

A Study on Factors Determining Dividend Policy in Banking Industry

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ABSTRACT

The increasing globalization of financial markets has heightened interest in emerging markets. However, much of the research in accounting and finance has focused on developed markets. The company may distribute profits in the form of either regular cash dividends or it may distribute profits in the form of shares dividends to shareholders. Trend analysis for the Banking industry over the last 12 years with all the above mentioned variables has significant relationship with the trend estimation except in respect of a few variables like Net worth, Return On Capital Employed and Dividend Payout Ratio. These variables do not have significant relationship with the projected values. The outcome of the research will help the finance managers in dividend decisions. Companies that want to achieve a target payout ratio can use the models developed in this research to manage the important determinants that have been identified in the result and achieve the desired result.

Keywords: Dividend determinants, Payout, Net worth.

INTRODUCTION:

Efficient functioning financial market plays a crucial role in facilitating the intermediation process between savers and borrowers, thereby helping translate savings into investments. The more efficient this process, the less is the cost of investing, and subsequently, the higher rate of investment/saving. The development of stock exchanges is crucial to achieve economic growth for development economics. The increasing globalization of financial markets has heightened interest in emerging markets. However, much of the research in accounting and finance has focused on developed markets.

The topic of dividend policy remains one of the most controversial issues in corporate finance. Dividend may be defined as the distribution of created value to the shareholders. It may be in the form 'Cash Dividend' or through distribution of stocks of the company which is known as 'Stock Dividend'. Dividend policy may be defined as the trade-off between the magnitude of retained earnings and distributed cash or securities. Dividend decision should not merely be taken to be a decision of appropriation of profits to the shareholders. There are several complex issues in it. As such the factors influencing the dividend are when, why, how the companies pay dividends and weather dividends creating or destroy value.

STATEMENT OF THE PROBLEM:

Previous studies have dealt with the dividends policy concept but most of them have dealt with one type of dividend (the cash dividend) (Miller and Modigliani, 1961, Horne and McDonald, 1971, Partington, 1985, Holder et al., 1998) and do not make a clear distinction between the dividends policy concept and dividend types. The dividends policy concept consists of three types of dividends (cash, share and repurchase) (Moyer et al., 1995). A number of studies deals with either share dividend (Barker, 1958, Grinblatt et al., 1984, Bali, 2003) or share repurchase (Ikenberry et al., 1995). The company may distribute profits in the form of either regular cash dividends or it may distribute profits in the form of shares dividends to shareholders. However, both forms may be distributed at the same time. On the other hand, shareholders can also obtain profits (as a capital gains)

when the company repurchases its shares, and considers the regular cash dividend as something quite common (Broyles, 2003).

OBJECTIVES OF THE STUDY:

- To identify the trends and patterns of major dividend determinants in banking industry
- To test the validity of dividend determinant variables for banking industry

LITERATURE REVIEW:

Merton H. Miller¹, “Both views are correct in their own ways. The academic is thinking of the expected dividend; the practitioner of the unexpected.” Miller conveys us that the practitioners’ view that dividends matter very much and the academic view that dividends do not matter. B. Graham and D.L. Dodd², According to Graham and Dodd, the stock market places considerably more weight on dividends than on retained earnings.

James Walter³, According to Walter, 4 dividend payout ratio do affect the share prices - (1) when the rate of return on investments exceeds the cost of capital, the price per share increases as the dividend payout ratio decreases, (2) when the rate of return on investment is equal to the cost of capital, the price per share does not changes in dividend payout ratio, (3) when the rate of return on investments is less than the cost of capital, the price per share increases as the dividend payout ratio increases.

M. H. Miller and F. Modigliani⁴, Miller and Modigliani have advanced the view that the value of firm depends solely on its earnings power and is not influenced by the manner in which its earnings are split between dividends and retained earnings. The view is referred to as the ‘dividend irrelevance theorem’.

Myron J. Gordon⁵, Gordon leads to conclusions, which are similar to that of the Walter’s. Moreover, Gordon’s model contends that dividend policy of the firm is relevant and the investors put a positive premium on current incomes/dividends. He argues that dividend policy affects the value of shares even in a situation in which the return on investment of a firm is equal to the required rate ($r = ke$).

RESEARCH DESIGN:

Research design is the blueprint of research work. Basically, since the nature of the study is Empirical and analytical. Several evidences from the earlier researches, company records are taken into consideration and multivariate analysis are used to arrive at the appropriate determinants that have more impact on dividend decisions. This research design is also Analytical because several financial data like sales turnover, EPS, DPS, PE, R&D expenses, EBIT, PAT....etc. are taken into consideration for our analysis.

‘Capitoline Plus’ and ‘Capitalstocks.ole’, manufactured, maintained and marketed by Capital Market, Mumbai, or ‘Prowess’, manufactured, maintained and marketed by Centre for Monitoring Indian Economy (CMIE), Mumbai are notable amongst these. These two sources form the primary source of data required for the study.

The researcher has selected the following influencing variables to determine the dividend policy of select manufacturing and service sectors.

- DPS (Rs) Dividend Per Share
- EPS(Rs) Earnings Per Share
- RONW (%) Return on Net Worth
- ROCE (%) Return on Capital Employed
- AGE(Yrs) Age of the Firm
- SIZE(Rs) Size of the Firm
- GROW(Rs) Growth in Sales
- TANG(Rs) Tangibility of the Firm
- DER(Times) Debt Equity Ratio
- OPR (%) Operating Profit Ratio
- NPR (%) Net Profit Ratio
- NPNW (%) Net Profit to Net Worth
- DPR(Times) Dividend Payout Ratio
- OCR (%) Operating Cost Ratio
- PAT(Rs) Profit After Tax
- INT(Rs) Interest Paid
- DTAX(Rs) Dividend Tax
- CTAX(Rs) Corporate Tax

DATA ANALYSIS AND DISCUSSION:

The determinants of dividend in banking industry were tested by analyzing different variables that have an impact on the dividend policy.

Dividend Determinants of Banking Industry

Ratios	Range	Minimum	Maximum	Mean	SD	Variance	Skewness	Kurtosis
DPS(Rs)	11.86	2.04	13.90	7.50	4.29	18.48	.39	-1.39
EPS(Rs)	69.66	5.68	75.35	35.76	22.86	522.61	.53	-.952
RONW(%)	8.19	16.71	24.90	19.35	2.53	6.44	1.29	.939
ROCE(%)	.39	.19	.58	.365	.148	.022	.531	-1.577
AGE(Yrs)	11.00	63.80	74.80	69.30	3.60	13.00	.000	-1.200
SIZE(Rs)	.88	2.73	3.61	3.278	.2792	.078	-.473	-.505
GROW(Rs)	.97	4.61	5.58	5.117	.319	.102	-.056	-1.293
TANG(Rs)	.01	.01	.02	.011	.003	.000	.404	-1.337
DER(Time)	27.86	50.37	78.23	67.62	8.74	76.44	-.610	-.635
OPR (%)	3415.1	-1959.8	1455.39	561.72	865.02	748260.51	-2.47	7.67
NPR (%)	1338.3	-391.69	946.94	562.45	339.06	114962.55	-2.160	6.259
NPNW(%)	15.02	10.11	25.14	16.208	5.657	32.006	.609	-1.546
DPR(Times)	.29	.18	.46	.308	.090	.008	.652	-.607
OCR(%)	80.41	40.83	121.23	64.591	26.78	717.605	1.258	.253
PAT (Rs)	4336.4	377.7	4714.24	2070.1	1405.9	1976602.7	.672	-.777
INT(Rs)	1025.1	97.59	1122.75	433.23	338.86	114827.23	.715	-.395
DTAX (Rs)	123.43	.45	123.88	54.90	41.02	1683.01	.388	-1.159
CTAX(Rs)	1844.8	213.52	2058.34	971.24	686.12	470771.77	.523	-1.549

Dividend per share ranged from Rs. 2.04 to Rs.13.90 with a mean of Rs. 7.50. The standard deviation of the industry was 4.29 and the variance 18.48. Further, the skewness was identified as positive.

Earnings per share of banking industry ranged from Rs 5.68 to Rs 75.35 with a mean of Rs 35.76. The standard deviation was 22.86 and the variance 522.61. Further, it is noted that the skewness is positive. Return on Net worth of Banking industry ranged from 16.71% to 24.90% with an average of 19.35%. The standard deviation of the industry was 2.53 and the variance 6.44. Further, it is noted that the skewness is positive.

Return on Capital employed of Banking industry ranged from 0.19% to 0.58% with an average of 0.365%. The standard deviation was 0.148 and the variance 0.022. Further, it is noted that the skewness is positive.

Age of firms in the Banking industry ranged from 63.80 years to 74.80 years with an average of 69.30 years. The standard deviation of the industry was 3.60 and the variance 13.00. The skewness was observed to be positive.

Size of the firms under study in the Banking industry ranged from 2.73 to 3.61 with an average of 3.278. The standard deviation of size was 0.2792 and the variance 0.078. Further, it is noted that the skewness was positive.

Growth of the firms in the Banking industry ranged from 4.61 to 5.58 with mean of 5.117. The standard deviation of the industry was .319 and the variance 0.102. Further, the skewness was observed to be positive.

Tangibility of the firms in the Banking industry ranged from .01 to .02 with an average of 0.011. The standard deviation of the industry was .003 and the variance .000. Further, it is noted that the skewness was positive.

Debt equity ratio of the firms under study in the Banking industry ranged from 50.37 to 78.23 with an average of 67.62. The standard deviation of the industry was 8.74 and the variance 76.44. Further, the skewness was observed to be negative.

Operating profit ratio of the firms under study in banking industry ranged from -1959.8% to 1455.39% with an average of 561.72%. The standard deviation was 865.02 and the variance 748260.51. Further, it is noted that the skewness was negative. Net profit ratio of the firms under study in banking industry ranged from -391.69% to 946.94% with an average of 562.45%. The standard deviation was 339.06 and the variance 114962.55. Further, skewness is observed to be negative.

Net profit to Net worth ratio ranged from 10.11% to 25.14% with an average of 16.208. The standard deviation of the industry was 5.657 and the variance 32.006. Further, it is noted that the skewness was positive.

Dividend payout ratio of the firms under study ranged from 0.18 to 0.46 with an average of 0.308. The standard deviation was 0.090 and the variance 0.008. Further, it is noted that the skewness was positive.

Operating cost ratio of banking industry ranged from 40.83% to 121.23 with an average of 64.591%. The standard deviation of the industry was 26.78 and the variance 717.605. Further, the skewness was positive.

Profit after tax of the firms under study in banking industry ranged from 377.7 to 4714.24 with an average of 2070.1. The standard deviation of the industry was 1405.9 and the variance showed 1976602.7. Further, it is noted that the skewness was positive.

Interest paid during the current year ranged from 97.59 to 1122.75 with an average of 433.23. The standard deviation was 338.86 and the variance showed 114827.23. Further, it is noted that the skewness was positive.

Dividend tax paid during the current year ranged from 0.45 to 123.88 with an average of 54.90. The standard deviation of the industry was 41.02 and the variance 1683.01. Further the skewness was observed to be positive.

Corporate tax paid during the current year ranged from 213.52 to 2058.34 with an average of 971.24. The standard deviation was 686.12 and the variance 470771.77. Further, it is noted that the skewness was positive.

FINDINGS OF THE STUDY:

- To analyse the trend of banking industry the researcher has selected six variables viz., Net sales, Net Profit, Net worth, Reserves and Surplus, Return on Capital Employed, and Dividend payout ratio. Trend analysis for the Banking industry over the last 12 years with all the above mentioned variables has significant relationship with the trend estimation except in respect of a few variables like Net worth, Return On Capital Employed and Dividend Payout Ratio. These variables do not have significant relationship with the projected values.
- The co-efficient of determination R^2 value shows that these variables put together explained the variations of DPS to the extent of 99% with respect to Banking industry.
- The results revealed from the Structural Equation Models applied to the banking industry discovered that the following **mediating variables** like, Earnings Per Share, Debt-Equity Ratio, Sales Growth, Net Profit To Net worth Ratio, and Operating Profit Ratio as the vital determinants for dividend decisions.

SUGGESTIONS OF THE STUDY:

- An investor in shares would like to estimate the expected dividend per share before deciding to invest in a share. The multiple regression models developed in the research will enable an investor to estimate the dividend per share and make an appropriate decision.
- The outcome of the research will help the finance managers in dividend decisions. Companies that want to achieve a target payout ratio can use the models developed in this research to manage the important determinants that have been identified in the result and achieve the desired result.

CONCLUSION:

The extent of relationship between the dependent and independent variables were identified and rediscovered by applying multiple regression analysis- a major multivariate tool. In the meanwhile, twelve hypotheses were tested to arrive at the tentative assumption in the formulation of the conceptual framework. Trend analysis for the Banking industry over the last 12 years with all the above mentioned variables has significant relationship with the trend estimation except in respect of a few variables like Net worth, Return On Capital Employed and Dividend Payout Ratio. These variables do not have significant relationship with the projected values.

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