used when there is no significant variation across entities or over time, assuming no entity-specific or time-specific effects. Fixed Effect models account for unobserved entity-specific factors that are correlated with the predictors, treating entity effects as fixed and correlated. Random Effect models assume unobserved entity-specific factors are random and uncorrelated with the predictors, allowing for both within and between-entity variation. Based on the above Table 8, all three models (Pooled OLS, Fixed Effect, and Random Effect) are statistically significant, as indicated by their F-statistics and low p-values (0.000000). This suggests that the independent variables jointly explain a significant amount of the variation in the dependent variable.

Next, to select the best model for this study, between the Pooled OLS and the Fixed effect model, the Redundant fixed Effect Test / Chow Test is employed.

Table 8. Chow test

F test	716.299699
Prob =	0.0000

Based on the above table, the significant result of the Chow Test (p-value = 0.0000) indicates that the Fixed Effect model is a better fit than the Pooled OLS model for the data. The Fixed Effect model should be selected, as it accounts for unobserved entity-specific factors that are important in explaining the variation in the dependent variable. To select among Pooled OLS and random effect models, Breusch and Pagan Lagrangian multiplier test is carried out.

Table 9. Breusch and Pagan Lagrangian multiplier test

Chi-squared (χ^2) statistic =	447.1640
Prob =	0.0000

The above table shows that since the LM test result is highly significant (p = 0.0000), the Random Effect model is better than the Pooled OLS model. This suggests that there are significant entity-specific random effects that the Pooled OLS model fails to account for, making the Random Effect model a more suitable fit for the data. Now, to select between the fixed effect model and the random effect model, the Hausman test was performed.

Table 10. Hausman test

chi2 (4)	21.620292
Prob =	0.0006

The Hausman test produced a chi-squared value of 21.62 with a probability of 0.0006, which is below the 5% significance level. Hence, this indicates that the fixed effect model is the preferred model for the study. As shown in Table 10, the results of the

fixed effects model are used to test the study's hypotheses. The fixed effects model revealed an adjusted R2 of 0.8854, indicating that about 89% of the variability in market share price is explained by the independent variables namely DPS, DPO, DY, FS, and LEV, while the remaining 11% is due to other factors not included in the study.

Hypotheses Testing Results

H_1: DPS has a positive and significant impact on market share price.

The regression coefficient for DPS in the fixed effects model is 0.011924 with a p value of 0.0001, indicating a strong positive and statically significant effect on share price. This result aligns with the findings of Farrukh et al. (2017), who demonstrated that higher DPS positively influences shareholders' wealth in the Pakistani context. Gul et al. (2012) and Charith and Davydenko (2021) similarly reported that dividend announcements contribute to favorable stock price movements in both emerging and frontier markets. Chang et al. (2024) showed that effective dividend signaling, particularly via DPS, enhances the predictive accuracy of future earnings. In contrast, Omodero and Amah (2017) found no significant relationship between DPS and market share price in Nigerian listed firms, suggesting that in some contexts, other firm fundamentals may overshadow dividend indicators.

H_2: DPO has a positive and significant impact on market share price.

The regression coefficient for DPS in the fixed effects model is 0.021064 with a p value of 0.0000, indicating a strong positive and statically significant effect on share price. This is consistent with the dividend relevance theory, which suggests that investors interpret high and stable payout ratios as signs of financial health and earnings sustainability (Lintner, 1956; Gordon, 1959). Empirical support comes from Bernard Alajekwu et al. (2020), who observed that DPO significantly affects firm valuation in both financial and non-financial firms. Baker and Weigand (2015) also confirm that markets respond favorably to stable and increasing payout ratios, especially in firms with strong governance. However, Subramaniam and Devi (2010) caution that overly generous payouts could constrain future reinvestment potential, especially in high-growth sectors, potentially tempering investor enthusiasm over the long term.

H_3: DY has a negative and significant impact on market share price.

The regression coefficient for DY in the fixed effects model is -0.564770 with a p value of 0.0070, indicating a strong negative and statically significant effect on share price. This finding aligns with Gordon's (1962) bird in hand theory, which suggests that risk-averse investors prefer dividends now over uncertain future returns. Yet, a high DY can signal limited growth opportunities, deterring growth-focused investors. Okeke, Anike and Onuora (2021) and Ansar et al. (2015) reported similar negative relationships between DY and firm value, particularly in industries with low reinvestment needs. Raed (2020) and Wirama et al. (2024) argue that an excessively high yield might reflect undervaluation driven by poor growth expectations. Conversely, Nambukara-Gamage & Peries (2019) and Wanjohi (2017) found that dividend yield can enhance perceived value in markets where consistent dividend income is preferred, especially among conservative investors. Thus, while DY generally shows a negative correlation with share price in this study, its interpretation may vary based on investor type and industry lifecycle.

Hence, the result of the fixed effect model revealed that DPS and DPO have a significant positive impact on the market value of the shares, while DY has a significant negative impact. These findings align with the dividend signaling theory and

dividend relevance theory (Charith & Davydenko, 2021), which suggests that higher dividends signal a company's strong future prospects to investors, leading to increased share prices. Conversely, the negative impact of DY may reflect the bird in the hand theory, suggesting that investors prefer the certainty of dividends over potential future capital gains, potentially causing a decline in perceived value when the dividend yield is high without corresponding growth expectations. However, the literature also shows that the effect of dividend variables may vary by region, firm maturity, and investor preference, demanding careful interpretation of these results.

V. Conclusion

This study examined the impact of dividend policy on share value for non-financial companies listed on the Colombo Stock Exchange in Sri Lanka from 2017 to 2021. The sample of the study is 90 firms with 450 observations. The fixed Effect model is employed after rejecting the Pooled OLS and Random Effect models based on the results of the Hausman, Chow and Lagrange multiplier tests. The findings confirmed the significance of dividend per share and dividend payout ratio in positively influencing market share value, thereby supporting both signaling theory and dividend relevance theory. These results highlight that dividends are not merely residual decisions but serve as meaningful signals about firm stability and future earnings potential. Conversely, the significant negative relationship between dividend yield and stock prices suggests that high dividend yields may hinder a firm's growth prospects due to reduced reinvestment opportunities and innovation potential. The results highlight the critical role of dividend policy in shaping market perceptions and stock valuation, offering valuable insights for academics, corporate managers, investors, and policymakers. For managers, the results highlight the strategic importance of dividend policy not only in investor communications but also in long term valuation outcomes. For policymakers, the study suggests that dividend behaviour can influence market efficiency and should be considered when evaluating investor protection frameworks. For investors, the findings offer guidance on interpreting dividend signals in light of firm growth prospects. Hence, by acknowledging the influence of dividend distribution on share prices, stakeholders can make informed decisions regarding market strategies and corporate growth planning. However, this study has a few limitations. It focuses solely on non-financial companies, and the study period ends in 2021 to avoid distortions from the post-crisis period, which may limit applicability during economic volatility. Hence, future research could further enhance understanding by investigating the effects of dividend policy during different economic cycles or exploring the moderating role of additional financial variables, such as leverage and earnings growth or macroeconomic shocks. Further, researchers can extend the study by incorporating financial institutions, exploring sectoral heterogeneity or introducing dynamic panel models to capture lagged effects. Moreover, examining how dividend policy interacts with corporate governance structures, ownership concentration, or ESG performance would offer a more holistic understanding of its role in value creation. In conclusion, this study contributes to the existing literature by providing empirical evidence of the relevance of dividend policy in an emerging market context like Sri Lanka.

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