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Company Characteristics and Dividend Payments in Banking Industry

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Abstract

In case of Banking Industry interest payment and lagged dividend were the most important determinants of dividend payment as the regression coefficients of these variables have the highest values during most of the years and were found statistically significant for six and seven years respectively. The regression coefficients of interest payment have negative values during most of the years under study, which suggests that there was a negative relationship between dividend payment This analysis suggests that there was a positive relationship between lagged dividend and dividend paid in the current year, which supports the hypothesis. Similarly the regression coefficients of operating profit have positive values during most of the years under study and were found statistically significant for nine years out of sixteen years of the study. This suggests that there was a positive relationship between operating profit and dividend payment, which supports the hypothesis. Likewise, the regression coefficients of company size have positive values during most of the years of study and were found statistically significant for four years out of the sixteen years of study which suggests that there was a positive relationship between company size and dividend paid which yet again supports the hypothesis It means companies larger in size tend to pay more dividend than the smaller ones The regression coefficients of debt equity ratio have negative values during most of the years under study period which suggests that there was a negative relationship between debt equity ratio and dividend paid which support the hypothesis. It means levered firms tend to pay fewer dividends than the unlevered ones. The regression coefficients of growth rate of total assets have negative values during most of the years under study and were also found statistically significant during four years. This suggests that there was a negative relationship between growth rate of total assets and dividend payment, which supports the hypothesis. It means companies having high growth opportunities tend to prefer retained earnings as source of found for investment. The regression coefficients of interest paid have negative values during most of the years and were found statistically significant for ten years out of sixteen years of study. This suggests that there was a negative relationship between interest payment and dividend paid which support the hypothesis. The regression coefficients of current ratio has positive values during most of the years and were found statistically significant for two years out of the sixteen years of the study. This suggests that there was a positive relationship between current ratio and dividend paid which support the hypothesis.

Keywords: Corporate Sector, Divided Policy, Company, Gurgaon, Haryana.

Introduction:

A reserve may be defined as the sum set aside out of divisible profits and retained earnings in order to provide for unexpected or unknown future losses, or to equalize dividends or to strengthen the financial position of the company.[1] In other words, it is a surplus created out of distributable profits representing the amount by which the assets of a concern exceed the sum of its paid up capital and liabilities properly valued on the basis of going concern.[2] The various kinds of reserves are as follows: surplus from reduction in par value of stock, surplus from revaluation of assets, surplus from sale of assets, accumulation of profits and surplus from issue of share at premium. These surpluses account for the equity of the owners over and above the capital stock[3]. Parts of these surpluses are earmarked for specific purposes. Conservative management often dictates that at least some of the surplus of a company should be ear-marked as not available for dividends. It may be because of: (a) contractual obligation which the company is preparing to meet; (b) the source of surplus makes it not available for dividends; (c) it is desirable to provide a buffer against future losses and declines in the assets values; and (d) to

provide for future expansion. A wise policy on the part of the management is not to distribute all the earnings of the company but to retain a part of it before declaring dividend. These retained earnings are in the form of reserves. [4,5]

Depreciation policy

Well-managed companies in India make regular provision of income to restore impairment in the value of their physical assets. [6] This impairment in serviceability of an asset is known as depreciation. [7] It is an allowance made for loss or diminution in the value of an asset generally on account of wear or tear. Depreciation policy has a bearing on the measurement of a firm's income; it practically affects all the important corporate matters. Depreciation is a non-cash item and this 'tax free loan' upto the time of replacement of assets, remains at the disposal of the management to be used in any manner as they deem appropriate. [8] Thus, the amount of external funds needed by the firm for growth also depends upon the depreciation policy of the firm. Depreciation policy affects investment decisions in two ways. Firstly, a rupee reported as depreciation, as compared to a rupee reported as taxable business income is worth several rupees because it avoids double erosion. [9] As a capital recovery, it is tax free. Because it is a recovery of investment reduces the risk of such investment and creates greater assurance. Depreciation policy is a matter of considerable importance because of its relationship to replacement policy. [10] Depreciation provisions increase the firm's working capital as the structural position of the assets is changed converting fixed assets (loss of depreciation) to current assets. These depreciation recoveries, in the short run are at the disposal of the financial manager to be used as he deems most appropriate. But, in the long- run they meant to replace the assets. [11] Secondly, the primary purpose of a business is to make profits for its owners and to distribute it in the forms of dividends. A business which does not earn profit to compensate the owners for the risks incurred is to be an economic failure. [12] Company profits are reward that accrues to the shareholders for their contribution of risk capital.[13] The reward distributed among the shareholders in the form of dividend risk that should include a normal rate of interest plus a return for the risk assumed.[14] In economic principle, dividend is the right of shareholders to participate in the profits and surplus of the company in whose capital they have equity. Dividend also is an aspect of corporation policy towards the management of profits. It is at the discretion of the Board of Directors that the disposal of profits is decided upon. They may distribute all the current profits or past profits or set apart a part of profits for reserves and distribute the balance in the form of dividends. Broadly speaking, the regularity and adequacy of earnings, the attitude of shareholders, the availability of cash balances and future requirements of the capital for the company are the basic principles governing the dividend policy.[14,15,16] The basic aim of every company is establishing a stable dividend policy consistent with the interest of the company and shareholders. Stable and progressive dividend policy keeps up the moral of the shareholders by duly compensating them for the capital they have risked. [17] It would ensure their unlimited co-operation in implementing other policies of the company. Regularity of dividend payment out of the normal earnings maintains and enhances the market value of the securities[18,19.]

Materials and methods:

To examine the various hypotheses, the study has used secondary data. The sample was drawn from the companies listed of Gurgaon, Haryana (India). Multiple Regression Model In order to establish the relationship between company characteristic and Dividend policy multiple regression model has been used wherein dividend payment has been used as dependent variable and company characteristics as operating profit (EBIT), debt equity ratio, company size (measured by market capitalization), growth opportunity (in terms of total assets), interest paid, current ratio and lagged dividend have been considered as independent variables. Mathematically,

$DIV_{it} = \beta_{0+} \beta_1 EBIT_{it} + \beta_2 DE_{it+} \beta_3 IP_{it+} \beta_4 CS_{it} + \beta_5 GTA_{it+} \beta_6 CR_{it} + \beta_7 LD_{it} + ë$

Where;

EBIT= Operating profit, DE= Debt Equity Ratio, IP= Interest Paid, CS= Company Size, GTA= Growth Rate in Total Assets, CR= Current Ratio (Short term Liquidity) and LD= Legged Dividend .

Results:

Table 1 displayed that in case of Banking Industry interest payment and lagged dividend were the most important determinants of dividend payment as the regression coefficients of these variables have the highest values during most of the years and were found statistically significant for six and seven years respectively. The regression coefficients of interest payment have negative values during most of the years under study, which suggests that there was a negative relationship between dividend payment and interest paid. It means companies having more interest burden, tends to pay less dividend. Similarly in case of lagged dividend, the regression coefficients as positive values during most of the years under study, which suggests that there was a positive relationship between lagged dividend and current dividend payment, which supports the hypothesis. Likewise, in case of operating profit and company size the regression coefficients of operating profit have positive values during most of the years and were found statistically significant for one year out of total years under study (Table 1).

The analysis suggests that there was a positive relationship between current dividends paid and lagged dividend, which supports the hypothesis. The regression coefficients of company size have positive signs during most of the years, which suggests that there is a positive relationship between company size and dividend payment, which again supports the hypothesis. It means companies larger in size pay more dividend than the smaller ones. The regression coefficients of current ratio show a negative value during most of the years, which suggests that there was a negative relationship between dividend paid and short term liquidity which was contrary to the hypothesis. The regression coefficients of debt equity ratio have negative values during most of the years and were found statistically significant for four years out of sixteen years of study. This suggests that there is a negative relationship between dividend paid and debt equity ratio, which supports the hypothesis. It means that levered firms tend to pay fewer dividends then the unlevered ones. The regression coefficients of growth rate in total assets have negative values during most of the years of study, which suggests that there was a negative relationship between growth rate of assets and dividend payment, which again supports the hypothesis. It means that companies having more internal investment opportunity tend to pay fewer dividends and favour the retained earnings as a source of funds for investing purpose (Table 1).

The coefficients of determinant r^2 which range between 0.39 to 0.99 indicate that the independent variables have been causing more than seventy per cent of the variation in the dividend paid by the companies belonging to Banking Industry. F values also indicate that independent variables are the important determinants of current year's dividend paid. The Durbin Watson test which has been applied to examine the existence of autocorrelation in the cross sectional data series, reveals the absence of autocorrelation in each year of the study as its values are near 2. Hence, the results of the model give reliable estimates (Table 1).

All this tends to confirm that interest payment and lagged dividend were the most important determinants followed by operating profit, company size, current ratio, debt equity ratio and growth rate in total assets in the Banking Industry (Table 1).

(Table 1): Company characteristics and Dividend Payments in Banking Industry

	Regression Coefficients							**Model summary**			
YEAR	**EBIT**	**DE**	**IP**	**CS**	**GTA**	**CR**	**LD**	**R^2**	**DW @**	**F**	**SIG**

2008	0.54 (2.47)	-0.03 (-0.24)	-0.88 (2.61)	0.23 (-1.03)	-0.10 (-0.1)	0.11 (0.59)	0.48 (-2.0)	0.99	2.11	22.11	0.044
2009	-0.20 (-0.38)	0.03 (0.12)	0.24 (0.39)	0.11 (0.28)	-0.35 (2.10)	-0.17 (-1.11)	0.73 (0.89)	0.99	2.66	14.84	0.197
2010	0.010 (-0.10)	0.010 (0.31)	-1.00 (38.9)*	-0.21 (-0.48)	0.03 (1.52)	-0.01 (-0.86)	0.01 (0.21)	1.00	1.98	717.4	0.000
2011	0.01 (0.07)	0.18 (1.89)	-1.08 (3.25)	-0.03 (-0.19)	0.04 (0.41)	-0.09 (-0.91)	-0.19 (-0.62)	0.90	1.75	17.99	0.000
2012	0.08 (0.72)	-0.02 (-0.37)	-0.28 (2.32)**	0.01 (0.20)	-0.02 (-0.40)	0.07 (1.72)	1.25 (11.37)*	0.98	1.52	114.6	0.000
2013	0.05 (0.12)	0.09 (1.04)	0.02 (0.14)	0.07 (0.69)	0.010 (0.02)	-0.04 (-0.52)	0.86 (5.60)*	0.93	1.88	36.03	0.000
2014	0.11 (0.56)	-0.47 (-1.51)	-0.26 (0.49)	-0.52 (-1.57)	0.02 (0.11)	0.39 (1.95)	0.80 (1.43)	0.39	1.34	1.75	0.157
2015	0.03 (0.41)	-0.07 (-1.11)	0.03 (0.26)	-0.02 (-0.24)	0.07 (1.10)	0.08 (1.37)	0.94 (14.34)*	0.94	1.37	41.49	0.000
2016	-0.05 (-0.70)	-0.17 (2.16)**	-0.76 (5.48)*	0.14 (1.12)	-0.10 (1.25)	-0.01 (-0.11)	0.24 (3.14)*	0.90	2.18	28.89	0.000
2017	0.04 (0.51)	-0.53 (4.99)*	0.28 (1.18)	0.12 (-0.77)	-0.05 (-0.61)	0.09 (1.13)	0.57 (3.09)*	0.91	1.64	28.97	0.000
2018	-0.05 (-0.64)	-0.06 (-0.36)	-0.82 (2.11)**	-0.06 (-0.16)	-0.11 (1.05)	-0.10 (-1.03)	0.23 (1.11)	0.88	1.40	19.46	0.000
2019	0.02 (0.35)	-0.09 (-1.12)	-0.64 (1.57)	-0.08 (-0.23)	0.010 (0.03)	-0.04 (-0.48)	0.41 (2.17)**	0.92	1.59	29.27	0.000
2018	-0.03 (-0.42)	0.010 (-0.02)	0.44 (0.88)	-0.02 (-0.06)	-0.01 (-0.14)	-0.03 (-0.44)	0.55 (2.51)**	0.92	1.81	29.80	0.000
2019	0.01 (0.17)	-0.17 (2.24)**	-0.88 (2.91)*	0.08 (0.38)	0.07 (0.93)	-0.05 (-0.75)	0.03 (0.14)	0.94	1.48	34.80	0.000
2020	0.11 (-0.84)	-0.38 (2.58)**	-1.85 (2.78)**	0.22 (-0.37)	0.15 (1.28)	-0.05 (-0.43)	-0.65 (-1.85)	0.89	1.55	15.18	0.000

*&** Statistically significant at 1% and 5% Respectively (Values in Brackets are t values)

@DW= Durbin Watson test, Source: Prowess Database (CMIE)

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