



Dividend policy and firm performance: A study of listed firms on national stock exchange

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Abstract

This study basically investigates the relationship between the financial performance and dividend payout among listed firms in NSE. The annual reports for the period 2012-2017 were utilized as the main source of data collection for the 20 sampled firms. The correlation and regression analysis method was employed as a statistical technique for analyzing the data collected. The results of the study provide evidence that the dividend policy measures are not significantly correlated with earnings per share, price earnings ratio and dividend payout as dividend policy, return on equity and return on assets as firm performance measures.

Keywords: firm performance, returns on equity, return on assets, dividend policy, dividend payout, earnings per share, price earnings ratio

Introduction

In Indian economy, privatization, liberalization, and globalization together with rapid strides of information technology, have acquired serious rivalry in all fields of business. This has made Indian firms confused, apprehensive, dazed, and anxious. To survive the competition, firms need to increase their value. Finance managers have to settle on basic business and budgetary choices that will meet their goal of expanding shareholders' wealth and firm's value. Hence, profit assumes an imperative position. Profit being the main economic drive for firms, can be attributed to two main destinations: it can be held in the firm to be used for its future growth, or can be distributed to shareholders. This distribution can be done in the form of dividends or through repurchasing circulating shares. Thus, firms need to create a dividend policy in order to determine whether or not to pay dividends and how.

Dividend Policy has attracted great interest over the past decade. The widely held view that dividend policy has an impact on the firm performance has led to increasing global attention. Investment activity is an activity faced with various risks and uncertainty condition which is mostly difficult to predict by investors. There is much information, not only achieved from the performance of the company, but also other relevant information, such as economic condition and the political situation in a country which are needed by investors to reduce the risks rate and any uncertainty that possibly appears. Information which is achieved from a company is commonly based on the company's performance, reflected from the financial report. Based on the report, investors could understand the company's performance and its capability to raise profits.

Dividend represents a distribution of earnings to the shareholders of a company that are usually declared at Annual General Meetings and paid to shareholders of record. Generally, the main purpose of investors when investing their assets is to search for income or the rate of return. Dividend is

one of the sources of income in such circumstances; each company is forced to operate with high efficiency in order to maintain the quality and capability of competing to raise a net income with the best result. Therefore, a company determines dividends policy to look forward the profit gained that will be allocated into two components: dividends and retained earnings.

If the market believes that the change is just a rearrangement of dividends through time, then the impact will be small. The reaction to the information contained in dividend changes is called the information content effect. This is particularly critical in the case of firm performance, one of the most relevant constructs in the field. Firm performance is a relevant construct in strategic management research and frequently used as a dependent variable. The concept of firm performance needs to be distinguished from the broader construct of organizational effectiveness.

Review of Literature

Rozeff (1982) is one of the first to propose a role for dividends in reducing agency-related losses, substituting for other bonding and auditing costs incurred by the firm. He finds that ownership concentration is negatively related to payout, which is consistent with the argument that greater insider concentration results in better monitoring thus reducing the need to pay dividends.

Olimalade & Adewumi (1987)^[27], it is seen as cash flows that accrue to equity investors. That is a form of return to shareholders on their investment, and the aim is to increase their confidence in the future of the company in which they have invested. Dividends are compensatory distribution to equity shareholders for both time and investment risks undertaken. Such distributions are usually net of tax and obligatory payments under debt capital and they represent a depletion of cash assets of the company.

Kale and Noe (1990) in a related study opined that a firm's dividend basically indicates the stability of the firm's future

cash flows. A review of related prior studies shows further that the main factors that influence a firm’s dividend decisions include cash flow considerations, investment returns, after tax earnings, liquidity, future earnings, past dividend practices, inflation, interest, legal requirements and the future growth projection. Dividends are compensatory distribution to equity shareholders for both time and investment risks undertaken. Such distributions are usually net of tax.

Alii, Khan, and Ramirez, (1993) ^[2] Examined that the relationship between expected price-to-book ratio, dividend per share, dividend payout ratio, systematic and unsystematic risks. The sample includes the non-financial firms in the DJIA, the period 1997-2006. The result show, the variations in price-to-book ratios, systematic and unsystematic risks are not due to dividends per share. Then, the relationships between expected price-to-book ratio and dividend payout ratios are intrinsically nonlinear. Finally, the expected dividend payout ratios can be used efficiently for signaling purposes as well as a proxy for measuring the agency problem.

Arnott & Asness (2003) pointed the positive relationship between dividend payout and growth in future earnings is that managers are reluctant to cut dividends. A high payout ratio indicates management’s confidence in the stability and growth of future earnings and a low payout ratio suggests that management is not confident of the stability of earnings or sustainability of earnings growth. Managers therefore pay low dividends to avoid dividend cuts when earnings drop.

Luis Correia da Silva, Marc Goergen, and Luc Renneboog (2004) pointed that Dividend policy and other corporate governance mechanisms are interacted. First, the conventional wisdom, which states that German dividends are lower than UK or US dividends, is not necessarily upheld as on a published profits basis; the exact converse is true. Second, dividends in the UK and US are relatively smooth as they are characterized by frequent, but small changes, whereas dividends in Germany show less frequent, but larger changes. Third, link between corporate control and dividend payouts. Fourth, evidence existence of a loss is an additional determinant of dividend changes. Finally, results have important implications for the current debate on the best corporate governance system.

Amidu (2007) revealed that dividend policy affects firm performance as measured by its profitability. The results showed a positive and significant relationship between return on assets, return on equity, growth in sales and dividend policy.

Oskar, Ivan, Oleksandr, Diw (2007) Investigated that two perspectives. First, explore the determinants of the dividend policy in Poland. Second, test whether corporate governance practices determine the dividend policy in the non-financial companies listed on Warsaw Stock Exchange. The findings are based on the period 1998-2004. Quantitative measures on the quality of the corporate governance for 110 non-financial listed companies. These results suggest that dividends may signal the severity of conflicts between controlling owners and minority shareholders. Those dividends in Poland have less of a signaling role than in the developed capital markets.

Samuel Kwaku Agyei, Edward Marfo-Yiadom (2011) examined the relationship between dividend policy and performance of banks in Ghana. The study used panel data

constructed from the financial statements of 16 commercial banks in Ghana for a period of 5 years, from 1999-2003. These financial statements were obtained from the Banking Supervision department of Bank of Ghana. STATA was used for the data analysis. Indicate that banks pay dividend increase their performance. Generally, the result is shown that dividend policy has an effect on firm value.

Uwalomwa, Jimoh and Anijesushola (2012) investigated the relationship between the financial performance and dividend payout among listed firms’ in Nigeria. Variables are ownership structure, size of firms and the dividend payouts. The period 2006-2010 was utilized as the main source of data collection for the 50 sampled firms. Find out that there is a significant positive association between the performances of firms and the dividend payout of the sampled firms in Nigeria. Additionally revealed that ownership structure and firm’s size has a significant impact of the dividend payout of firms too.

Research Methodology

Objectives of the Study

The following objectives are taken for the study.

1. To determine the relationship between firm performance and dividend policy for manufacturing companies listed on NSE.
2. To determine the impact of firm performance on dividend policy of manufacturing companies listed on NSE.

Development of Hypotheses

The hypotheses to be tested in this study are stated below in their null form:

H1: There is no significant relationship between the financial performance and dividend payout of listed firms in Nigeria.

H2: There is no significant relationship between firm size and the dividend payout of listed firms in Nigeria.

Data Collection

Data on dividend policy and firm performances were collected from secondary sources as Annual reports of the 20 manufacturing companies, national stock exchange publications and URL of the national stock exchange for the period of 2012 to 2017.

Mode of Analysis

The following Dividend Payout Ratios and firm performance ratios are taken into accounts which are given below.

Table 1

Dividend payout ratios	
Earnings Per Share	Net Income / Total Number of Capital
Price to Earnings Ratio	Market Price per Share / Earnings per Share
Dividend Payout Ratio	Total Dividends / Total Net Earnings x 100%
Firm performance	
Return on Asset	Return / Total Asset X 100
Return on Equity	Profit after interest & tax / Equity capital X 100

Table 2: Calculations of Dividend Policy Ratios and Firm Performance Ratios.

Multiple regression analysis was performed to investigate the

impact of Dividend Policy Ratios on Firm Performance which the model used for the study is given below. Firm Performance = f (ROA; and ROE) It is important to note that the firm performance depend upon Earnings Per Share (EPS), Price to Earnings Ratio(P/E), Dividend Payout Ratio (DPOR). Since two Firm Performance Ratios Return on Asset (ROA) and Return on Equity (ROE). The following two models are formulated to measure the impact of Dividend Policy Ratios on firm performance is as follows.

$$ROA = \tilde{\alpha} + \beta_1 EPS + \beta_2 P/E + \beta_3 DPOR + \epsilon \dots \dots \dots (1)$$

$$ROE = \tilde{\alpha} + \beta_1 EPS + \beta_2 P/E + \beta_3 DPOR + \epsilon \dots \dots \dots (2)$$

Where, $\tilde{\alpha}$, is constant, $\beta_1, \beta_2, \beta_3$ & β_4 are coefficients of variables, ϵ , is error term.

Analysis and Interpretation

Correlation analysis was carried out to find out the relationship between determinants of dividend policy and the measures of firm performance.

Table 2: Correlations matrix

		dividend payout ratio	Earning per share	price Earning ratio	return on assets	return on equity
Dividend payout ratio	Pearson Correlation	1	-.434	.127	-.474	.342
	Sig. (2-tailed)		.465	.839	.420	.574
Earnings per share	Pearson Correlation		1	.082	.002	.387
	Sig. (2-tailed)			.895	.998	.520
Price earnings ratio	Pearson Correlation			1	-.319	.555
	Sig. (2-tailed)				.601	.332
Return on assets	Pearson Correlation				1	.087
	Sig. (2-tailed)					.890
Return on equity	Pearson Correlation					1
	Sig. (2-tailed)					

According to the correlation in table 1 shows that the firm performance such as return on equity, return on assets, are not significantly correlated with dividend pay out ratio, earning per share and price earnings ratio as the measures of dividend

decisions it means companies are still not properly practiced dividend policy guidelines. The regression analysis was performed to recognize the impact of firm performance on dividend policy.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1. ROA	.652 ^a	.424	-1.302	7.23877
2. ROE	.809 ^b	.654	-.383	2.3814

a. Predictors: (Constant), price earnings ratio, earning per share, dividend payout ratio

The specification of the three variables is price earnings ratio, earning per share and dividend payout in the model revealed the ability to predict dividend policy and firm performance. R square value of .424 and .654 which are in the model denote that 42.4% and 65.4 % of the observed variability in firm performance and dividend policy can be explained by the differences in both the independent variables namely earning per share, price earnings ratio and dividend payout ratio.

Remaining 57.6% and 34.6 % of the variance in firm performance and dividend policy is related to other variable which is not explained, because they are not depicted in the model. R square values of 42.4% and 65.4% indicate that there may be number of variables which can have an impact on firm performance and dividend policy that needed to be studied.

Table 4: Coefficients for Predictors of Dividend Policy

Model		Unstandardized Coefficients				Standardized Coefficients		T		Sig.	
		B		Std. Error		Beta		ROA	ROE	ROA	ROE
1	(Constant)	53.403	-9.578	38.054	12.519			1.403	-.765	.394	.584
	dividend payout ratio	-.499	.189	.706	.232	-.605	.540	-.707	.814	.608	.565
	Earnings per share	-.256	.256	.879	.289	-.248	.585	-.291	.886	.819	.538
	price earnings ratio	-1.455	.994	4.135	1.360	-.272	.438	-.352	.731	.785	.598
a. Dependent Variable: return on assets,											
b. Dependent Variable: return on equity											

The results of the regression analysis in table show that the coefficient for all three variables such as earnings per share,

dividend payout ratio and price earnings ratio is not significant. Further t values for three variables of dividend

policy are insignificant at 5% level. It means that these variables are not contributing to the firm performance of return on equity and return on assets.

Conclusion

The major objective of this research is to investigate the influence of dividend policy on firm's performance and shareholders' wealth. The total 20 companies from NSE index were sampled for the time period 2012–2017 by employing common constant effect model. The correlation and regression analysis method was employed as a statistical technique for analyzing the data collected. The results of the study provide evidence that the dividend policy measures are not significantly correlated with earnings per share, price earnings ratio and dividend payout as dividend policy, return on equity and return on assets as firm performance measures.

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