

# DIVIDEND POLICIES OF COMPANIES

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## Abstract

The study on "Dividend Policies of Companies" delves into the intricate decisions and strategies that companies employ in distributing profits to their shareholders. Dividend policy is a crucial aspect of corporate finance that has significant implications for both investors and the overall financial health of a company. This research aims to provide a comprehensive understanding of the various factors influencing dividend policies, the diverse approaches adopted by companies across different industries, and the implications of these decisions on shareholder value.

The research methodology encompasses a systematic review of existing literature, financial reports, and case studies to analyze the historical trends and current practices in dividend distribution. Key factors influencing dividend policies, such as profitability, cash flow, growth prospects, and industry dynamics, will be examined to uncover the underlying rationale guiding companies in formulating their dividend strategies.

Furthermore, the study explores the impact of macroeconomic variables, regulatory frameworks, and market conditions on shaping dividend policies. Additionally, it investigates the relationship between dividend policies and a company's stock performance, investor perceptions, and overall market dynamics.

The findings of this research aim to contribute valuable insights for investors, financial analysts, and corporate decision-makers, aiding them in making informed decisions regarding investment strategies, risk management, and capital allocation. Ultimately, a deeper understanding of dividend policies can enhance the efficiency of financial markets and contribute to the overall stability and sustainability of corporate entities.

## KEYWORDS

Dividend Policies ,Corporate Finance,Shareholder Value ,Profit Distribution,Financial Health,Investment Strategies,Cash Flow Management,Growth Prospects

## 1. INTRODUCTION

The dividend policy of a company is a critical aspect of corporate finance, influencing the distribution of profits to shareholders and shaping the overall financial landscape. When a company generates profits, it faces the decision of whether to reinvest in the business or distribute earnings to shareholders in the form of dividends. Dividends, in essence, represent a share of the company's profits allocated to its shareholders.

This research explores the multifaceted nature of dividend policies, analyzing factors such as profitability, cash flow, growth prospects, and industry dynamics that influence the decision-making process. The annual dividend per share divided by the share price gives rise to the dividend yield, a key metric in assessing returns for investors. Dividend policies vary across industries, with joint-stock companies allocating dividends based on a fixed amount per share, ensuring proportional distribution among shareholders.

The study also delves into the legal considerations surrounding dividend payouts, emphasizing that dividends must be declared out of retained earnings to prevent firms from jeopardizing creditor interests. Additionally, tax regulations, such as Internal Revenue Service Section 531, discourage improper accumulation of funds to evade personal income taxes on dividends.

Various factors, including liquidity position, debt repayment needs, and the rate of asset expansion, play pivotal roles in establishing a firm's dividend policy. The research evaluates different dividend

payment methods, such as constant dollar amounts, constant payout ratios, and low, fixed dividends with special dividends. The impact of dividend decisions on stock prices is explored, with a focus on the "cliente" effect, where investors' preferences for dividends or capital gains influence market dynamics.

Ultimately, the study aims to provide insights for investors, financial analysts, and corporate decision-makers to make informed choices regarding investment strategies and capital allocation. By examining dividend policies across diverse sectors, the research seeks to contribute to a deeper understanding of the factors driving these financial decisions and their implications for shareholder value and market stability.

## 2. Body of Paper

The expected results and hypotheses in your study revolve around examining the correlation between the P/E ratio and financial performance, particularly in the context of companies with increasing dividends versus those with decreasing and constant dividends. Here's a breakdown of your expected results and hypotheses,

### Expected Results:

1. **Positive Correlation:** If a strong positive correlation between the P/E ratio and financial performance is found, it suggests that investors value a company's shares more highly when it exhibits superior financial performance. The anticipation of future earnings growth and confidence in the firm's

profit-making capacity could be driving this correlation.

2. No Apparent Relationship: If there is no clear relationship between the P/E ratio and financial performance, it implies that factors other than financial success criteria might be influencing the valuation of stocks. These could include market conditions, investor sentiment, industry dynamics, or company-specific variables.

3. Negative Correlation: A negative correlation between the P/E ratio and financial performance might indicate that investors have concerns about the company's future growth or perceive risks that are not reflected in financial performance metrics alone.

## Hypotheses

### 1. Null Hypothesis (H0):

Statement: There is no significant difference in the impact of profit margin, return on assets, and long-term debt on the P/E ratio between companies with increasing dividends and companies with decreasing and constant dividends.

Implication: If H0 is accepted, it suggests that the trend of dividend within companies does not play a significant role in predicting the P/E ratio beyond the impact of financial performance metrics.

2. Alternative Hypothesis (H1): Statement: There is a significant difference in the impact of profit margin, return on assets, and long-term debt on the P/E ratio between companies with increasing dividends and companies with decreasing and constant dividends.

Implication: If H1 is accepted, it implies that the trend of dividends within companies is an important factor in predicting the P/E ratio of stocks, in addition to financial performance. This suggests that investors consider the dividend trend as a significant variable when assessing a company's valuation.

### 5.1 Descriptive statistics

Variable	Obs	Mean	Std. dev.	Min	Max
PE1	258	22.30724	19.63549	-26.556	152.039
PM	258	7.280581	5.527598	-7.415	27.459
ROA	258	8.443973	5.663207	-5.597	32.386
LTD	258	4430.787	14222.65	0	103226

Table 1- Descriptive statistics of increasing dividends sample

In the analysis focusing on companies with increasing dividends, a total of 258 observations were included. The mean P/E ratio (PE+1) for these companies stood at 22.30724, exhibiting a standard deviation of 19.63549. The range of P/E ratios spanned from -26.556 to 152.039, indicating a considerable variability in the valuation of these companies.

Looking at profitability metrics, the average profit margin (PM) was calculated at 7.280581, with a standard deviation of 5.527598. The profit margin ranged from -7.415 to 27.459, showcasing diverse levels of profitability across the considered companies.

Assessing asset efficiency, the mean return on assets (ROA) was found to be 8.443973, accompanied by a standard deviation of 5.663207. The return on assets exhibited a range from -5.597 to 32.386, highlighting variations in how effectively assets were utilized among the companies.

Analyzing financial leverage, the average long-term debt (LTD) was 4430.787, with a standard deviation of 14222.65. The long-term debt ranged from 0 to 103226, indicating different levels of leverage adopted by the companies.

Variable	Obs	Mean	Std. dev.	Min	Max
PE1	242	25.54745	55.65451	-89.149	427.5
PM	242	5.428099	8.033375	-25.689	27.407
ROA	242	6.69126	8.82969	-18.392	36.608
LTD	242	9489.796	25929.89	0	122627

Table 2- Descriptive statistics of decreasing or constant dividends

In the analysis of the sample comprising companies with decreasing or constant dividends, it is observed that all variables exhibit a higher standard deviation compared to the increasing dividend sample. This sample includes a total of 242 observations.

Looking at the mean P/E ratio (PE+1) for these companies, it is calculated to be 25.54745, with a notably higher standard deviation of 55.65451 when contrasted with the increasing dividend group. The P/E ratio ranged from -89.149 to 427.5, indicating a wider dispersion in valuation among these companies compared to those with increasing dividends.

Examining profitability metrics, the average profit margin (PM) was found to be 5.428099, accompanied by a standard deviation of 8.033375. The profit margin ranged from -25.689 to 27.407, illustrating varying levels of profitability across the considered companies.

Assessing asset efficiency, the mean return on assets (ROA) was calculated at 6.69126, with a higher standard deviation of 8.82969. The return on assets

ranged from -18.392 to 36.608, indicating differences in asset efficiency among these companies.

Analyzing financial leverage, the average long-term debt (LTD) was 9489.796, with a higher standard deviation of 25929.89. The long-term debt ranged from 0 to 122627, highlighting a wide range of leverage among the companies in this sample.

Comparing the descriptive statistics of the two sets, it is evident that the average profit margin and return on assets of the increasing dividend sample are higher than those of the decreasing and constant dividend sample. This suggests that the increasing dividend sample exhibits better financial performance. Additionally, the long-term debt is lower in the increasing dividend sample. Notably, the higher standard deviation in the decreasing or constant dividend sample indicates greater variability in the dataset.

## 5.2 Model diagnostics

### 5.2.1 Pearson's Correlation

	PE1	PM	ROA	LTD
PE1	1			
PM	0.1747	1		
	0.0049			
ROA	0.0865	0.6839	1	
	0.1662	0		
LTD	0.0316	0.2367	-0.1287	1
	0.6134	0.0001	0.0389	

Table 3- Correlation matrix of increasing dividends

The correlation matrix for the increasing dividend sample provides insights into the relationships between the variables, as measured by the Pearson correlation coefficient:

#### 1. Profit Margin (PM) and P/E Ratio (PE1):

- There is a weakly positive correlation between Profit Margin (PM) and the P/E Ratio (PE1) with a correlation coefficient of 0.1747.

- This correlation is statistically significant with a p-value of 0.0049, indicating that there is a weak positive linear relationship between profit margin and the P/E ratio.

## 2. Return on Assets (ROA) and P/E Ratio (PE1):

- The correlation between Return on Assets (ROA) and the P/E Ratio (PE1) is also weakly positive, with a correlation coefficient of 0.0865.

- However, this correlation is not statistically significant at the 0.05 level, as the p-value is 0.1662. This suggests that the relationship between return on assets and the P/E ratio is not strong enough to be considered significant.

## 3. Long-Term Debt (LTD) and P/E Ratio (PE1):

- The correlation between Long-Term Debt (LTD) and the P/E Ratio (PE1) remains weak and statistically insignificant.

- The correlation coefficient is 0.0316, and the p-value is 0.6134, indicating that there is no significant linear relationship between long-term debt and the P/E ratio.

	PE1	PM	ROA	LTD
PE1	1			
PM	0.053	1		
	0.4121			
ROA	0.0578	0.862	1	
	0.3708	0		
LTD	0.0404	-0.2052	-0.2506	1
	0.5319	0.0013	0.0001	

Table-4 Correlation matrix of decreasing or constant dividends

For the decreasing or constant dividend sample, the correlation analysis indicates an insignificant relationship between P/E Ratio (PE1) and the other financial variables. The positive correlation between PE1 and Profit Margin (PM) is not statistically significant ( $r=0.0530$ ,  $p=0.4121$ ). Similarly, the weak connection between PE1 and Return on Assets

(ROA) is also statistically insignificant ( $r=0.0578$ ,  $p=0.3708$ ). Additionally, there is a small positive correlation between PE1 and Long-Term Debt (LTD), but it is not significant ( $r=0.0404$ ,  $p=0.5319$ ). These results suggest that, for the decreasing or constant dividend sample, there is no substantial and significant link between P/E Ratio and the considered financial performance indicators.

## CONCLUSION

In conclusion, this research paper delves into the intricate landscape of dividend policies, exploring various factors influencing decision-making, legal considerations, and tax implications. The study employs a correlational research design, analyzing the impact of factors such as profit margin, return on assets, and long-term debt on the P/E ratio, particularly in the context of companies with increasing dividends compared to those with decreasing or constant dividends.

The developed hypotheses aim to ascertain whether there is a significant difference in the impact of these financial performance indicators on the P/E ratio based on the trend of dividend distribution within companies. The analysis of the increasing dividend sample reveals positive correlations between P/E ratio and profit margin, and return on assets, albeit with varying levels of statistical significance. On the other hand, the decreasing or constant dividend sample exhibits generally insignificant correlations between P/E ratio and financial variables.

These findings suggest that the relationship between financial performance and P/E ratio may differ based on the trend in dividend distribution. If the hypothesis asserting a significant difference is



accepted, it underscores the importance of considering dividend trends when predicting the P/E ratio of stocks alongside financial performance metrics.

Moreover, the descriptive statistics highlight variations in valuation and financial performance among companies with different dividend trends. The increasing dividend sample generally demonstrates higher mean profit margin, return on assets, and lower long-term debt compared to the decreasing or constant dividend sample.

In essence, this research contributes insights into the multifaceted dynamics of dividend policies and their interplay with financial performance metrics, shedding light on potential nuances that investors and corporate decision-makers should consider. The study underscores the need for a nuanced understanding of how dividend trends may influence stock valuation, providing valuable implications for investment strategies and capital allocation decisions.

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