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A STUDY ON DIVIDEND POLICY AT SELECT INFRASTRUCTURE COMPANIES IN INDIA

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ABSTRACT

Investors consider dividend and market price of shares as important signals before making investments and the rate of dividend acts as one of the factors that determine the price of shares. Hence, finance managers and boards of management are to be more cautious before finalizing the rate of dividends. While fixing a dividend rate that may satisfy equity shareholders they should also see to it that sufficient funds are retained by companies for their future growth. The present study is carried out with the objective of finding out the factors that influence the dividend policy of select cement and steel companies in India. The result of regression reveals that the rate of dividend per share in the previous year, current ratio, sales growth, leverage, age of the company and reserves significantly influence dividend declaration.

Keywords: Dividend Policy, Cement, Previous Year Dividend, Tax Rate, Retained Earnings

INTRODUCTION

India is the third largest economy in the world next to United States and China. There are various sectors that contribute to the growth of India's Gross Domestic Product and cement and steel industry play a key role. India is second largest manufacturer of Cement and Steel next to China. A country's economic progress largely depends on infrastructure facilities that prevail in a country. Hence, both Central and State governments have started allocating huge funds for infrastructure development. Thus, Cement and Steel industry will have a huge growth. It is expected that production of the cement industry may touch between 550 and 600 million tonnes and steel production may reach 300 million tonnes by 2025. Thus, both cement and steel industry have a huge growth potential in the coming years.

Investors, who are the source of funds for any business enterprise expect adequate returns for their investment. The return that they demand may be of current income, namely dividend. Generally, shareholders expect high rate of dividend for maximizing their wealth. But the company would prefer to retain a portion of profit for their future expansion and diversification. Hence, the finance managers should allocate sufficient funds that may satisfy shareholders expectations and for the future growth of business too.

REVIEW OF LITERATURE

Eugene Fama and Harvey Babiak (1968) in their study ascertained that net income determined dividend policy. Sankar De (1975) in his study identified that dividend payout ratio was associated with price earnings ratio. Khurana (1984) in his study pointed out lagged profit, lagged dividend, profit after tax and company liquidity position determined dividend payout. Ahmed, Mushtaq (1989) in his study observed that investment expenditures, availability of external funds and financial variables had important bearing on the decisions of corporates on dividend. Bramhandkar Alka (1990) in his study ascertained that cash position and sales growth determined dividend policy. Jayadev, M. (1992) in his study observed that dividend declaration was associated with cash flow, earnings, flow of debt, liquidity and prevailing rate of interest. D'Souza (1999) in his study identified that market risk was associated with dividend payout. DeAngelo et al. (2004) in their study identified that firm size, leverage, sales growth, cash balance, profitability and previous year dividends determined dividend policy. Eriotis (2005) in his study identified that the size of the company determined dividend policy. Jitendra Mahakud (2005) in his study identified that dividend payout was related to lagged dividend, earning, sales and the size of the firm. Kaustar Sen and Viswanth (2005) in their study observed that retained earning determined dividend policy. Kumudha George (2006) in her study identified that a company's dividend policy depended on lagged dividend. Mohammed Amidu, (2006) in his study identified that growth in sales, profit and cash flow affected dividend policy. Nalinaksha Bhattacharyya (2008) in his study found that a company's executive compensations influenced its dividend policy. Al Najjar (2009) in his research work identified that the asset size of a company, its profitability, ownership, leverage ratio and business risks determined its dividend policy. Basil Al Najjar (2009) in his study identified that there was an inverse relationship between dividend policy and the number of outside directors in a firm. Parua, Anupam and Gupta, Arindam (2009) in their study pointed out that cash position and cash flow, current year profit and past year profit determined dividend declaration. Pourheydari, (2009) in his study observed that stable cash flow and profitability and investment opportunity determined dividend payout ratio. Amitabh Gupta, (2010) in his study observed that leverage and liquidity determined dividend policy. Abor and Bokpin (2010) in his study ascertained that stock market capitalization and profitability determined dividend policy. Gayathridevi and Mallikarjunappa (2012) in their study ascertained that lagged profit, lagged dividend, cash flow, the size of the company and profit after tax determined dividend policy. Mehta (2012) in his study ascertained that a company's size and earning capacity determined dividend decision. Zameer et al. (2013) in their study observed that profitability, lagged dividend, liquidity and company ownership structure determined dividend policy. Maladjian and Khoury (2014) in their study identified that firm size, lagged dividend and capital structure determined dividend policy. Nuhu (2014) in her study ascertained that capital structure, earning capacity and board independence determined dividend policy. Narman Kuzucu (2015) in his study identified that the age of a company, its sales growth, firm size, and the ratio of price earnings determined dividend policy. Rajesh Kumar and K Abdul Waheed (2015) in their study found out that liquidity was the most important factor that determined dividend policy. Farman Ali Khan and Nawaz Ahmad (2017) in their study identified that a company's solvency position and earning capacity determined its dividend decision. Faruk Bostanci et al. (2018) in their study identified that a firm's size, lagged dividend, solvency position and market value of shares determined its dividend policy.

STATEMENT OF THE PROBLEM

Dividend policy will influence a company's growth, market price of its shares and its shareholders' wealth. Thus, the Board of Directors of a company has to consider various factors before finalizing the dividend ratio. While the declaration of high rate of dividend increases the shareholders' income and market price of shares, it will hamper the company's expansion plans. Similarly, retaining a huge portion of profit for future company expansion and diversification will lead to declaration of a low rate of dividend, which leads to dissatisfaction of shareholders and reduction of share price. Thus, the managements have to maintain a fine balance sufficient funds for future business expansion and fulfilment of the shareholders' expectations. So, an attempt has been made in this research work to identify the factors that determine dividend policy.

OBJECTIVE OF THE STUDY

❖ To determine the factors influencing dividend policy.

Scope of the Study

The present study has been carried out to determine the factors that affect dividend policy in select infrastructure companies in India. Infrastructure companies considered for the study are Cement and Steel. Ambuja Cement, Larsen and Toubro, Tata Sponge and Tata steels.

RESEARCH METHODOLOGY

Data

Secondary data required for the study were collected from Prowess database for a period ranging between 2005 and 2019.

Sampling

By adopting purposive sampling method, i.e. companies for which data are available for a continuous period of 15 years are selected.

Tools Used

Regression analysis is employed for carrying out the required analysis.

FINDINGS

Profit after tax, profit and dividend of the previous year, current ratio, sales growth, price earnings ratio, leverage, tax rate, company size, interest, age of the company, current reserves, reserves of the previous year, depreciation and inflation are introduced as independent variables and current year as dependent variable. Following regression equation is framed to determine the impact of select independent variables towards dividend payout.

$$DP = a + b_1 PAT + b_2 PYP + b_3 PYDPS + b_4 CR + b_5 SG + b_6 PER + b_7 LEV + b_8 TR + b_9 CS + b_{10} INT + b_{11} AOC + b_{12} RES + b_{13} PYR + b_{14} DEP + b_{15} INF + e$$

where,

DP	=	Dividend Payout
a	=	Intercept Term
PAT	=	Profit After Tax
PYP	=	Previous Year Profit
PYDPS	=	Previous Year Dividend Per Share
CR	=	Current Ratio
SG	=	Sales Growth

PER	=	Price Earnings Ratio
LEV	=	Leverage
TR	=	Tax Rate
CS	=	Company Size
Int.	=	Interest
AOC	=	Age of the Company
Res.	=	Reserves
PYR	=	Previous Year Reserves
Dep.	=	Depreciation
Inf.	=	Inflation
e	=	Error Term

Determinants of Dividend -Multiple Regression Analysis

Variables	Regression coefficient	Standard error	t
PAT	0.043	0.039	1.103
PYP	-0.058	0.038	-1.526
PYDPS	0.383**	0.125	3.064
Current Ratio	1.847**	0.514	3.593
Sales Growth	0.033**	0.010	3.300
PE Ratio	-0.120	0.124	-0.968
Leverage	1.764**	0.311	5.672
Tax Rate	0.447	0.442	1.011
Company Size	-0.026	0.016	-1.625
Interest	0.051	0.122	0.418
Age of the Company	-0.130**	0.037	-3.514
Reserves	-0.037*	0.019	-1.947
Previous Year Reserves	0.018	0.011	1.636
Depreciation	-0.016	0.016	-1.000
Inflation	-0.121	0.252	-0.480

* Significant at five per cent level ** Significant at one per cent level

Constant	: 0.267
Std. Error of Estimate	: 3.677
$\overline{R}^2$	: 0.809
R^2	: 0.858**

The result of regression reveals that previous year dividend per share, current ratio, sales growth, leverage, age of the company and reserves significantly influence current year dividend by 85.80 per cent.

- Company may declare dividend for the current year based on that of the previous year.
- Based on company short-term solvency position or liquidity position, a company can declare its dividend.
- A company whose annual sales keeps on increasing will declare a high rate of dividend.
- Old and established companies declare a low rate of dividend.
- Companies, which retain a low portion of profit towards their reserves will declare a high rate of dividend.

SUGGESTIONS

- Based on its short-term or liquidity position, a company should decide on its dividend payout ratio.

❖ Only a company that has a profitable opportunity for expansion of business should maintain a large portion of its profits as reserves. Else, companies have to declare high rates of dividend to maintain a higher price level of their market shares.

❖ Newly-promoted companies may find it difficult to mobilize funds from equity market. Hence, to attract more capital, they should declare a high rate of dividend. Equity shareholders may expect capital appreciation from old or established companies. Further, established companies may not find it difficult to mobilize capital from the market. Hence, old and established companies may declare a low rate of dividend.

CONCLUSION

The result of study portrays that dividend per share, current ratio, sales growth, financial leverage, age of the company and reserves significantly influence dividend payout. Dividend decision not only reveals the financial performance of the company but also reflects on a company's financial health. Thus, various factors are to be considered by the managements before declaring dividend in order to maintain a good image among the stakeholders and improve the market price of their shares.

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