Dividend Payout and Financial Performance: An Empirical Study of Iron and Steel Industries in India

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Abstract

Dividend policy is one of the important areas of making financial decision. The dividend policy protects the interest of the shareholders as well as the value of the firm. The profit of a company is distributed in the form of dividend to their existing shareholders. The dividend policy not only creates value for an enterprise but also maximize wealth of the shareholders. New shareholders are always expecting stable dividend behavior of a company in which they are going to invest. This paper seeks to analyze the dividend behavior of the selected Indian Iron and Steel Companies. The study was conducted for a period of ten years from 2004-05 to 2013-14. Relevant statistical tools and techniques have been applied to conduct the study.

Keywords: Dividend, Earnings, Liquidity, Performance

Introduction

Dividend constitutes most significant part of financial management of a firm. Dividends are the portion of company's profit which is distributed to its shareholders. It is one of the important aspect of the dividend policy is to determine the portion of profit to be distributed and to be retained in the business. The main objective of a firm needs value maximization in the long run. An organization needs funds to finance its various activities and operations. The organization raises funds from internal as well as external sources. Financing from external sources requires paying fixed rate of interest. However, for internal sources the organizations pays returns, known as dividend. The amount of dividend may be fluctuating as these are fluctuations in profit due to different factors. However, if the firm earns a huge profit then it may pay a higher return i.e. dividend to its shareholders.

Dividend policy aims at determining the amount of profit to be distributed among the shareholders. Payment of dividend involves outflow of cash. The cash available for the payment of dividend is affected by the firm's investment and financial decisions. The expectation of shareholders increases, when the organization generates more profit and they demand higher dividend. In general the shareholders prefer to receive regular dividend. A firm's dividend policy involves how much the amount of profit to be distributed and how much amount will be retained in business. Retained earnings provide employment of funds for a firm's long term growth.

When dividend decision is treated as financing decision, the net earnings of the firm may be considered as a source of long-term funds.

If the firm has no better investment opportunities then the firm will pay the dividend. The firm may prefer retained earnings than the external finance, as the cost of external financing is much higher than the retained earnings. Thus, retention and dividend payment are two sides of the same coin. If more and more profits are retained, the rate of dividend gets reduced. On the other hand payment of entire profit as dividend will have impact o the future growth of the firm. Thus, a balance between dividend distribution and retention is desirable for the interest of the firm. When dividend is declared, it becomes the liability of the firm and therefore, it becomes necessary for the Board of Directors to adopt a resolution on this behalf. In practice, firms may follow a particular dividend policy. Thus, it can be mentioned that a firm must consider a dividend policy according to its own needs. Firm may adopt a constant percentage of earnings in which current earnings are distributed as dividend. Therefore, if the earnings are rising, the shareholders will be more benefited over time and under declining profit condition this policy will not be preferred by the shareholders. This will in turn affect adversely the share price of the firm. On other hand constant dividend rate may be follow by a firm as its dividend policy. In this policy shareholders can get a fixed rate of dividend. The market price of share of a firm may be higher if it pays a stable dividend over time. This policy is favorable when profits are rising, when it is declining, difficulties may arise to maintain the same.

A firm may formulate dividend policy by taking into consideration all aspects of dividend payment, such as rate of dividend stability, methods of payment etc. By the adoption of dividend the interest of both firm and shareholders are to be protected. There are factors affecting the dividend policy. Therefore, it needs to be considered in formulating a dividend policy of a firm. In this paper an attempt has been made to analyze the dividend payout policy of Iron and Steel Companies in India.

Literature Review

Mohanty (1999) revealed that most of the companies don not maintain a constant payout ratio. It was also observed that most of the companies successfully maintained the dividend rates after the bonus issues. The objective of the study conducted by Amidu (2007) is to examine corporate dividend policies of publicly traded companies in Ghana. It was observed from the study that there is a positive relationship between return on assets, dividend policy and sales growth. The study also revealed negative association between return on assets and dividend payout ratio and leverage. Kapoor, Anil and Mishra (2010) stated that profitability is a primary determinant factor for dividend distribution. The selected companies have high score on dividend stability and consistency. The study also depicts a negative relationship between liquidity, and dividend payout ratio. Ramachandran and Packkirisamy (2010) conducted study to analyze the impact of capital structure on dividend policy in respect of the size of firms under study. It shows that dividend trend of previous year plays a vital role in determining the current year dividend payout. The study also stated that there are chances of reduction in dividend payout with increase in debt fund. Bawa and Kaur (2013) observed that there is significant difference in average market value relative to book value of equity between dividend payers and non payers of selected IT sector companies. It is also stated that dividend is considered as an important factor which determine the shareholders wealth. Balyan (2013) identified the relationship between dividend and earnings of the selected Steel Companies in India and found that Tata Steel, SAIL and Kalyani Steel have followed a constant dividend per share policy, whereas Jindal Steel and Bhusan Steel follow a stable dividend policy irrespective of its earnings. Soni and Gaba (2015) conducted study on dividend pattern of 50 Nifty Companies. The study finds that there is no significant correlation between the dividend per share and Turnover of the companies. The study also observed that few companies having less profits might have paid higher dividend. Chhatoi (2015) observed that the selected steel companies exercised precautionary measure in declaring dividend decision. It is also asserted that the companies have maintained consistent EPS, DPS and DPR. It is apparent from the above study that a very few number of papers on the impact of profitability, liquidity, size and Investment decision on dividend policy in Steel Sectors. In this paper an attempt has been made to analyze the impact of above factors on dividend policy of select Steel Companies in India.

Objective of the Study

The main objective of the study is to find out the impact of Profitability, Liquidity, Size and Investment Decision on the dividend policy of some selected Iron and Steel Companies in India. The study also finds the relationship between the above variables.

Methodology and Data collection

The study is empirical in nature based on secondary data. Four Iron and Steel companies have been selected for the study. The study was conducted for a period of ten years from 2004-05 to 2013-14. The data of the selected companies have taken from the annual reports and accounts. For the purpose of the study Dividend Payout Ratio (DPR) is taken as the dependant variable and Return of Capital Employed (ROCE), Current Ratio (CR) and Retained Earnings (RE) have been considered as independent variable. For analyzing the data Average, Correlation, ANOVA etc. have been applied to test the hypotheses.

Hypotheses development

Hypothesis 1

H0: The Profitability has a negative impact on dividend policy.

HA: The Profitability has a positive impact on dividend policy

Hypothesis 2

H0: The Liquidity has a negative impact on dividend policy.

HA: The Liquidity has a positive impact on dividend policy.

Hypothesis 3

H0: Retained earnings have a negative impact on dividend policy.

HA: Retained earnings have a positive impact on dividend policy

Findings and Interpretation

Table 1: Test of ANOVA of DPR and ROCE

SUMMARY

Groups	*Count*	*Sum*	*Average*	*Variance*
DPR	4	81.87958	20.469895	9.679859
ROCE	4	42.16089	10.540222	146.2409

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	197.196	1	197.196	2.529	0.162	5.987
Within Groups	467.762	6	77.96			
Total	664.959	7				

Source: Annual Reports compiled through MS Excel

The table showed that the critical value of F at 5 percent level of significance for d.f. (1, 6) is 5.98. The null hypothesis is accepted as the computed value of F (2.529) is lower than the critical value of F, hence it can be concluded that there is negative significant impact of ROCE on the DPR of the selected companies.

Table 2: Test of ANOVA of DPR and CR

Anova: Single Factor

SUMMARY

Groups	*Count*	*Sum*	*Average*	*Variance*
DPR	4	81.87958	20.469895	9.679859
CR	4	6.897015	1.7242538	0.39696

ANOVA

Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	702.79	1	702.798	139.488	0.0000222	5.987
Within Groups	30.23	6	5.038			
Total	733.02	7				

Source: Annual Reports compiled through MS Excel

The test of ANOVA shows that the calculated value of F is 139.48, which is greater than the tabulated value of F (5.987). Therefore, the null hypothesis is rejected and hence it can be concluded that the Current Ratio of selected companies have positive impact on dividend policy.

Table 3: Test of ANOVA of DPR and Retained Earnings

Anova: Single Factor

SUMMARY

Groups	Count	Sum	Average	Variance
DPR	4	81.87958	20.469895	9.679859
RET	4	31103.59	7775.8963	35843842

ANOVA

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	120293276	1	120293275	6.712	0.0411	5.987
Within Groups	107531553	6	17921925			
Total	227824829	7				

Source: Annual Reports compiled through MS Excel

The test of ANOVA shows that the calculated value of F is 6.712 which is greater than the tabulated value of 5.987. Therefore, null hypothesis is rejected. Therefore, it can be concluded that there is significant positive impact of Retained Earnings on dividend payout ratio of the selected companies during the study period.

Table 4: Correlation Matrix

	DPR	ROCE	CR	RET
DPR	1			
ROCE	-0.376972	1		
CR	0.512559	-0.87242	1	
RET	0.6287155	0.234297	0.2118092	1

Source: Annual Reports compiled through MS Excel

From the above table it can be concluded that there is moderate degree of positive correlation between DPR and CR and DPR and Retained Earnings. There is low degree of negative correlation between DPR and ROCE. The result also indicates that there is a fairly high degree of negative correlation between ROCE and CR. There is very low correlation between CR and RET and ROCE and RET.

Conclusion

The study concentrates on the impact of independent variables on dependent variable. From the above study it can be concluded that during period of the study profitability as measured by ROCE has negative impact on the dividend policy of the sample companies, which indicates that the more profitable firms pay less dividends, whereas the liquidity and retained earnings have positive impact on the dividend payout, which indicate more liquid firms pay more dividend.

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