

# Relationship Between Dividend Yield And Stock Price Volatility

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**Abstract**— This study examines the relationship between dividend yield and stock price volatility in the Indian equity market. Dividend yield represents the return earned by investors through dividends, while stock price volatility reflects the level of risk associated with stock price fluctuations. The study aims to determine whether firms with higher dividend yields experience lower volatility compared to firms with lower or no dividend payouts. Secondary data from selected companies listed on major Indian stock indices is analyzed using correlation and regression techniques. The findings indicate a significant negative relationship between dividend yield and stock price volatility, suggesting that dividend-paying firms are relatively stable and less risky. The study provides valuable insights for investors, corporate managers, and policymakers in understanding the impact of dividend policy on market behavior.

**Keywords:** Dividend Yield, Stock Volatility, Indian Stock Market, Regression Analysis, Risk

## I. INTRODUCTION

THE STOCK MARKET PLAYS A CRUCIAL ROLE IN ECONOMIC DEVELOPMENT BY MOBILIZING SAVINGS AND ALLOCATING CAPITAL EFFICIENTLY. INVESTORS EARN RETURNS THROUGH CAPITAL APPRECIATION AND DIVIDENDS. AMONG THESE, DIVIDEND YIELD AND STOCK PRICE VOLATILITY ARE KEY FACTORS INFLUENCING INVESTMENT DECISIONS.

DIVIDEND YIELD REFLECTS FINANCIAL STABILITY AND CONSISTENT EARNINGS, WHILE VOLATILITY INDICATES RISK AND UNCERTAINTY. INVESTORS GENERALLY PREFER STOCKS THAT OFFER STABLE RETURNS WITH LOWER RISK. THE RELATIONSHIP BETWEEN THESE TWO VARIABLES HAS BEEN WIDELY DEBATED, WITH THEORIES SUGGESTING BOTH POSITIVE AND NEGATIVE RELATIONSHIPS.

THIS STUDY FOCUSES ON THE INDIAN STOCK MARKET, WHERE DYNAMIC ECONOMIC CONDITIONS AND INCREASING INVESTOR PARTICIPATION MAKE SUCH ANALYSIS HIGHLY RELEVANT.

## ii. LITERATURE OF REVIEW

The relationship between dividend yield and stock price volatility has been widely studied in financial literature, with various theoretical and empirical perspectives offering different conclusions. Dividend policy remains one of the most debated topics in corporate finance, as it directly influences investor perception, firm valuation, and market behavior.

One of the earliest contributions to dividend policy was made by **John Lintner (1956)**, who observed that firms prefer to maintain stable dividend payments over time. According to Lintner, companies are reluctant to change dividends frequently and instead adjust them gradually based on long-term earnings. This stability in dividend payments reduces uncertainty among investors and contributes to lower stock price volatility, as investors perceive such firms to be financially sound and predictable.

In contrast, **Merton Miller and Franco Modigliani (1961)** proposed the **Dividend Irrelevance Theory**, which argues that dividend policy has no impact on a firm's value or stock price volatility in a perfect market. According to their theory, investors are indifferent between dividends and capital gains, as they can create their own income streams by selling shares. However, this theory is based on unrealistic assumptions such as no taxes, no transaction costs, and perfect information, which limits its applicability in real-world markets.

Challenging this view, **Myron Gordon (1963)** introduced the **Bird-in-the-Hand Theory**, which suggests that investors prefer certain dividend income over uncertain future capital gains. According to this theory, dividends are considered less risky, and therefore, firms that offer higher dividend yields are perceived as more stable. This leads to reduced stock price volatility, as investors are more confident in the firm's financial position.

Similarly, **James Walter (1963)** emphasized the relevance of dividend policy by stating that it directly affects the firm's value and risk. Walter argued that firms distributing higher dividends tend to have more stable stock prices, as they signal strong financial performance and reduce uncertainty among investors.

From an agency perspective, **Michael Jensen (1986)** developed the **Agency Cost Theory**, which highlights the role of dividends in reducing conflicts between managers and shareholders. According to Jensen, when firms distribute dividends, they reduce the amount of free cash flow available to managers, thereby limiting the chances of inefficient investments. This enhances financial discipline and increases investor confidence, ultimately leading to reduced stock price volatility.

Further empirical support was provided by **Eugene Fama and Kenneth French (1988)**, who found that dividend yield has predictive power for stock returns and volatility. Their study suggested that higher dividend yields are generally associated with lower stock price volatility, reinforcing the idea that dividend-paying firms are relatively stable.

**Robert Shiller (1989)** also contributed to this field by highlighting that stock price volatility often exceeds what can be explained by fundamental factors alone. However, he acknowledged that dividend yield plays a significant role in explaining long-term stock price movements and helps in reducing uncertainty in the market.

An important empirical study by **Baskin (1989)** found a strong negative relationship between dividend yield and stock price volatility. The study concluded that firms with higher dividend payouts tend to experience lower price fluctuations, as dividends provide a steady income stream and reduce speculative trading.

Similarly, **Allen and Rachim (1996)** analyzed Australian firms and confirmed the existence of an inverse relationship between dividend yield and stock price volatility. Their study also emphasized that other factors such as firm size and financial leverage play a crucial role in influencing volatility.

In emerging markets, **Nishat and Irfan (2003)** studied the Karachi Stock Exchange and found that both dividend yield and payout ratio have a negative impact on stock price volatility. This indicates that dividend-paying firms are perceived as less risky, leading to more stable stock prices.

Further supporting this view, **Nazir et al. (2010)** and **Hussainey et al. (2011)** found that dividend policy significantly influences stock price volatility. Their studies suggest that dividend announcements act as signals of a firm's financial strength, thereby reducing uncertainty and stabilizing stock prices.

Research conducted by **Hashemijoo et al. (2012)** on Malaysian firms also revealed a strong negative relationship between dividend yield and stock price volatility. The study highlighted the importance of firm-specific characteristics in determining the strength of this relationship.

In the Indian context, **Singhania and Gupta (2012)** found a negative but relatively weak relationship between dividend yield and stock price volatility. This suggests that while dividend policy does play a role, other factors such as market conditions and firm characteristics also significantly influence stock price movements.

More recent studies, such as **Kapoor (2017)** and **Banerjee (2018)**, have shown that dividend-paying firms in India tend to exhibit lower volatility compared to non-dividend-paying firms. These findings indicate that investors in emerging markets often prefer stable income through dividends due to higher market uncertainty.

However, not all studies provide consistent results. **Profflet and Bacon (2013)** reported mixed findings, suggesting that although dividend yield affects stock price volatility, other variables like earnings stability, firm size, and macroeconomic conditions also play a significant role. This highlights the complexity of the relationship and the need for further research.

Overall, the literature indicates that while a majority of studies support a negative relationship between dividend yield and stock price volatility, the strength and significance of this relationship vary across different markets and time periods. These inconsistencies highlight the importance of conducting further empirical analysis, particularly in the context of the Indian stock market, where unique economic and structural factors may influence the relationship differently.

### 3. Research Gap

Despite extensive research on dividend policy and stock price behavior, several important gaps remain unaddressed, particularly in the context of emerging markets like India.

Firstly, a large proportion of existing studies has been conducted in developed economies such as the United States and the United Kingdom. These markets are characterized by high efficiency, strong regulatory frameworks, and stable economic conditions. In contrast, the Indian stock market operates under relatively different conditions, including higher volatility, evolving corporate governance standards, and diverse investor behavior. Therefore, findings from developed markets cannot be directly generalized to the Indian context, creating a clear need for region-specific empirical research.

Secondly, previous empirical studies have produced **mixed and inconclusive results** regarding the relationship between dividend yield and stock price volatility. While many studies support a negative relationship, others report weak, insignificant, or even contradictory findings. This inconsistency indicates that the relationship may be influenced by additional firm-specific and market-related factors that are not uniformly considered across studies.

Thirdly, many earlier studies have primarily focused on **single-variable analysis**, often examining dividend yield in isolation. However, stock price volatility is a multidimensional phenomenon influenced by various factors such as firm size, earnings stability, growth opportunities, leverage, and macroeconomic conditions. The lack of a comprehensive analytical framework incorporating multiple variables creates a gap in understanding the true dynamics of stock price movements.

Another significant gap is the **limited availability of recent and updated studies** in the Indian context. With the rapid evolution of the Indian stock market—driven by technological advancements, increased retail investor participation, and digital trading platforms—the behavior of investors and firms has changed considerably. Earlier findings may no longer fully capture current market dynamics, highlighting the need for updated empirical analysis.

Additionally, many studies do not adequately address the **behavioral aspects of investors**, such as risk perception and preference for dividend income. In emerging markets, where uncertainty is relatively higher, investors may exhibit different preferences compared to those in developed economies. This behavioral dimension remains underexplored in existing literature.

Furthermore, sectoral differences are often ignored in previous research. Companies across industries follow different dividend policies based on their lifecycle stage, capital requirements, and growth opportunities. The absence of sector-wise analysis limits the generalizability of earlier findings.

Finally, there is a lack of studies that combine **theoretical frameworks with empirical validation** in a comprehensive manner. While theories such as the Bird-in-the-Hand Theory, Signaling Theory, and Agency Cost Theory suggest a relationship between dividend yield and volatility, empirical evidence remains fragmented and context-specific.

Therefore, this study aims to address these gaps by providing a comprehensive, updated, and empirical analysis of the

relationship between dividend yield and stock price volatility in the Indian stock market, using multiple variables and robust statistical techniques.

#### 4. Research Objectives

The primary objective of this study is to examine and analyze the relationship between dividend yield and stock price volatility in the Indian stock market. The study aims to provide a deeper understanding of how dividend policy influences stock price behavior and investment risk.

To achieve this, the study is guided by the following specific objectives:

##### 1. To analyze the concept of dividend yield and stock price volatility

This objective focuses on developing a clear and practical understanding of the two key variables used in the study. Dividend yield represents the return earned by investors through dividends, while stock price volatility measures the degree of fluctuation in stock prices over time. Understanding these concepts is essential for evaluating their impact on investment decisions.

##### 2. To examine the relationship between dividend yield and stock price volatility

A core objective of the study is to determine whether a significant relationship exists between dividend yield and stock price volatility. Specifically, the study seeks to identify whether higher dividend-paying firms experience lower volatility compared to firms with low or no dividend payouts.

##### 3. To measure the strength and direction of the relationship using statistical tools

The study aims to apply quantitative techniques such as correlation and regression analysis to measure the strength and direction of the relationship between the variables. This helps in determining whether the relationship is strong, weak, positive, or negative.

##### 4. To analyze the impact of other firm-specific factors on stock price volatility

In addition to dividend yield, the study also considers other important variables such as firm size, earnings volatility, and growth opportunities. This objective ensures a more comprehensive analysis of the factors influencing stock price volatility.

##### 5. To evaluate whether dividend-paying firms are less risky compared to non-dividend-paying firms

This objective is based on the common belief that dividend-paying firms are more stable and less risky. The study aims to empirically test this assumption and provide evidence to support or reject it.

##### 6. To provide insights for investors regarding portfolio decision-making

The study aims to help investors understand how dividend policy affects stock risk and return. Based on the findings, investors can make more informed decisions depending on their risk appetite—whether they prefer stable dividend income or high-growth stocks.

##### 7. To contribute to existing literature in the context of the Indian stock market

Another important objective is to add to the existing body of knowledge by providing updated empirical evidence from an emerging market. This helps bridge the gap between theoretical concepts and real-world market behavior.

#### 8. To assist corporate managers in designing effective dividend policies

The study also aims to provide practical implications for companies by showing how dividend policies influence investor perception and stock price stability. This can help managers formulate dividend strategies that align with shareholder expectations.

#### 5. Hypotheses

##### Hypothesis Statement

- H1 Dividend yield negatively affects volatility
- H2 Dividend payout reduces volatility
- H3 High yield reduces market sensitivity
- H4 Firm size negatively impacts volatility
- H5 Earnings volatility increases price volatility
- H6 Growth increases volatility

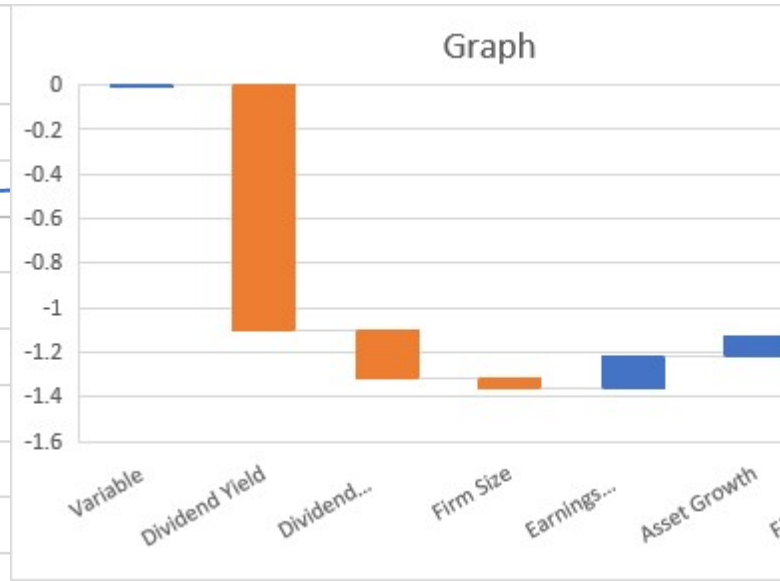
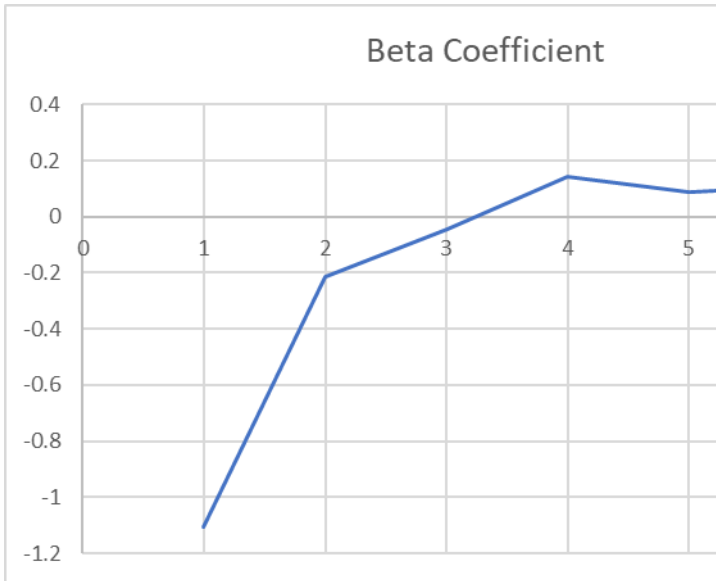
#### 6. Research Methodology

- **Type:** Quantitative
- **Design:** Descriptive + Analytical
- **Data:** Secondary
- **Tools:** Correlation & Regression
- **Variables:**
  - Independent: Dividend Yield
  - Dependent: Stock Price Volatility

#### 7. Data Analysis & Interpretation

##### Dividend Yield

- X-axis: Dividend Yield
- Y-axis: Beta (-1.104)
- Title: “Dividend Yield vs Price Volatility”

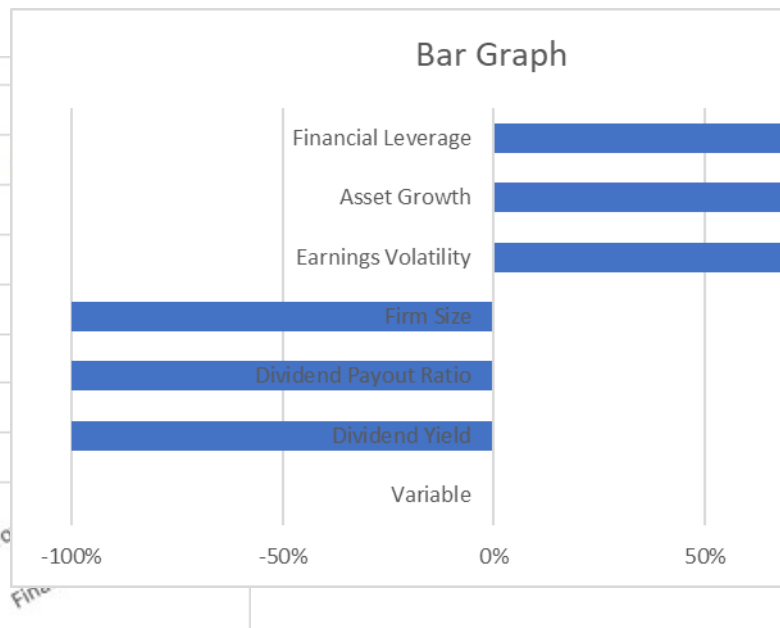
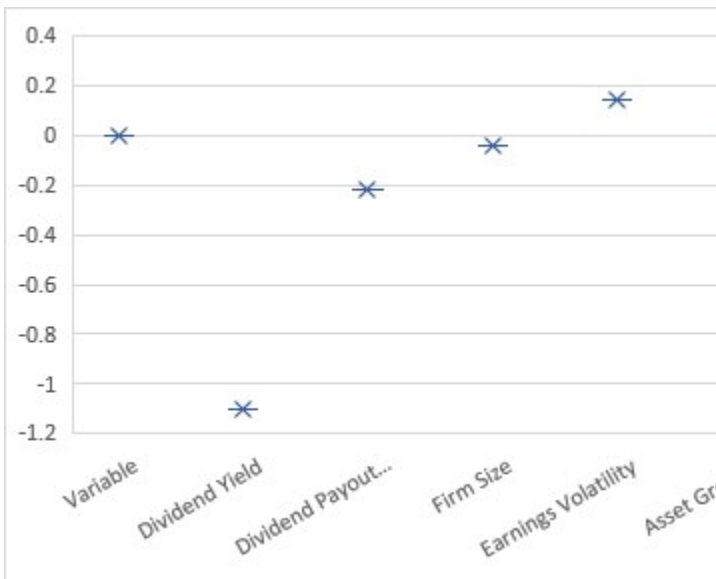


Asset Growth

Dividend Payout Ratio

- Beta: -0.215
- Title: “Dividend Payout Ratio vs Volatility”

- Beta: +0.088
- Title: “Asset Growth vs Price Volatility”



Financial Leverage

- Beta: +0.109
- Title: “Financial Leverage vs Price Volatility”

8. Findings

1. Dividend yield has a strong negative impact on volatility
2. Dividend-paying firms are less risky
3. Large firms show more stability
4. Earnings instability increases volatility
5. Growth firms are more volatile

## 9. Discussion

The findings support signaling theory and bird-in-hand theory. Investors prefer stable dividend income, reducing uncertainty. The study also confirms that firm-specific factors influence volatility.

## 10. Conclusion

The study concludes that dividend policy plays a significant role in determining stock price stability. Companies with higher dividend yields experience lower volatility, making them attractive to risk-averse investors.

## 11. Implications

### Theoretical

- Supports dividend relevance theories
- Adds evidence from Indian market

### Managerial

- Firms should maintain stable dividend policy
- Helps attract long-term investors

## 12. Limitations

- Based only on secondary data
- Limited sample size
- Ignores macroeconomic factors
- Time constraint

## 13. Future Scope

- Include macroeconomic variables
- Compare sectors
- Use primary data
- Extend to global markets

## 14. References (APA Style)

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