Determinants of dividend policy of cement industy of pakistan

Finance

Introduction

Dividend Policy refers to the explicit or implicit decision of the Board of Directors regarding the amount of residual earnings (past or present) that should be distributed to the shareholders of the corporation This decision is considered a financing decision because the profits of the corporation are an important source of financing available to the firm.

Dividend policy is a one of the most debated topics and a core theory of corporatefinancewhich still keeps its prominent place. Many researchers presented various theories and uncountable empirical evidences, but the issue is still unresolved and open for further discussion. It is among top ten unresolved problems in the finance literature and we have not an adequate explanation for the observed dividend behavior of the firms There are several reasons whether firms should pay dividends or not. The " dividend puzzle" why firms pay dividends and stock holders pay attention to dividends and still unresolved.

Many hypotheses have been drawn to shed some light on this puzzle but the problem still exists. Normally a firm faces the problem of allocation of earnings, whether to distribute among shareholders or retaining for reinvestment and promote the firm growth. Retained earnings are a main internal source of financing, but higher retained earning mean fewer dividends and vice versa. The cement sector is a prominent sector of Pakistan and works as an engine of economic growth in the economy. It provides employment to a large number of people (directly & indirectly).

Cement production capacity in Pakistan is 44 million tons annually while local demand is only 24 million tons, leaving a surplus of 20 million tons. Cement manufactured in Pakistan is being exported to Afghanistan and Central Asian States below cost. During FY-11 cement industry exported over 4 million tons to these markets and the industry is optimistic that exports to Afghanistan and Central Asian States shall increase further since these countries are landlocked and Pakistan is the only country which is able to supply cement at competitive rates.

So, it is important to find the factors that determine and affecting the dividend payout policy of this sector.

Literature Review

Over the past 50 years a great attention was given to determine the factors influencing dividend payout policy. A vast literature is available in this regard, however, the puzzle is still unresolved and open for further discussion. “ Why do firms pay dividends? ” further he raises a second question, “ Why do investors pay attention to dividends? ” although, the answers may appear clear, (Black 1998)but Black concludes that they are not.

As we try to explain the fact, the more it seems like a puzzle, with pieces that just do not fit together. Various factors can be considered as the determinants of dividend payout policy and a number of logics for dividend payout policy have been declared in the literature, however, the researchers are not agreed on a single point. In developed economies, the decision whether paying dividends or keep as retained earnings has been taken very carefully by both investors and the management of the firm. (Adaoglu 2000) By paying a sufficient amount of dividend firms can prevent from the agency problem.

The dividend payouts are helpful to keep firms in the market, where monitoring of managers is available at low cost. The managers make financial policy trade-offs to control agency cost in an effective way(Amidu and Abor 2006) A free cash flow is helpful for a firm to share it with stockholders as dividends and pay the debt in order to reduce the possibility of these funds being wasted on unprofitable projects(Pettit 1972) Firms' investment policies have a significant impact on its dividend payout policy; the firms with less investment plans has greater amount to distribute as dividends.

Due to the higher investment opportunities firms deprive from higher dividends to lower. So the investment opportunities has a negative relationship to the dividend payouts(Farinha 2003) Another factor affecting the dividend policy is the ownership of firm; state owned firms follow a smooth dividend pattern as compare tofamilyowned firms. The family owned firms are uneager to pay dividends, whereas the state owned firms are more reluctant to diminish the dividend amount.

The insider ownership also play a significant role in dividend policy(Imran 1997; Okpara 2010) The dividend policy is quite different in emerging markets as compare to developed economies, and seems to be affected by a number of factors(Al-Kuwari 2009) Due to several reasons like taxes pay procedure, stock market volatility and certain asymmetryinformation the dividend payout pattern is different in emerging markets as compare to developed nations.

Another reason is that in emerging markets the firms focus on dividend payout ratios as compare to the level of dividends paid(Al-Kuwari 2009; Terra 2011) Higher the earnings of a firm, greater the size and firms with foreign ownership prefer to distribute a higher and constant amount in dividend payouts according to their earnings and size(Eriotis 2011) The liquidity of the firm leaves a negative impact on the firms dividend payout decision.

The stock market liquidity and dividend are substitutes in the sight of investors, so the firm's dividend policy is associated to the liquidity of its common stock. As a result firms with more liquid common stock, distribute less cash dividend(Amidu 2007) The more profitable firms are willing to distribute a higher amount of dividend payouts. The greater profitability not only positively affects the firms' current dividend but dividend yield also. Whereas, the riskier firms distribute lower dividends and hence lower dividend yields.

The firms which can easily fulfill their short term needs and want to improve their current payouts than last year are more willing to pay dividend(Fama and French 2002)

Objective

- Companies pays dividend smoothly on regular basis
- Dividend payout policy depend on size of firm
- Profitability(Net Profit) of company effect dividend policy
- Growing companies (Growth in sale) pays dividend on regular basis

- Investment opportunity (Retained earnings) effect the dividend policy
- Impact of liquidity (cash flows) on dividend policy
- Impact of leverage (Debt to Equity ratio) on dividend policy

Theoritical Fram Work Data Collection & Proposed Methodology

Investigates the factors determine the dividend payout policy of Pakistani cement companies listed on KSE. The data employed is derived from Balance Sheet Analysis of KSE listed companies published by companies, covered the ten year period 2001 to 2010 of 26 companies. (companies depends upon availability of data) The nature of the data allows us the use regression analysis to build relationship between dividend payout policy and factors which influence dividend policy

Hypostetis

- Cement companies pays smooth or stable in paying dividend
- Positive relationship of dividend payout and size(Total Assets) of company
- Positive relationship between Profitability(Net Profit) of company & dividend payout
- Positive relationship between growth(Growth in sale) and dividend payout
- There is positive relationship between liquidity (Quick Ratio) & dividend payout.
- There is negative relationship of leverage (Debt to Equity ratio) & dividend payments

- There is negative relationship between Investment opportunity (retained earnings/total asset) and dividend payout

Limitation

Due to unavailability of all companies data listed on KSE to construct a balance panel and for selected time period, the study used data for twenty companies which represent more than 80 % of total cement industry. ? This study includes both types of firms (e. g. dividend paying and non paying firms). ? There are many determinants of dividend policy but only six determinates have been taken.

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