

An Analytical Study of The Determinants of Corporate Dividend Policy

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ABSTRACT

Dividend is the actual reward given to the shareholder after a long wait of commitment of the funds in an organization. The policy which decides whether this reward should be given to the shareholder or not depends upon various factors. The main objective of the paper is to discuss the determinants of dividend policy covering the time-period of 1975 to 2017. The findings of the study reveals that profitability position of the concern has a positive impact on the flow of dividend followed by company size, leverage position, company size etc. and the factors like government Policy, competitors strategies, growth plans etc. have a negative effect on the flow of dividends.

Key Words: Dividend, Indian, Banks, Determinants, Public Sector, Private Sector.

1. INTRODUCTION

The origin of word dividend is believed to be in the latin word “Dividendion” which literally means “that which is to be divided”. In the modern day language dividend refers to the part of the profits of a company which are to be distributed amongst shareholders of the company.

Certain characteristic features associated with dividends are enumerated as below:

- Companies declare dividends when they have sufficient profits.
- They are declared on the recommendations of the Board of Directors.
- Their declaration has the acceptance of shareholders through the annual general meeting.
- They are income tax free.

Dividend Decisions: The decisions that determine the plan of division of earnings between payment to shareholders and retained earnings are referred to as Dividend decisions. They are an integral part of the financial management of an organization as they have a direct impact on the capital structure and stock prices of an organization. While making the dividend decisions in an organization there are certain issues that have to be taken into account which include:

- Free cash flow theory which implies that the company provides the money to the shareholders which remains with it after investing in all projects of the organization which have a positive net present value.
- Signaling of information which leads to the development of the consideration that whenever a company announces that it would provide more dividends to its shareholders it leads to an increase in the prices of its shares.
- Clients of dividends which implies that while making dividend decisions the organization must be aware about the needs of various stock holders as a particular type of distribution might not be suitable to a certain group of shareholders

The decision related to payment of dividend is highly significant for organizations, the issues which lend significance to these decisions are enlisted as below:

- a. They help the firms to maintain balance between its growth and distribution of profits to shareholders.
- b. They have a critical influence on the value of the firm.
- c. They help to strike balance between long term financing decisions of organizations and the wealth maximization of the shareholders.
- d. They have a direct impact over the market share prices of the company.
- e. They have a significant impact over the growth of company, corporate liquidity, flow of funds, stock prices, financial structure, stock prices and investor's satisfaction.

Numerous studies have already been conducted in this area but there have been no conclusive results in this regard. This paper has divided into three different sections to study the factors which have a significant impact over the dividend policy of public sector and private sector banks in India. Section I discusses the introduction and the background of the study. Section II discusses various issues pertaining to the dividend policy like profitability, liquidity, leverage, company policies etc. and their impact on the same and Section III is basically conclusive in nature.

2. ISSUES PERTAINING TO DIVIDEND POLICY

2.1 DIVIDEND POLICY AND PROFITABILITY

Profitability is the ability of a company to use its resources to generate revenues in excess of its expenses. It is the company's capacity of generating profits from its activities. Profitability is one of the most important factors which are considered for while making decisions with regard to the dividend payout ratio. A lot of research has been done to analyze the relation of profitability with dividend payout ratio. A study conducted over FMCG firms found that profitability of the firm was the primary determinant for dividend distribution and had scored well with regard to stability and consistency issues in dividend payout determination (Kapoor, et. al., 2010). Net Profit was found to be the most important factor responsible for increasing the rate of dividend

and also net profit was having a significant impact on dividend payment decisions as compared to other factors (Sarvanakumar, 2011). A positive relationship was observed between profitability and dividend payout ratio in a study conducted on the dividend policy of banking sector in Pakistan (Zamir et. al., 2013). In case of Islamic banks profitability was found to have a significant relationship with the dividend payout ratio however the relationship was non-significant with regard to period i.e. before and after the crisis (Ahmed, 2015). In a study of listed IT companies a study revealed that net profit after tax has a significant impact over the equity dividend (Kumar & Jha, 2012). In another study of Indian companies it was found that for both the sub periods of the study that profitability had a significant impact on the dividend payout determination (Labhane & Mahakud, 2016). However, certain studies also reported for negative results in this regard. Like in a study conducted over public and private sector banks in India a negative association of profitability was found with dividend payout policy (Devanadhen & Karthik 2015). Similarly in a study of Lebanese banks also it was found that dividend payout ratio was negatively affected by profitability (Maladajian & El Khoury 2014). Yet another study with regard to dividend disbursement in commercial banking it was found that the significance of coefficient of change in profit was not having a high effect over dividend disbursement (Gupta & Walker, 1975).

Thus, profitability can be considered as an important factor that has an influence on the dividend decisions and predominantly the impact of profitability is positive over the amount of dividend to be paid.

2.2 DIVIDEND POLICY AND LIQUIDITY

Liquidity is the working capital position of an organization. It depicts how well an organization is able to meet its short term expenses and obligations.

Dividend is a critical finance function as it involves determination of amount to be distributed to shareholders. The amount to be distributed depends on so many factors and liquidity is one of them. A study carried out over the corporate dividend policy of Islamic banks helped to conclude that liquidity had a significant relationship with the dividend payout ratio (Ahmed, 2015). Another study on the dividend policies of the Indian companies found that liquidity had a significant impact on the dividend payout determination (Labhane & Mahakud, 2016). Past studies on the dividend policies of banks in Pakistan (Zamir et. al., 2013) and public and private commercial banks in India (Devanadhen & Karthik 2015) found that Liquidity was having a negative impact on dividend payout. Similarly a study on the FMCG sector organizations found that liquidity bears a significant negative relationship with dividend payout (Kapoor et. al., 2010). An analysis carried out with regard to corporate dividend policy was helpful to conclude that one of the most important factors found responsible for increasing rate of dividend is the enhanced liquidity position of an organization. It was further found in the study that liquidity was having a significant impact on dividend payment decisions as compared to other factors (Sarvanakumar 2011). Another study conducted over the dividend policies of the Indian corporates found that liquidity was strongly positively associated with the dividend rates of Indian companies (Gupta & Banga,

2010). However, in a study of dividend disbursement practices of commercial banks it was reported that the liquidity coefficient does not have a high effect over dividend disbursement (Gupta & Walker, 1975).

Liquidity hence can be regarded as another major factor having an impact on the dividend decisions. It has also been regarded as an important element along with other determinants that affect the dividend policy.

2.3 DIVIDEND POLICY AND FIRM SIZE

Firm size or it is commonly referred to as the market capitalization of an organization refers to the figure used to determine the size of an organization. A variable used in place of sales or total assets of an organization. It is also an important parameter which is to be considered at the time of dividend payment. Many studies have been done to check the association of firm size with dividend payment behavior. It was found that firm size was not having significant impact on the dividend payout behavior of the Pakistani banks (Zamir et al., 2013). Firm size was also found to be unrelated to dividend payouts in case of private and public commercial banks in India (Devanadhen & Karthik 2015). However, a study of carried out over the dividend policies found that the size of the firm has a statistically significant positive relationship and influence over the current dividend policy of the firm (Kamat & Kamat, 2013). It was also found in a study of dividend policies of Indian companies that size of the company had a significant impact on the dividend payout determination (Labhane & Mahakud, 2016).

Firm size is thus a vital asset in an organization as a determinants in the dividend policy of organizations.

2.4 DIVIDEND POLICY AND LEVERAGE

Leverage is the employment of an asset/source of finance for which firm pays fixed cost/fixed return (Khan and Jain, pg-18.3). Leverage was not found to be having a significant impact on the dividend payout behavior of the Pakistani banks (Zamir et al., 2013). It was also found to be unrelated to dividend payout by private and public commercial Indian banks (Devanadhen & Karthik 2015). In a sectoral analysis of companies registered on the Karachi stock exchange it was found that leverage had a positive impact on organisations in six of the sectors while it had a negative impact in three sectors of organizations (Khan & Shamim, 2017). Another study found that leverage was strongly negatively associated with the dividend rates of Indian companies (Gupta & Banga, 2010). The effect of leverage ratio however was found to have a significant impact on the dividend payout determination in case of Selected Indian companies. (Labhane & Mahakud, 2016).

Therefore, Leverage is regarded as an important factor which should be considered for the formulation of dividend policy.

2.5 DIVIDEND POLICY AND DEPRECIATION

Depreciation refers to the decrease observed in the value due to several reasons including wear and tear.

In an analysis of factors having an influence over the dividend policy decisions of Indian banking sector it was found that depreciation had no significant impact over the current dividends (Sura et. al., 2012). However, in

another study with regard to the determinants of dividend policy of Indian banks it was found that current year depreciation was an important influencing factor over the dividend distribution (Sudhahar & Saroja, 2010). It was reiterated in a yet another study of listed IT companies on the BSE that amount of depreciation had a significant impact over the equity dividend (Kumar & Jha, 2012).

Depreciation is hence an important factor in determination of dividend policy of an organization.

2.6 DIVIDEND POLICY AND SALES

Sales/Growth in Sales refers to the amount by which the average sales volume of a company's products or services has grown typically in a year to year format.

In a study conducted with regard to the corporate dividend policy of Indian banks it was concluded that sales was one of the most important factors found responsible for increasing rate of dividend. It was also found that sales were having a significant impact on dividend payment decisions alongwith some other factors (Sarvanakumar, 2011). Sales was found to have a positive impact in four sectors and negative impact for three sectors as evidenced in a study conducted for a sectoral analysis of companies registered at the Karachi stock exchange (Khan & Shamim, 2017). Another study conducted over the dividend policy of Indian banks remarked that the volume of sales was having a positive influence on the dividend policy of banks however, it was usually when there had been a negligible decline in debt irrespective of trivial increase in dividend tax rate (Sudhahar & Saroja, 2010). However, in a study of listed IT companies at the BSE it was found that change in sales in the preceding two years has an insignificant impact over dividend policy (Kumar & Jha, 2012).

Thus, sales is another important determinants of dividend policy.

2.7 DIVIDEND POLICY AND CASH FLOWS

Cash Flows simply imply flow of money i.e. real or virtual movement of money.

A study carried out for the dividend policy of companies in the Indian corporate sector in the post liberalization regime revealed that the joint effect of all variables including cash flows was significant over the design of dividend policy of these firms (Sur & Majumdar, 2012). Another study carried out with regard to the dividend policies of FMCG firms stressed that the quality of cash flows (which are measures of liquidity of firm and firm size) was an important determinant of dividend payouts (Kapoor et. al., 2010). Similar outcomes were also obtained in a study of dividend policies of Indian IT sector companies listed on the BSE, which revealed that cash flow had a significant impact over the equity dividend (Kumar & Jha, 2012).

From the above it can be concluded that Cash Flows is an important factor in determining dividend policy of an organization.

2.8 DIVIDEND POLICY AND LAST YEAR DIVIDEND

Last Year Dividend is the share of profit which has been shared by the company among its shareholders during the previous financial year.

An analysis of dividend policy of banks in Pakistan revealed that the last year dividend paid by the banks was an important variable in predicting the future dividend payment behavior of the banks (Zamir et. al., 2013). Another study of dividend policy of Lebanese listed banks found that the dividend payout policy was positively affected by previous year's dividend (Maladajian & El Khoury, 2014). Yet another study found that dividend per share for the previous year was one of the major factors that led to determine the cash dividends for the considered commercial banks in the study period (Bassey, Asinya, & Elizabeth, 2014). However, a study of dividend policies of Indian banks found that among the various factors considered for analysis for impact over dividend policy last year dividend was the most important factor which had a positive factor (Sudhakar & Saroja, 2010). Another study over the dividend policies in the Indian context found that last year's dividends have a statistically significant positive relationship and influence over the current dividend policy of the firm (Kamat & Kamat, 2013).

Thus, Last year dividend is the one of the most important factors in the flow of dividend and it the most vital component for most of the enterprises.

2.9 DIVIDEND POLICY AND EARNINGS PER SHARE

Earnings per Share are the indicator of company's profitability. It is that portion of a company's profit which is allocated to each outstanding share of common stock.

A study of dividend policies of the Indian service sector revealed that there existed a positive relationship between earnings variability and long term solvency with dividend payout (Kapoor, et. al. 2010). In a sectoral analysis of companies listed at the Karachi stock exchange it was found that Earning per share had a positive impact on Dividend payout in eight of the sectors considered whereas only in one of the sectors considered it had a negative impact (Khan & Shamim, 2017). Similarly, in a study for dividend policies of Nigerian commercial banks it was reiterated that current earnings per share is one of the major factors that led to determine the cash dividends for the considered commercial banks in the study period (Bassey, Asinya & Elizabeth, 2014).

Thus, EPS is an important factor that causes the flow of dividend and having an impact on the dividend policy of organizations.

2.10 DIVIDEND POLICY AND GROWTH OPPORTUNITIES

Growth/ Growth Opportunities implies increase in size or something that is expanding.

In a study of the dividend policies of the Pakistani banking sector (Zamir et al., 2013) and in a study of Indian public and private sector commercial banks (Devanadhen and Karthik, 2015) it was found that growth was not having a significant impact or was unrelated to their dividend payout behavior. However, in other studies which included an analysis of dividend policies of Lebanese banks (Maladajian & El Khoury, 2014), Latin American companies (Benavides, Berggrun, & Perafan, 2016) and Indian FMCG sector (Kapoor, et. al., 2010) it was

found that dividends were negatively affected by opportunity growth, expansion, investment opportunities and profitability.

Thus Growth is important for the organization but is not having much impact on dividend policy.

2.11 DIVIDEND POLICY AND RISK

Risk implies danger or probability of loss. Risk may be of various types which includes diversifiable or non-diversifiable risks.

Risk was not found to having a significant impact on the dividend payout behavior of the Pakistani banks (Zamir et al., 2013). Risk was having a positive effect on dividend payout for private and public sector commercial banks in India (Devanadhen & Karthik 2015). However, a study of Lebanese listed banks found that the dividend payout policy was positively affected by risk (Maladajian & El Khoury, 2014).

CONCLUSION

After going through extensive literature review, various conflicting views were found. However, the below given table sums up the results of the study:

Dependent Variable	Independent Variable Reviewed	Findings (In terms of relationship with the Dependent Variable)
Dividend Policy	Profitability	Positive
	Liquidity	Negative
	Firm Size	Positive
	Leverage	Positive
	Depreciation	Negative
	Sales	Positive
	Cash Flows	Positive
	Last Year Dividends	Positive
	Earnings per Share	Positive
	Growth Opportunities	Negative
	Risk	Positive

This paper is an attempt to comprehend the relationship of various determinants of dividend policy with the dividend policy and creates an opportunity for further research work.

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