CHAPTER 9

CONCLUSIONS AND FUTURE RESEARCH AND THINKING

9.1 CONCLUSIONS

Academic researchers cannot specify a theoretical optimal dividend policy that simultaneously fits all firms (a macro-level policy). Because of the complexities involved, it is skeptical that a one-size-fits-all theory of dividend policy will ever gain acceptance. Over the years researchers have proposed numerous theories on how imperfections—various market frictions—might influence dividend policy. Each firm faces a combination of potentially different market frictions with varying levels of relevance; the optimal dividend policy for each firm may be unique. If each firm has a uniquely optimal dividend policy, one should not be surprised that significant statistical generalizations still elude researchers. Existing models studying the impact of dividend policy on firms' value cannot fully reflect the complexities of the market environment. The goal of this research is to provide a comprehensive framework to assist managers in making dividend policy decisions.

Corporate Financial Managers view dividend decision as important and relevant decision. However any advice offered to managers on how to set their dividend policies must be made at the firm-specific level. These Corporate Financial managers must examine how the various market frictions affect their firms, as well as their current claimholders, to arrive at "Optimal" dividend policies for their firms.

Usually management of a firm believes that three market frictions are relevant to a firm: They are taxes, asymmetric information, and agency costs. The firm's managers should evaluate the impact on a dividend decision of each market friction in isolation and then consider the potentially complex interaction of the three imperfections before formulating a reasonable dividend policy. The figure 9.1 shows the competing frictions framework, or schematic model. If a balance of scale is considered on which the merits of the dividend policy are weighted on the right-hand side against dividend policy irrelevance on the left-hand side as illustrated in 9.2. Panel (a) reflects the view of dividend policy relevance in a world of perfect capital markets, in which the scale
strongly tips toward the irrelevance of dividend policy. In Panel (b) portrays the scale in a world beset with market imperfections. It is believed that the forces of market frictions tip the scale toward the relevance of dividend policy. For certain firms, specific frictions will have a large influence; for other firms these same market imperfections may be insignificant. In other words, the weights on the market frictions will differ from firm to firm.

Figure 9.1: The "Balance Scale" of Dividend Relevance

In the forthcoming sections the big three imperfections have been discussed and their interaction with the little frictions has been discussed. An attempt has also been to throw light on how financial managers should incorporate these imperfections into their decision-making.

**9.1.1 THE BIG THREE MARKET IMPERFECTIONS AND THEIR INTERACTION WITH LITTLE FRICTIONS**

**9.1.1.1 Taxes**

Firms should have a reasonable idea of the identity of their main categories of shareholders. The attributes of the shareholders generally can be classified as:

- Investors who prefer capital gains,
- Investors who prefer dividend income,
Investors who are tax-neutral.

Evidence supporting the existence of tax-induced dividend clienteles of shareholders is limited. It may be stated such tax-induced clienteles may not exist in India as dividend income is tax exempt for shareholders. However, literature believes that investors have a tendency to self-select into investing in firms that have dividend payouts that best match their tax circumstances.

However, in the long-run, one tax-induced dividend clientele should be as good as another. Because of the potential importance of tax considerations in making the dividend policy decision, financial managers should keep a close eye on changes in the tax code. Substantial changes may dictate a shift in dividend policy. The dual moral of this discussion is, Know Both The Investors and Tax Code!

9.1.1.2 Agency Costs

Firms should adopt a dividend policy that allows implementation of an investment policy that maximizes market value. In general, firms should not underpay dividends. Retained funds should be invested in projects that pass the NPV Rule. Having too much cash lying around is an ill-advised investment. Consistent with this observation is research that illustrates that the market responds positively to the announcement of increases in capital expenditures.

In short, excessive cash balances increase managers' degree of investment flexibility, which may be to the detriment of shareholders. After all, managers experience a normal set of human temptations. If management compensation and/or prestige is based on firm size or sales, managers may be tempted to over invest in projects or to acquire other firms that may not be strategically advisable nor value enhancing. Several researchers have identified dividend payments as a source to mitigate agency conflicts.

In general, high-growth firms can afford to write strict or tight dividend constraints that severely limit their ability to pay future dividends. Moreover, dividends are less important to investors in high-growth firms who seek out these firms in the expectation of receiving little, if any, dividend income. Dividend slack decreases the
protection of debt holders and results in an interest rate that is too high relative to the risk of the debt.

For the opposite reasons, low-growth firms should negotiate looser dividend constraints. With a scarcity of future positive NPV investments, these firms are likely to generate large free cash flows that should be paid to shareholders. Without the dividend payout commitment, overinvestment may be a temptation. Dividend slack under the constraints is desirable in case of future economic setbacks and the desire to maintain a high dividend payout level.

Highly leveraged firms can write strict dividend policy constraints. Heavy debt service obligations limit these firms' ability to overinvest, and frequent refinancing provides capital market discipline. Indeed, empirical research indicates that growth firms and firms with higher leverage, all else being equal, choose tighter dividend constraints and pay fewer dividends (Kalay 1979). Thus, the evidence suggests that many financial practitioners share these views.

9.1.1.3 Information Asymmetry

Research consistently has shown that dividend changes convey significant information to the market. One of the most compelling pieces of empirical evidence regarding dividends is the announcement effect of dividend changes on share prices. Several empirical studies have documented significant increases in share prices when firms initiate payment of dividends for the first time or after a hiatus of at least five years. Several studies also have documented share-price increases on announcement of dividend increases versus dramatic share-price decreases when firms reduce dividends. Hence managers must be aware of documented market reactions before they make dividend policy decisions.

The empirical evidence also documents that the market infers different messages with respect to different dividend types. For instance, the market reacts more strongly to regular dividend increases relative to specially designated dividends, or dividends labeled extra or special.

Decreases in free cash flows should not be accompanied by dividend cuts, unless the reduced levels of free cash flow are expected to continue into the future. Investors
interpret dividend cuts as especially bad news, and share prices decline dramatically when dividend cuts are announced.

Similarly, managers should be cautious about large increases in dividends, again to avoid the possibility of subsequent dividend decreases. If increases in free cash flows occur and are expected to persist, the dividend increases should be made gradually over time. Alternatively, or simultaneously with the increase in dividends, a firm should declare some of the distribution as a specially designated dividend or engage in some share repurchases, along with smaller dividend increases. This approach avoids making implicit (optimistic) statements that later may have to be reversed.

Again, while the market's interpretation of the underlying cause of dividend changes is not well understood, it is not known that such changes are met with significant market reactions. This observation supports an effort to smooth dividends in relation to expected free cash flows over time as suggested by the John Lintner (1956).

Similarly little market imperfections can also have an impact on firms’ dividend policy decisions. Considered in isolation, the existence of transaction costs favors a managed dividend policy. If firms have a consistent and stable dividend policy—whether the policy is high, low, or no distribution—investors can select the policy that best matches their consumption and tax profiles.

Similarly, flotation costs favor a residual policy when considered in isolation. Flotation costs can be substantial, especially for small firms and small equity issues. Accordingly, small firms should pay out cash only if operating cash flows exceed expected capital expenditure levels. Managing dividends will, almost without doubt, result in a higher level of flotation costs.

In the real world, imperfections affect firms interactively, and managers should consider these interactions when making dividend policy decisions.

The number of permutations of the six market imperfections discussed is large. For instance, we could consider a market setting that includes (1) taxes and agency costs, (2) taxes and asymmetric information, (3) taxes plus transaction and floatation costs, (4) agency costs plus floatation costs, or (5) asymmetric information, taxes, transactions costs, and floatation costs.
9.1.2 STRATEGIES IN DEALING WITH MARKET IMPERFECTIONS

Dealing strategically with market imperfections can be diagrammed on multidimensional axes in a competing frictions model, as illustrated in Figure 9.2 wherein the frictions (imperfections) are weighted by management's assessment of importance. Managers should qualitatively mark each market imperfection having an impact on their firm on a continuum reflecting their assessed level of importance. The managers can sequentially analyze the dividend policy implications of the relevant imperfections. Decisions on the trade-offs among imperfections must be made in the context of their relative importance.

For example, if the management believes that three market imperfections—taxes, asymmetric information, and agency costs—are relevant to the dividend decision for their firm. Further, they believe that these imperfections affect their dividend decision in this same order of importance. Within this framework, the managers consider each imperfection in isolation and then in combination to arrive at their choice of dividend policy. (Refer again to Figure 9.2)

The present study is a fact finding research and complicated in nature like the other functional areas of finance. In course of the study the importance and nature of dividend decision in Indian corporate sector has been examined. The various dimensions of dividend decisions have been dealt in the light of the existing theories on dividend policy. The detailed review of empirical studies and the research work has provided a direction and insight into various determinants having a direct bearing on the dividend policy decision of the firm. This may help the financial managers in handling the crucial and the complicated dividend policy decision-making. The analysis of trend of dividend payout ratio tries to bring a close shot on payout policy of the companies belonging to select sample industries.

The analysis of the determinants of dividend policy in select sectors in India based on sophisticated statistical models highlighted the determinants that best explains dividend policy in Indian IT, FMCG and Service sectors in India. Thus, this analysis provides adequate information to the investors, managers and researchers to know the relative significance of the various determinants influencing the dividend payment decision of companies.
As discussed in the section on literature review dividend relies on two sets of explanation. Dividend signaling or information asymmetry models and secondly agency costs. Both explanations to the dividend theories have been studied in the present research work.

This study has tested empirically the agency cost theory, Lintner model, dividend signaling and smoothing effects using a framework of various econometric models. An attempt has also been made to identify linkage of dividend decision with shareholders’ wealth.

Assuming that dividend has information content and managers try to make efforts to smooth dividend payments, the validity of the Lintner model in the select sectors under study was tested. This also highlighted to what extent dividend smoothing efforts are done by managers in the three sectors chosen for study.

Out of the chosen sectors Lintner model fits well in the FMCG sector signifying that the dividend signaling and smoothing effects are present. Thus these firms follow stable dividend policy year on year basis, even though earnings might change dramatically. The findings in the FMCG sector are in alignment with Brave et al. that managers are very reluctant to cut dividends once they are initiated. This reluctance leads to dividends that are sticky, smoothed from year to year and tied to long run profitability of the firm.

The regularity of dividend payment and constancy of its rate is an important objective of the dividend policy followed by the Chief Finance officers of the FMCG sector. The findings reflect the companies ensure that the current dividend signals their performance and the desire of management to maintain a stable dividend.

The target payout ratio in FMCG sector hovers with in the range of 69% to 128%. The partial adjustment factor is found to be 0.115 to 0.52, which lies between one sixth and one half as highlighted by Lintner in his findings. Due to strong bias against dividend cuts, increase in earnings is translated into increase in dividends only gradually to avoid future downward revision. It may be stated that the principal determinant of dividend policy in FMCG sector is profitability. Thus, FMCG firms use dividends to signal their surge in profit margins over the years. These findings are in conformity
with Mookerjee Rajen (1992) who found that Lintner model is successful in explaining dividend payout behavior of private corporate sector.

The amount of dividend distributed during the previous year was also found to be a significant factor governing the dividend distribution of the current year. The results in FMCG sector is in conformity with the pattern seen in developed economies like USA and Germany and is in agreement with the studies by Fama and Babiak (1968) and Behm and Zimmermann (1993).

However, IT sector and service sector demonstrated a pattern, which is seen in emerging economies like Tunisia, Zimbabwe and Turkey. These sectors are characterized by high target payouts coupled with high speed of adjustment coefficient. The target payout ratio in service sector derived from $\beta_1$ lies between the broad ranges of 31 to 35%. This is relatively a low target payout ratio as compared to what was suggested by Lintner. The partial adjustment factor is found to be with in the range of 0.369 to 0.5278, which lies between one sixth and one half as highlighted, by Lintner in his study. The choice of a particular speed of adjustment factor depends upon possible variations in net earnings after tax and stability of dividends required. Stable net earnings after tax would induce a management to choose a higher adjustment coefficient. But if net earnings were subject to wide fluctuations, a desire to have stable dividend would lead to choosing lower adjustment coefficient.

It may be stated that the principal determinant of dividend policy in Service sector is profitability. The results signify that Service sector companies score high on dividend stability. Firms in Service sector use cash dividends to signal their prosperity to the shareholders. The results are in agreement with the previous studies on banking industry, which state that banks use their dividend history to set their dividend. These results were established by Dickens N. Ross and Newman A. Joseph in their study “Bank Dividend policy: explanatory factors” and Pal Karam and Goyal Puja “Leading determinants of Dividend policy: A case study of the Indian Banking Industry”. Bodla B.S., Pal Karam, Sura S Jasvir “Examining Application of Lintner’s Dividend Model in Indian Banking Industry”
The firms in IT sector are not averse to cut dividends. Profits seem to be a noteworthy determinant of dividend payments during entire time period under study. PAT is significant at 5% level depicting for all the IT firms profitability is an indispensable factor to be considered while determining dividend policy. But it should always be kept in mind there are other factors also apart from profitability that may affect dividend payments. However the regression coefficient of Div_{t-1} is insignificant showing that dividend paid during current year is not governed by dividend paid during previous year. This also proves the fact that only one of the variables given by Lintner has an impact on dividend declared by the firms in IT sector.

The target payout ratio in IT sector revolves around 30%. This payout ratio is lower than target payout ratio of 50 % suggested by Lintner. As regards the speed of adjustment coefficient the value lies between 1.16 to 1.51, which is much higher compared to what was suggested by Lintner. This high speed of adjustment coefficient denotes that actual changes in the dividend may be much higher than desired changes. This low target payout ratio coupled with high speed of adjustment factor shows the absence of dividend smoothing and dividend signaling. The IT firms’ dividend payout fluctuates with changes in the earnings. This suggests that higher dividend payout is witnessed in IT industry only in the case of increased profitability of the companies. Any variation in the earnings is quickly reflected in dividend payment.

Firms in the IT sector use dividends to signal their surge in profit margins over the years. The regularity of dividend payment and constancy of its rate is not an important objective of the dividend policy followed by IT industry in India. These findings are validated by the fact that IT sector is characterized by low target payout ratio and high speed of adjustment factor.

Thus, the analysis of the first objective has unearthed the applicability of smoothing and signaling approaches and relevance of information asymmetry models in IT, FMCG and Service sectors in India.

Through the analysis of second objective it was found that there are sectoral differences in corporate dividend policy determinants. The results are consistent with the conclusion of Baker, Farrelly, and Edelman (1985) and Ho Horace (2002) that firm’s industry type influence dividend policy. A factor which may be relevant for one
industry becomes irrelevant for another depending upon the industry characteristics like growth phase, ownership pattern, size, systematic risk and earnings variability.

The period undertaken for study i.e. 2000-2008 covered both recessionary and booming phases of Indian IT sector and FMCG sector. A shift in the dividend payment pattern was observed in the IT sector as there was hike in the dividend payout ratios of the major companies belonging to this sector. The firms in IT sector do not use dividends as a medium to signal their prosperity to the shareholders. The findings reflect that there is lesser information asymmetry in this sector. The information is becoming more and more symmetrical due to better Corporate Governance practices adopted by IT companies.

IT sector is a human intensive sector and do not require huge capital asset base like manufacturing companies for their operations. The major asset of this sector is manpower. The funds required for recruitment and retention of manpower is comparatively less than funds required for purchasing capital assets. So these firms can easily release funds for payment of dividends. Also a negative relationship between liquidity can be attributed to the fact that agency problems are not very relevant so that monitoring mechanism i.e. dividend payout may be less needed. A negative regression coefficient of liquidity and Dividend Payout ratio can be attributed to the fact that in IT sector capital gains are preferred to cash dividends.

Retained earnings are a vital variable governing the Dividend Payout ratio of IT firms. The results show that Factor of retained earnings and Leverage is positively related to DP ratio. Generally, higher debt equity ratio may negatively influence the dividend payout of company. But in case of IT firms the proportion of debt in the total capital structure of the company is relatively low as they are very low debt or zero debt companies eg. Infosys (a zero debt company). Therefore, Bondholders do not consider dividend payment as a way to expropriate their value. The positive relation depicts that debt holders do not reduce the cash available for the dividend by imposing debt covenants and related restrictions. This positive relationship between Dividend payout ratio and Debt equity ratio is in alignment with the findings of Easterbrook (1984). According to him firms with high leverage are those whose value shifting is potentially costly. Such firms are expected to pay large dividends.

The Factor of profitability and pecking order, long-term solvency, Shareholders wealth and earnings variability, have not emerged as an imperative factors affecting the dividend payout ratios of IT firms.
FMCG sector recovered from its prolonged slump in 2005. FMCG companies have been known to be generous dividend distributors to its shareholders. These stocks were known as ‘dividend yield’ stocks till 2004. The companies maintained consistent dividend payouts to some extent even when the profits were not on surge. After 2004, FMCG stocks were purely viewed as ‘dividend growth stocks’ since the companies deployed their resources for sustaining larger product baskets. The FMCG companies adopted a CAPEX mode and started ploughing profits for future expansion plans. But the high profitability enabled the firms to continue pay encouraging dividends even after retaining a part of the profits. HLL, Godrej, ITC are among the top dividend payers.

FMCG companies are known to be generous payers of dividend due to their strong cash flow and minimal Capex requirement. Indian FMCG companies like their global peers have developed some strong brands, sustained stable growth, high dividend payout and high return on net worth (RONW).

The analysis of the second objective showed that Profitability is a primary determinant factor for dividend distribution. FMCG companies score high on dividend stability and consistency, as Lagged dividend and PAT are important factors governing dividend distribution. These findings are in alignment with the findings of Aharony and Wary(1980), Asquith and Mullins(1983), Petit(1972), John and Williams(1980), Bhattacharya(1979), Miller and Rock(1985).

The quality of cash flows, which is a measure of liquidity of the firm and firm size are found to be a noteworthy determinant of the dividend payout. According to previous research studies larger firms face lower issuing cost and external debt financing making it easier to raise funds. Thus, they can go for generous dividend payouts. These findings are consistent with the findings of Smith and Watts (1992).

The opportunities for future growth and expansion are found to be negatively related to dividend payout ratio. Larger is the growth and investment opportunities available to the firm, lesser is the incentive to pay dividends as the firms prefer to retain larger proportion of profits. According to Pecking order hypothesis, firms should prefer to finance investment by retentions rather than debt. The regression results also disclose negative and significant relationship with Retained earnings and Capital Expenditure.
during the current year. This result is in alignment with the existing literature, which suggests that results are logically, and theoretically correct. In other words, dividend decisions are not independent of uses of corporate funds and changes in fixed assets i.e. capital expenditure is an important determinant of dividend payments in FMCG sector.

The systematic risk, earnings variability and financial risk obstruct the stable dividend payout but the results report that in case of FMCG sector in India the Dividend Payout ratio is increasing even if the firm faces higher risk.

Dividend Payout ratio is found to be positively related to long term solvency of the firm. But this relationship is significant at 10% level. The firms in FMCG sector operate with very low level of debt. At the same time these firms are highly liquid firms, therefore increase in debt proportion in capital structure do not put pressure on firms capacity to pay dividend and consequently a positive relation can exist between Debt Equity ratio and Dividend Payout ratio through the results Dividend are less important to investors in high growth firms who seek out these firms in the expectation of receiving little dividend income as these firms need outside financing regularly and therefore are subject to the discipline of frequent capital market scrutiny. This also indicates lesser degree of conflicts between bondholders and shareholders. The bondholders do not reduce the cash available for dividend distribution by imposing indenture restrictions.

Indian service sector comprises of trade hotels, transport, communication, IT and software, banking and insurance etc. Till 2002 service sector was ignored in India and the main emphasis was on manufacturing and agricultural sector. It was only after 2002 that service sector started growing at a healthy rate of 8-10%. Today it is the highest contributor to the GDP of our economy.

The dividend payout of service sector in India has increased leaps and bounds in last few years. These hefty dividend payments can be attributed to surged profitability of firms in this sector.

The results portray that higher the earnings variability higher will be dividend paid by the companies in Service sector. A positive relationship has also been reported
between Dividend payout ratio and long-term solvency. Higher ICR indicates that the firm is financially sound to meet its precommited cash outlays in form of interest

A finding of the study that refutes the existing literature is that through the analysis a negative relationship has been found between firm’s size and the dividend payout ratio. This finding is not consistent with Pecking order hypothesis and stands in sharp contrast with results in Smith and Watts (1992). Larger companies despite having the opportunity to tap easily the financial markets by issuing stocks or bonds prefer to retain dividends so as to avoid the costly external financing. Moreover, small firms, which are more risky, need to have a high payout ratio, in order to attract investors to buy their stocks.

The analysis of third objective demonstrates that the influence of ownership pattern on the dividend payout is heterogeneous. It has been observed that there are sectoral differences in impact and influence of ownership groups on dividend payout. India is a common Law country characterized by strong investor protection and dispersed ownership (the role of the insider is played by the manager), hence the agency conflicts are not so severe and cash dividends may not be essential to mitigate the agency conflicts.

The results in terms of ownership variables in IT sector give an interesting picture. The debt equity regression coefficient is positive which is strikingly different from the negative linear relationship proposed by studies in the past. The positive relationship can be interpreted in the sense that agency conflicts are not so grave in the Indian IT sector. This relationship highlights lesser conflicts between two groups of stakeholders i.e. shareholders and bondholders in the Indian IT sector. Stockholders may expropriate wealth from bondholders by paying themselves dividends. Bondholders try to contain this problem through restrictions on dividend payments in bond indenture. Thus, the positive relation depicts that debt holders do not reduce the cash available for the dividend by imposing debt covenants and related restrictions. This positive relationship between Dividend payout ratio and Debt equity ratio is in alignment with the findings of Easterbrook (1984). According his research firms with high leverage are those whose value shifting is potentially costly. Such firms are expected to pay large dividends. The positive relation may also exist because the debt proportion in capital structure of IT companies is very less eg. Infosys. Low-leveraged
firms also should negotiate looser dividend constraints relative to firms with high debt levels to provide future flexibility. Low debt service obligations mean less debt refinancing and discipline imposed by capital markets. Accordingly, dividends and dividend slack are relatively more important. Moreover, since debt levels are low anyway, wealth transfers to bondholders by maintaining slack is not a significant concern.

The further analysis in the IT sector results are consistent with Manager Entrenchment hypothesis depicting that institutional holding regression coefficient is positive in level and negative in square. This implies that upto a certain threshold\(^43\), dividends act as substitute for corporate governance. After the threshold the direct monitoring efforts of institutional holders are insufficient or become too costly. Therefore, dividend payments are increased so that managers are forced to raise finance from external capital markets and acts as an external monitoring device. These results are in agreement with the findings of Short, Zhang and Keasey 2002, and Farinha, 2003). A non-monotonic and parabolic relationship has been established by the research in IT sector for the period under study. This in conformity with the findings of Demsetz and Lehn (1985) and Schleifer and Vishny (1986)

A negative sign of Institutional holding can be justified on the grounds that they act as a monitoring device reducing the need of high dividend payments.). However, it also suggests that institutions may influence higher dividend payouts by a company to enhance managerial monitoring by external capital market, as their own monitoring efforts may be insufficient or too costly. Higher dividends would thus push the firms frequently towards capital market for raising funds. The positive relationship occurs beyond a certain threshold\(^44\)

Institutional investors, most of whom are banks and Financial Institutions (either as shareholders or debt holders) are also the creditors to the firm and to protect their credit they may hold low level of holding. They prefer paying themselves interest rather paying dividends. However at low level of holding, their benefit from the dividends payout may be less than that at high level of holding. Thus, institutional

\(^{43}\) Jayesh Kumar in his study on association between corporate Governance and dividend payout identified this threshold level to be 25 %

\(^{44}\) Jayesh Kumar (2006) identified this threshold level to be 25%
shareholders have negative impact on payout at low level of shareholding and positive impact after certain threshold level of holding.

An analysis of pooled data regression results in IT sector showed that FII holding also has an effect on the dividend payout ratio at higher levels of holding because it is significant negatively related to dividend payout ratio in square. However promoter holding is significantly negatively related to dividend payout ratio in level and positively in square. Most of the IT companies in India have high promoter holding. In the recent scenario companies like Wipro Ltd. have been generous in rewarding their owners with cash dividends than some of the largest business groups in the country. In FY07, the dividend earnings of promoters grew around 20% over the previous year more than twice the rate of earnings growth of non-promoters. Since the dividends are tax-free for promoters in India, they prefer rewards in form cash dividends as their controlling stake in the company increases. Thus, promoter holding and Institutional holding have emerged as the two major ownership groups that have an impact on dividend payout ratios of companies in IT sector.

As regards Service sector, linear relationship between ownership groups and Dividend payout ratio is found to be a better fit. FII holding has a major influence on dividend payout ratios. This sector became active post liberalization i.e. after opening up of the Indian economy. The foreign institutional investors negatively influence the dividend payout of Service sector companies. During last 8 years there has been a significant increase in FII holding in Service sector companies chosen as sample for this research work. But still the percentage of shares owned by this group is relatively lower as compared to other ownership groups. According to previous research studies a positive and significant relationship between FII and dividend payout can be expected only at higher levels of holding. According to Jayesh Kumar (2006) beyond a threshold of 10%, FIIIs may be interested in investing only in specific firms that are well managed and profitable or vice versa and may target such firms only for their investments. They may be going systematically after quality or systematically seeking out under performing assets. Thus, FII holding may be higher for firms, which are profitable and consequently pay higher dividends.

An explanation for the negative relationship could be that according to dividend signalling hypothesis, dividends and institutional ownership can be viewed as two
alternative means of signalling. Since the presence of the specific investors can, by itself, act as a signal of satisfactory profitability, mitigating the need for maintenance of a high dividend yield for informational reasons. This leads to the conclusion that FII holding in a firm may signal the prosperity of the firm to the shareholders. Therefore, such a firm may not pay huge dividends. Higher is the holding lower will be the dividend payout.

However in the FMCG sector none of the ownership groups were found to have considerable influence on dividend payout. It has been found out that shareholding pattern is not an important variable that influence the dividend policy of the FMCG companies. The relationship varies for different types of shareholders and at different levels. In other words, it can be said there is no uniform influence of the shareholding pattern on dividend policy of the company. The results Random effect model show that corporate holding is a major ownership variable that influences dividend payout. A close look at the shareholding pattern of companies in FMCG sector indicates that the level of corporate holding in total holding is comparatively less. Therefore, Corporate bodies view dividend payment as a source to mitigate the agency conflicts. Results indicate no significant relationship of corporate holding with Dividend Payout ratio at higher levels of holding. The results also show that there is not much impact of liberalization and foreign institutional investors for determination of dividend payout ratios of the FMCG companies as this variable is found to be insignificant in all the Models under study. The results Random effect (Model IV) also denotes a significant negative relationship between Debt equity ratio and dividend payout at 10% level which in agreement with existing literature. This relationship can be attributed to the fact that high-growth firms with low leverage and broad ownership, dividends are relatively more important in controlling potential agency conflicts between managers and shareholders. All else being equal, dividend payments force a firm—especially a high-growth firm—to the capital markets more regularly. The scrutiny provided by the capital markets limits the extent of managements' self-serving behavior.

The regression results indicate that none of Models developed to study the impact ownership groups has fitted well in FMCG sector. Thus, it can be stated that ownership groups is not a significant factor determining the dividend payment patterns and decisions in the FMCG sector.
Through the analysis of the fourth objective it has been found that cash dividends may not always create abnormal returns for the shareholders. In the modern scenario a gradual drift to other modes of payment of dividends has been observed. Small abnormal returns on dividend announcement can also be attributed to the fact that the dividend announced is below the investors’ expectations. More so, dividend income, being a marginal constituent in investment return, may not inspire much to the over enthused investors in rising capital markets. The findings of the research highlight that in Service sector investors respond positively to cash dividends announcements whether increasing or decreasing. Thus, the investors in this sector welcome cash dividends. Considering the statistical significance of CAARs and AARs it can be said that signaling hypothesis partially holds. However abnormal returns are created in FMCG sector but they are not sustained over the event window and gradually CAARs become negative. However, in the IT sector no significant abnormal returns are generated on dividend announcement.

The results in IT sector do not strongly refute the informational efficiency of the markets. To some extent semi-strong form of market efficiency is highlighted through the analysis. Though positive abnormal returns of 0.83% and 1.18 % are generated on cash dividend announcements but they are not statistically significant. The stock prices do react positively on dividend announcement but abnormal returns generated are not found to be statistically significant. The shareholder value could not be sustained in the post announcement period. This can be attributed to the fact that the corporates usually face constraints to declare lesser dividends due to the possibility of large cash outflows on account of taxes. Therefore, dividend announced may be much below investors’ expectations.

In FMCG sector the results showed that the investors lost more value in ex dividend period than the value gained in the pre dividend announcement period. Thus, it can be stated that dividend announcements do not carry information about future earnings and cash flows of the companies. Dividend payout may not add to shareholders wealth if the companies have positive net present value projects in hand. The findings of the Market model strongly refute the signalling hypothesis and information content of dividends. These results are in alignment with findings of many authors who have dismissed the information role of dividend as unimportant. They suggest that equally
efficacious, cheaper alternatives exist through which managers can disseminate information (e.g., Miller and Modigliani; Pet 1972, Black 1976, Stern 1979).

In Service sector, the results cannot be taken in support and endorsement of information efficiency because of positive incidence of AARs and CAARs and their corresponding statistical significance. The results indicate semi-strong form of market efficiency because any information content associated with dividend announcements is not absorbed in the price movement on the announcement day only but it leads to abnormal returns during post dividend announcement period also. This is alignment with the findings of Ball and Brown (1968), Fama et al. (1969), Gupta (2001) and Chaturvedi (2001). Thus, the results partially support the dividend-signalling hypothesis in the Service sector. The reason for the partial support can be attributed to the fact that not all the positive incidences of AARs and CAARs in the event window are statistically significant. This information content of dividends hypothesis has been formalized by Bhattacharya (1979, 1980), John and Williams (1985), Miller and Rock (1985), Ambarish et al. (1987) and Offer and Thakor (1987).

This research work has made an attempt to evaluate the three crucial sectors of Indian economy (IT, FMCG and Service) on the basis of four commonalities. These commonalities are Lintner dividend Model, 21 variables affecting the dividend payout ratios (based on literature survey) ownership patterns and agency conflicts and finally dividend linkages with shareholders’ wealth maximization. On the whole the findings of this research indicate that despite the fact that managers view dividend decisions as important it cannot be concluded that market rewards a carefully managed dividend policy with higher share price. In India finance managers typically view dividend decisions as an important part of their job. The typical firm does not follow a residual policy nor leave its dividend payout to chance. Rather, firms manage their dividends as proposed by Lintner’s model and partially follow stable dividend policy. The results are in support of semi-strong form of market efficiency. The study also by and large supports the signaling and information content of dividend. A sectoral difference in determinants of dividend payout ratios has been observed. The results also indicate that in Indian context the impact of ownership groups on dividend payment is heterogeneous.
9.2 FUTURE RESEARCH AND THINKING

The trouble of people is not that they don’t know, but that they know so much that ain’t so- Henry Whealer Shaw; Josh Billing’s Encyclopedia of Wisdom.

No research work is complete without suggesting the directions for future research. The research work offers numerous links that can be picked up by future researchers in Corporate Finance more specifically in the area of ‘Dividend Policy’.

The research has primarily focused on empirically testing the validity of Lintner Dividend model in IT, FMCG and Services sector respectively. How the various determinants of dividend payout ratios vary across the sectors? Most importantly, dividend announcements and its linkages with shareholders’ wealth has been analyzed.

As revealed through the research, ownership groups influence the dividend payout of a company. There is a significant scope for investigating further the relationship between dividends and ownership over a longer period of time and to compare the behavior of Indian firms with other countries’ corporations. A second possibility for future extension of the present study is to examine the interactions between dividend policy and other financial decisions and ownership structure. Examining the influence of board structures on dividend payout policy can also be a future area of research. More studies especially, in emerging economies are needed which can increase the understanding of the relationship between block holders’ identity (ownership concentration) on dividend policy. A well-known fact is controlling the corporation also makes it possible to control dividend decisions. There may be controlling groups in the organization, which may influence dividend payout ratio of a company. However the influence on dividend decisions may depend on controlling groups’ perspective and their preferences. The three groups that are affected the most by the firm’s dividend policy are stockholders, bondholders and managers. How the controlling groups’ perspective and preferences change in different situations and its corresponding impact on dividend payout policy requires more attention.

The research covers three sectors of Indian economy. Accordingly, further research is needed to explore the issues surrounding payout policy more fully by extending the
research to other sectors of Indian economy. Every possible effort has been made to make the study more intensive and practicable but the time and resources have been the limiting factors due to which there may exist some gaps in the present study. Hence future research may be directed to bridge the gap so as to enhance the scope of analysis. Most of the previous empirical studies on dividend determinants done in Indian context have focused on manufacturing sector. These studies predominantly include Kumar Jayesh (2001); Mishra and Narender (1996). One of the sectors on which the present research has focused is Services sector. Therefore, in future a comparative study between Dividend policy determinants of Service and Manufacturing sector can be conducted. This would reveal the sectoral differences in the dividend policy determinants.

This research has examined the impact of a set of 21 variables on dividend payout ratios of three respective sectors. Through the work done an attempt has been made to suggest a comprehensive framework that can be useful to the companies, investors and regulators in three chosen sectors for analysing dividend policy. The future research on dividend payout determinants in Indian context can investigate two possible issues. First of all, one may examine the suitability of the statistical methods applied in studying dividend payout policy. There is no prior guarantee that the relationship between dividend payout and its determinants is of linear form (an assumption made in majority of the empirical studies). Furthermore, better proxies of the existing determinants may be identified to obtain better results.

In Indian context, several studies have empirical analysed Lintner dividend Model (1956). The present research work has tested the validity of Lintner Dividend Model using pooled data and static panel data analysis. However, a step ahead could be to empirically test the Lintner model using a framework of Dynamic panel data models.

The Lintner dividend model, which is a finance classic, is based on survey of CFOs of top 28 American Corporations. Subsequently many other survey researches have been reported which also gained popularity but till date Lintner model remains a “finance classic”. Other survey researches include Baker et al. (1985); Farrelly et al. (1986); Baker and Farrelly (1988); Pruitt and Gitman (1991); Lazo (1999);Mohanty (1999); Baker and Powell (2000); and Baker et al. (2001). So far in Indian context Anand Manoj (2002) has done a survey research on dividend policy determinants. He did
survey of 81 CFOs of Business Today 500 companies to find out the determinants of the dividend policy decisions of the corporate India.

Therefore, one of the future research directions can be to do a survey of CFOs to identify determinants having a significant bearing on dividend payout ratios of the three sectors under study. Such research can be undertaken using a survey method approach and a sample of corporate financial managers can be asked about the factors they consider most important at the time of formulating the dividend policy. This will assist assessment of management’s perception about factors governing dividend policy decisions. Further this will also facilitate researchers to know whether managers in different industries (categorized by age, size, investment and industry group) in India share similar views about determinants of dividend policy or not.

It is a well-established fact the characteristics of capital markets vary according to the difference in cultural, financial, legal and political environment of a country. These environmental factors cause differences in the level of disclosure requirements of stock markets in response to various levels of political, financial and economic risks, which have implications for dividend policies. Given the diversity in corporate objectives and environments, it is conceivable to have divergent dividend policies that are specific to firms, industries, markets, or regions. Researchers may try to investigate the extent to which dividend policy is affected by environmental variables, and interactions among the environmental variables in three sectors chosen for study. Further impact of legal systems, institutional factors on dividend policies can be examined. Dividend policy decisions and their linkage with level of investor protection in India could also be ascertained in line with the studies done by La Porta et al. (2000).

However, till date little attention has been paid to the market reaction of dividend initiation announcements, which, according to Asquith and Mullins (1983), are less likely to be anticipated. A dividend initiation is defined as dividend payments by a firm for the first time in its entire corporate history or after a hiatus of more than three years. Several studies in USA and UK have been undertaken to study the impact of dividend initiation on shareholders’ wealth. Most prominent and popular studies in the area are Asquith and Mullins (1983), Dielman and Oppenheimer (1984), Healy and Palepu (1988), Michaely et al. (1995), Mitra and Owers (1995), Howe and Shen
(1998) and Alangar and Bathala (1999). The present research focuses exclusively on finding the impact of dividend announcement on shareholders’ wealth in IT, FMCG and Services sector. An attempt can be made in future to study the dividend initiation impact in these three sectors as most of studies done in Indian context have focused stocks listed on Bombay stock exchange.

The share price reaction to dividend initiation may also differ according to the information environment in which the firms operate. Therefore the empirical studies may be extended to study share price reaction to initial dividend announcements across different information environments. Conceptually, dividend information announcement should provoke stronger price reaction to a “low information environment” relatively to a “high information environment”. Similarly, the volatility increase during the event period should also be higher for “low information environment” firms due to higher uncertainty compared to “high information environment” firms. Therefore, a study can be done in three sectors under question to examine how initiation impact varies for a firm operating in “low information environment” to a “high information environment”.

At the same time the estimation of post announcement stock price and profitability performance for dividend-initiating firms across different information environments should also be examined.

This research has made an endeavor to find the impact of cash dividend announcements (whether increases or decreases) on shareholders’ wealth. Future research in this area can focus on examining the impact of cash dividend increases and decreases announcements on shareholders wealth separately. The impact of alternative modes of dividend distribution like bonus issue and stock buybacks on shareholders’ wealth can also be investigated. This is because it is presumably a possibility that market returns of the companies declaring dividend through alternative modes can be higher as these alternative forms are gradually gaining popularity.

Therefore, it is well understood that despite promising theoretical and empirical work, more research is needed to provide a satisfactory theoretical model; more explicitly specified empirical tests, and guidance to managers concerning optimal dividend policy.
Finally, according to Baket et al. (2002, p.257) “Researchers have identified all the key pieces of the dividend puzzle but need to focus their attention on developing firm-specific dividend model. If this puzzle is jigsaw puzzle, different firms use different combinations of puzzle pieces to form different pictures of the firm. This results because each firm has different characteristics, managers, and stockholders”. In nutshell, further work is necessary to explore the possibility of additional factors that will suggest added guidelines in setting an optimal dividend policy.

Dividend puzzle has remained unexplained over half a century and still it can be stated: “The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don’t fit together”. This research work is a humble contribution to solve dividend puzzle existing in the field of Corporate Finance.

This thesis is an attempt to convey the true economic meaning of the dividend phenomenon to the investors and financial decision makers. If this thesis can make a contribution towards the better understanding of dividends, and dividend policy, the untold number of trees that were required to print the thesis were not cut down for naught.
CITED REFERENCES


