Dividend policy

An Empirical Analysis of Dividend Payout Policy Indian Corporate ABSTRACT

In the present paper an attempt has been made to assess the dividend payout policies of Indian Companies. For the purpose of study BSE Sensex -30 companies have been selected as sample for the study. To study impact of profitability, liquidity and size of business on dividend payout regression analysis were carried out. An attempt has also been made to calculate estimated dividend payout based on regression results.

The result of the study indicates dividend policies of Indian companies were highly influenced by profitability and liquidity of the firm. The major companies follow conservative dividend policy. Keywords: Dividend Payout Policy; Indian Capital market. An Empirical Analysis of Dividend Payout Policy Indian Corporate Introduction: Dividend policy is one of the most controversial subjects in finance. Dividend policy is one of the most important financial policies, not only from the viewpoint of the company, but also from that of the shareholders, the customers, the workers, regulatory bodies and the Government.

Finance scholars have engaged in extensive theorizing to explain why companies should pay or not pay dividends. Lintner, 1956; Brittain, 1964; Modigliani and Miller, 1961; Pettit, 1972; Black and Scholes 1973, Michael, Thaler and Womack, 1995; Dhillon and Johnson, 1994; Amibud and Murgia, 1997; Charitou and Vafeas, 1998, studies has determined on the developed countries, the decision between paying dividend and retaining earnings has been taken seriously by both investors and management, and has been the subject of considerable research by economists in the last four decades.

Financial economists have therefore, acknowledged the after tax earnings of any business firm as an important internal source of investible funds and also a basis for dividend payments to shareholders. The decision to retain, reinvest or pay out after tax earnings in form of cash or stock dividend is important for the realization of corporate goal which is the maximization of the value of the firm (Soyode (1975), Oyejide (1976), Ariyo (1983). In this study we analyse the impact of profitability, liquidity and size of the business operations of selected firms on its dividend policy of corporate firms in India.

Initially, we examine the main determinants of dividend decisions of corporate firms in India using pooled cross sectional data and address shortcomings of prior studies by presenting a more comprehensive model of dividend policy. Literature Review The most primitive attempt to explain dividend behavior of companies has been credited to John Lintner (1956) who conducted his study on American Companies in the middle of 1950s. Since then there has been an ongoing debate on dividend policy in the developed markets resulting in mixed, controversial and inclusive results.

Miller and Modigliani (1961) view dividend payment as irrelevant. According to them, the investor is indifferent between dividend payment and capital gains. Black (1976) poses the question again, " Why do corporations pay dividends? " In addition, he poses a second question, " Why do investors pay attention to dividends? " Although, the answers to these questions may appear obvious, he concludes that they are not. The harder we try to explain the phenomenon, the more it seems like a puzzle, with pieces that just do not fit together. After over two decades since Black's paper, the dividend puzzle persists.

Dakshinamurthy and Narasimha Rao (1978) has conducted empirical research and he has tested Speed of Adjustment (Dividend) model in Indian Chemical Industry for the period of 1960-1973 and he finds that the Cash Flow Model explains better the corporate dividend behaviour in the Indian Chemical Industry as against the basic Linter’s model. There are other factors influencing a firm's dividend policy. For example, some studies suggest that dividend policy plays an important role in determining firm capital structure and agency costs.

Since Jenson and Meckling (1976), many studies have provided arguments that link agency costs with the other financial activities of a firm. Gupta and Sharma (1981) have made an attempt to study the dividend behaviour of 112 tea companies of India and they concluded that Linter’s model is applicable to the tea industry. Easterbrook (1984) says that firms pay out dividends in order to reduce agency costs. Dividend payout keeps firms in the capital market, where monitoring of managers is available at lower cost.