"Each excellent thing, once learned, serves for a measure of all other knowledge."

-Sir Philip Sidney

Before starting the discussion, let’s trace the origin and evolution of corporate dividends. In early sixteenth century, captains of sailing ships in Great Britain and Holland began selling investors’ claims to the financial payoffs of the voyages. At the conclusion of the voyages, proceeds from the sale of the cargo and shipping assets, if any were divided among the participants proportionate to ownership in the enterprise. These distributions were in fact nothing more like payments that effectively liquidated the venture, or liquidating dividends. By the end of the century, these claims on voyage outcomes began trading in the open market. These claims to outcomes were later replaced by share ownership (Kostyuk, 2006)\(^1\). Even before the modern capital theory developed alongside with the statistical measurement of the impact of diversification on portfolio risk, investors in these sailing ventures regularly purchased shares from more than one captain to diversify the risk in these endeavors.

### 2.1 REVIEW OF LITERATURE

In an attempt to find evidence for why companies pay dividend and its impact, the research in the concerned field have been undertaken mostly on two conduits: one
regarding verifying the theoretical approaches to dividend and second, concerning undertaking survey of management people to find out the reasons for and impact of dividend distribution. Lintner (1956)\textsuperscript{2} is credited for the effort for conducting a decisive study in the field of dividend in the United States. He is also being recognized for providing the groundwork for gaining in depth understanding of the dividend policy. He discovered the fact that, past dividend and current profits were considered as influential for predicting current dividend. However, still the corporate world is sans a theory of dividends that squares well with these polished yet stylized specifics. In a survey of literature on dividend policy, Allen and Michaely (1994)\textsuperscript{3} concluded:

\textit{

"Much more empirical and theoretical research on the subject of dividends is required before a consensus can be reached."
}

2.1.1 Review of Literature on Basic Aspects of Dividend: Management’s Perception, Types of Dividend and Its Impact

While Lintner (1956)\textsuperscript{4} provided the stylistic portrayal of dividends, the turning point in the theoretical modeling of dividends was the classic paper by Miller and Modigliani (1961)\textsuperscript{5}, which first proposed dividend irrelevance. As per the model, given a firm’s investment program, the dividend policy of the firm is irrelevant to the firm value, since a higher dividend would necessitate more sale of stock to raise finances for the investment program. The crucial assumption of the model is that the future market value will remain unaffected by current dividends. The argument rests on the assumptions that the investment program is determined independently and that every stockholder earns the
same return (i.e. the discount rate remains constant). Their dividend-irrelevance argument is elegant, but it does not explain why companies, investors, the general public and investment analysts are so interested in dividend announcements.

Pettit (1972)\(^6\) investigated the impact of dividend announcement on returns vis-a-vis earnings announcement. For each month of the study, the dividend announcements were examined and were classified into seven categories. He then classified the reported earnings according to whether they decrease or increase from the expected earnings. An event study approach was adopted for each of the earnings categories and for each of the dividend categories. He concluded that dividends gave more information than earnings.

Watts (1973)\(^7\) studied 310 firms during 1945-67 for the information signaling hypothesis of dividend increases, and found that on average the relationship between future earnings changes and current unexpected dividend changes was positive and therefore, consistent with information hypothesis. But it was found that even though future-earning changes associated with unexpected dividend changes conveyed information to the market participants, the information was insignificant.

Miller and Scholes (1978)\(^8\) provided a fresh rationale for the dividend irrelevance position. Their argument was based upon a common income tax provision, which allowed interest expenses to be deducted from income before applying tax. They showed that by borrowing an appropriate amount, the interest amount could be set off against the dividend income in a way that reduced the taxable income to zero.
Bhattacharyya (1979) developed another explanation for the dividend policy based on asymmetric information. Managers had private knowledge about the distributional support of the projected cash flow and they signal this knowledge to the market through their choice of dividends. In the signaling equilibrium higher value of the support was signaled by higher dividend. His work was followed by a number of other papers which posited that managers use dividend to signal information to the market. Notable works in signaling paradigm of dividend policy are those of Miller and Rock (1985); John and Williams (1985) and Ambarish, John and Williams (1987). These signaling models typically characterize the informational asymmetry by bequeathing the manager or the insider with information about some aspect of the future cash flow. In the signaling equilibriums obtained in these models, the higher the expected cash flow, the higher is the dividend. In John and Williams (1985); Ambarish, John and Williams (1987), the differential taxation of dividends vis-à-vis capital gains sustains the signaling equilibriums.

Aharony and Swary (1980) investigated whether dividend announcements provided information to the market in addition to the information released by the earnings announcement, using an event study methodology. The results showed that an announcement of dividend increase/decrease did release information to the capital market over and above that released by an earnings announcement.

Asquith and Mullins Jr. (1983) conducted a study to investigate the impact of dividends on stockholders’ wealth by making an analysis of 168 firms that either paid the first
dividend in their corporate history or initiated dividends after a 10-year break. The findings were consistent with the view that dividends convey unique and valuable information to the investors.

Divecha and Morse (1983)\textsuperscript{17} conducted an event study on dividend announcements. They took a sample of 1039 dividend increases for 735 firms from May 1977 through February 1979. They divided their sample into two parts — those where dividend payout has increased (Sample Size=668) and those where dividend payout has decreased (Sample Size=371). They found that the excess return for the firms whose payout ratio had decreased was more than that for the firms whose payout ratio had increased.

Miller and Rock (1985)\textsuperscript{18} carried out a study, in which their model corresponded to higher earnings, was signaled by higher “dividends.” The model in this study had the feature that there was no role for taxable cash dividends as long as a non-taxable payout source, such as share repurchases, existed. Their results implied that total payout was more volatile than earnings. If earnings increased with 1, total payout would increase with more than 1.

Jensen (1986)\textsuperscript{19} gave a free cash flow (FCF) theory that provided an alternative explanation for the positive relationship between the direction of the dividend change and the stock price reaction. This theory predicted that higher free cash flow should lead to higher dividend payments in order to prevent firms from over investing. The results were further strengthened in a study conducted by Barclay (1987)\textsuperscript{20} where he found that share
values declined by the full value of dividends before adoption of income taxes in 1913, but not after that.

Healy and Palepu (1988)\textsuperscript{21} discovered that firms initiating dividend payments experienced rapidly increasing earnings both prior to the first dividend and for two years afterwards. However, for firms omitting dividends they find that earnings decline in the year of the omission but then increase substantially in future years.

Lobo, Nair and Song (1989)\textsuperscript{22} conducted a study to explore the signaling property of dividends by examining whether time-series forecasting models that incorporate both dividend and earnings information provided the forecast of future earnings that were more accurate than the forecast incorporating earnings information only. Their results strongly supported the signaling hypothesis.

Brennan and Thakor (1990)\textsuperscript{23} undertook the study to model that the information asymmetry was not between managers and shareholders but among different shareholders. As information was costly and it was not necessarily profitable for every shareholder to get hold of information, stock repurchases led to redistribution of wealth from uninformed to informed stockholders. The larger was the intended cash distribution, the more shareholders would be willing to get informed.

Denis, Denis and Sarin (1994)\textsuperscript{24} found the evidence supporting the signaling hypothesis. Corporations announcing dividend increase enjoyed a 1.25% abnormal return, and
corporations announcing dividend reductions suffered a -5.71% abnormal return. They found the evidence that analysts significantly revised their earnings estimates in the direction of the dividend change following the announcements, and that the corporations change their capital expenditures in the direction of the dividend change following the announcements.

Rao (1994)\textsuperscript{25} in a study conducted on BSE listed companies during 1988-89 found that the stock prices react positively to dividend increased announcements and this reaction started even two days before the formal announcement was made. For bonus announcements, the adjustment of stock prices occurred exactly on the announcement day itself, whereas in case of right issue announcements, the adjustment started one day late and it continued till next day.

Michaely, Thaler and Womack (1995)\textsuperscript{26} found that dividend initiations were followed by positive abnormal returns of 3.4%, and dividend omissions were followed by abnormal losses of 7.0%. Corporations substituting stock dividends for cash dividends found that their stock prices decreased by an abnormal 3.1% during the 3-day event period. When they lengthen the time frame of their analysis to examine the long-term effect of the change in dividend policy, they found the evidence that initiating corporations continued to enjoy positive abnormal returns and omitting corporations continued to suffer negative abnormal returns for a year after the announcement.
Yoon and Starks (1995)\(^{27}\) find that their study did not support the free cash flow hypothesis of dividend policy. The investment opportunity set is proxied by Tobin’s Q. They discovered that, low Q firms (Q<1) have higher dividend yields and larger dividend changes as well as smaller size.

Han, Lee and Suk (1999)\(^{28}\) tested the agency cost based hypothesis, which predicted, dividend payout to be inversely related to the degree of institutional ownership and the tax based hypothesis, predicting the dividends to be positively related with the institutional ownership. They provided hold up for the tax-based hypothesis, suggesting a “dividend clientele” for institution’s preference for higher dividends.

Wei Chen et al. (1999)\(^{29}\) empirically analyzed the dividend policy of Shanghai stock market by the method of Cumulative Abnormal Return (CAR) and studied the existence and character of the signaling effect of dividend policy in this market. The study showed that the degree of CAR was very different from different dividend policies. The CAR of right issue was higher than cash dividend but lower than bonus.

Ayers, Cloyd and Robinson (2000)\(^{30}\) investigated the stock price reaction to the 1993 increase in the top U.S. statutory individual tax rate. They hypothesized that the higher a firm’s dividend yields, the more negative will be the firm’s stock price reaction to the rate increase. They found that the higher a firm’s dividend yield, the more negative the stock price reaction over their event period, but that the returns were more negative for stocks in which the marginal investor is likely to be an individual taxpayer.
Collins and Kemsley (2000)\textsuperscript{31} extended the above-mentioned study. The study included capital gains taxes in the model and scrutinized the influence of dividend taxes on current and retained earnings. The study concluded that when the effects of implicit dividend taxes are taken into account, dividend payouts could provide a net tax benefit for the shareholders instead of the generally assumed net tax penalty.

Faccio, Lang and Young (2001)\textsuperscript{32} studied the relationship of dividends rates to the discrepancy that existed between the shareholder’s ownership rights and its control rights. The ratio of ownership and control rights was used as a measure of the corporation’s vulnerability to insider expropriation within a group of corporations. The study found out that significantly the corporations that were tightly affiliated paid higher dividends to a business group.

Travlos, Trigeorgis and Vafeas (2001)\textsuperscript{33} conducted a study to examine the stock market reaction to announcements of cash dividend increases and bonus issues (stock dividends) in the emerging stock market of Cyprus using standard event-study methodology from 1985-1995. This study contended that special characteristics of the Cyprus stock market delimited applicability of most traditional explanations for cash and stock dividends in favor of an information signaling explanation.

Grullon, Michaely and Swaminathan (2002)\textsuperscript{34} undertook a study on 6,284 dividend increases and 1,358 dividend decreases for a total of 7,642 dividend change announcements. They found that firms that increased dividends experienced a significant
decline in their systematic risk while firms that decreased dividends experienced a
significant increase in systematic risk. Thus, the free cash flow hypothesis became a
significant element of the maturity hypothesis.

Jong, Vijk and Veld (2003)\textsuperscript{35} conducted a study on dividend and share repurchase policy
of Canadian firms. The results were consistent with a structure in which the company
first decides whether it wants to pay out cash to its shareholders or not. In the second
stage the firm decided on the form of the payout: dividends, share repurchases or both.

Lee and Ryan (2002)\textsuperscript{36} analyzed the dividend signaling-hypothesis and the issue of
direction of causality between earnings and dividends - whether earnings cause dividends
or vice versa. For a sample of 133 dividend initiations and 165 dividend omissions, they
found that dividend payment was influenced by recent performance of earnings, and free
cash flows. They also found evidence of positive (negative) earnings growth preceding
dividend initiations (omissions).

Raaballe and Bechmann (2002)\textsuperscript{37} made an attempt to solve dividend puzzle. It was
concluded that companies with a quality lower than the critical level would signal using
only sources other than cash dividends and indicating that higher payouts would imply a
higher market value of the shares. But the authors still concluded the fact of dividend as a
puzzle.
Uddin (2003) conducted a study in Dhaka on the effect of dividend announcement on shareholders value. The study was carried out on the sample of 137 companies paying dividend during October 2001 to September 2002 and listed on Dhaka stock exchange. The study reflected that the shareholders suffered a loss of about 20 percent of value over a period of 30 days prior to the dividend announcement through to 30 days after the announcement. Overall, the evidence supported the dividend irrelevancy hypothesis.

DeAngelo, DeAngelo and Stulz (2004) conducted a study on the relationship between dividend, agency cost and earned equity. The study suggested that firms with relatively high amounts of earned equity (retained earnings) are especially likely to pay dividends. In their study, they observed the existence of a highly significant relation between the decision to pay dividends and the ratio of earned equity to total equity or total assets, controlling for firm size, profitability, growth, leverage, cash balances, and dividend history.

Gryglewicz (2004) conducted a study on how the market observe and act in response to announcement of stock repurchases and dividends and what determinate corporate payout policy in Polish exchange-listed firms. The study reflected that the average abnormal returns in the announcement period were relatively high.

Caskey and Hanlon (2005) looked into whether dividends provided information about earnings quality by examining the dividend payout policies of firms accused by the Securities and Exchange Commission (SEC) of committing financial accounting fraud.
They found evidence consistent with the alleged fraud firms paying out dividends less often and of a lower amount than a matched sample of firms not accused of financial accounting fraud.

Hanlon, Myers and Shevlin (2007)\textsuperscript{42} investigated whether dividends provided information to the market about future earnings. This study was undertaken by investigating the association between current year stock returns and future earnings for the firms that paid dividends in the current year as compared to firms that did not pay dividends. The study revealed that relative to non-dividend paying firms; dividend-paying firms had current returns that were more associated with future earnings.

Indro, Lee, and Wann (2006)\textsuperscript{43} made an attempt to study the liquidity and corporate payout policy covering the time period of 1965-2004. The results confirmed that the informational asymmetry benefits of liquidity were more important for high growth firms, and the agency costs of liquidity, more significant for low growth firms. Payouts increased (decreased) in positive (negative) liquidity shock events.

Kostyuk (2006)\textsuperscript{44} conducted a study on dividend payout and its impact on firm’s value. In all, 60 enterprises were taken from Ukraine, Russia and Croatia. To conduct the study, the regression analysis was used. The study concluded that there existed a positive relation between firms paying dividend and its value.
Li and Zhao (2007)\textsuperscript{45} analysed that a firm’s information environment, measured by the number of analysts following the firm, was an important factor in the firm’s dividend policy. The firms with greater analyst coverage were found to be associated with a reduced propensity to make dividend payments and to initiate dividends, considering other thing same. Among dividend payers, greater analyst coverage was negatively associated with the amount of dividends paid.

Mollah and Mobarek (2007)\textsuperscript{46} investigated whether dividend announcements conveyed information to the market or whether investors considered announcements of dividends as a signaling device of the firm’s future prospects of the listed companies on the Dhaka Stock Exchange (DSE) for the period preceding and following the financial crisis of 1998 were considered in this study. The results suggested that there was no significant impact of dividend announcements on the security prices of the DSE, which implied that dividend announcements did not contain any information and effectively appeared insignificant in the stock market of Bangladesh.

2.1.2 Review of Literature on Factors Affecting Dividend: Basis, Reflection, Behavior, Firm’s Structure, Capital Structure, Trends, Impact, Cuts and Its Determinants

Lintner (1956)\textsuperscript{47} undertook one of the classic studies on how managers in USA made dividend decisions. For conducting the study, he constructed a model comprising of variables like size of firm, expenditure on plant and equipment, willingness to use external financing, use of stock dividends, earnings stability and ownership by control
groups. A sample of 600 industrial listed companies was taken. In his study, he uncovered the fact for the first time that firms in USA maintained a target dividend payout ratio and adjusted their dividend policy to this target. The long-term sustainable investment and growth objectives determined the firms’ target payout ratios. These findings suggested that firms establish their dividends in accordance with the level of current earnings as well as dividend of the previous year.

Darling (1957)\textsuperscript{48} undertook a significant study on dividend behavior with the help of multiple regression analysis. He took into consideration data for a number of manufacturing corporations for the period 1921-54, omitting the years 1936-38. He concluded that the dividends tend to vary directly with current profits, lagged profits, the rate of amortization recoveries and shifts in anticipation of future earnings; and inversely with persistent changes in level of sales.

Fama and Babiak (1968)\textsuperscript{49} conducted a study on the determinants of dividend. The study covered the time period of 1946-64 and it was carried out on the individual firms. The study concluded that net income provided a better measure of dividend rather than cash flow.

Kennedy (1979)\textsuperscript{50} attempted to determine those factors which influence the dividend payout decision of large U.S. commercial banks. A two pronged approach was used. First, a model was developed using twenty variables which could be theorized to discriminate those large banks which paid a relatively low or medium proportion. The
second approach involved a survey of bankers to rate importance of various factors in influencing their dividend decision. The most important factors based on average rating were: a) paying a level of dividend per share which can be maintained in future and b) paying at least as much in cash dividend per share as was paid at the last date.

Bhole (1980)\textsuperscript{51} using simple, multiple and step-wise regression analysis techniques, tested retained earnings, dividends and share prices of medium and large public limited companies for the period 1960-61 to 1975-76. He concluded that the single most important determinant of the saving ratio in the case of medium and large public limited companies is the net profit after tax. He also concluded that Lintner’s model did not perform well during the period of study.

Litzenberger and Ramaswamy (1982)\textsuperscript{52} found a positive relationship between returns and dividends, even after including controls for the information effects of dividends. They concluded that it is still an open question as to whether personal taxes or some omitted variable (other than information effects) account for their results.

Khurana (1985)\textsuperscript{53} sought to determine the influence of factors like net profits, liquidity, reserve position, share prices, investors’ expectations, investment level etc. on dividend policy. A sample of 65 manufacturing concerns was taken for the time period of 1962-63 to 1976-77. His study revealed that lagged profits offered a significant explanation of the current level of dividends and concluded that lagged profit was considered as an important factor in dividend decision.
DeAngelo and De Angelo (1990)\textsuperscript{54} examined the US data for 1980-85 so as to study the dividend policy of the firms who had complained of poor earnings despite of continuous dividend declaration. They discovered that around half of all firms with ten or more year’s prior positive dividends and earnings cut dividends in the initial loss year.

DeAngelo, DeAngelo and Skinner (1992)\textsuperscript{55} analysed the relationship between dividends and losses and the information conveyed by dividend changes about the earnings performance of 167 NYSE firms. They found that 50.9\% of 167 firms with at least one loss during 1980-95 reduced dividends, compared to 1\% of 440 firms without losses. The results of the study supported the signaling hypothesis in that dividend changes improve the ability to predict future earnings performance.

Jensen, Solberg and Zorn (1992)\textsuperscript{56} examined the determinants of cross-sectional differences in insider ownership, debt, and dividend policy. They found that the firms with higher insider ownership chose lower level of debt and dividends.

Mookerjee (1992)\textsuperscript{57} made an attempt to apply the Lintner model to developing countries, focusing on India. For this purpose, the data of aggregate Indian corporate sector for the time period 1949-81 was taken. The study concluded that the model applies well in Indian conditions.

Mahapatra and Sahu (1993)\textsuperscript{58} analysed the determinants of dividend policy using the models developed by Lintner (1956)\textsuperscript{59}, Darling (1957)\textsuperscript{60} and Brittain (1966)\textsuperscript{61}. The
sample size for the study was 90 companies covering the period 1977-78 to 1988-89. The study exposed the fact that cash flow was the major determinant followed by net earnings.

Bhat and Pandey (1994)\textsuperscript{62} made an attempt to study the manager’s perception regarding the importance of various factors in determining dividend policy of 425 Indian companies for the period 1986-87 to 1990-91. They found that on an average profit-making Indian companies have distributed about one-third of their net earnings and that the average dividend payout ratio was 43.6 percent. The study reflected that payment of dividend was dependent on current and expected earnings and also on past dividends.

Glen et al. (1995)\textsuperscript{63} studied the dividend policies of firms in emerging markets. The study exposed the fact that firms did have the target dividend payout rate but were less concerned with dividend volatility. Further, the study also concluded that shareholders and government exerted a great influence on dividend policy.

Lee (1996)\textsuperscript{64} tried to test the existence of long-term relationship between earnings and dividend. For this purpose, the data was taken from S&P Index for the year 1871-1992 and bivariate time-series model has been used. The study concluded that earnings determine dividends. Further, the study also concluded that Lintner’s model performed well when target pay-out ratio is a function of permanent earnings.
Mishra and Narender (1996)\textsuperscript{65} analyzed the dividend policies of 39 state-owned enterprises in India for the period 1984-85 to 1993-94. They found that earning per share (EPS) was a major factor in determining the dividend payout.

Benartzi et al. (1997)\textsuperscript{66} examined the relation between dividend changes and earnings. For the study, a sample of 7186 dividend announcements made by NYSE or AMEX firms during the period 1979-91 was undertaken. They found a lagged relation between dividend changes and earnings.

Kaur (1997)\textsuperscript{67} conducted the doctoral research on determinants of corporate dividend policy in India. The sample for the study consisted of 29 companies in Chemical industry, 20 companies in Metals and Alloys, 17 companies in electrical industry and 34 in Engineering industry, totaling 100 companies. The data was analysed using multiple linear regression model. The study concluded that out of the variables chosen for the study, five variables were found to be most influential in determining the corporate dividend policy, namely: lagged dividend, behavior of share prices, current net profits, lagged net profits and net profit ratio.

Olatundun (nd)\textsuperscript{68} conducted a 882 firm-year study on a sample of 63 quoted firms in Nigeria over a wider testing period from 1984 to 1997. Dividend behavior was tested using the Lintner-Brittain model and its variants on the pooled cross sectional / time series data for the full sample of observations from 1984-1994. The models were estimated using the Ordinary Least Square (OLS) method. The result showed that there
was no significant interaction between the conventional Lintner / Brittain model and dividend decisions of Nigerian firms. The empirical results revealed that the dividend policies of Nigerian companies were influenced by after tax earnings, economic policy changes, growth potentials and long-term debt.

Lazo (1999)\(^69\) conducted a study on the signaling aspect of dividends as far as the future earnings were concerned. For the purpose of the study, he undertook the survey of 110 managers from Standard & Poor’s 500 companies. The study brought out the fact that about 90% of the companies were using dividends as a signal of their future earnings.

Baker, Veit and Powell (2001)\(^70\) studied the factors influencing dividend policy decisions of corporate firms traded on the Nasdaq of 188 firms out of a total of 630 firms that paid dividends in each quarter of calendar years 1996 and 1997. The findings of the study included that the factors influencing the dividend decision were pattern of past dividends, stability of earnings, and the level of current and future expected earnings. The study also reported statistically significant differences in the importance that managers attach to dividend policy in different industries such as financial versus non-financial firms.

Baker et al. (2002)\(^71\) has studied dividend behavior along with managerial perspectives. They identified four factors that might influence firm’s policy of moving cash: market imperfections, behavioral considerations, firm characteristics and managerial preferences. They concluded that there cannot be a single model for all firms and that the optimal model would fit, given the temporal circumstances.
Frankfurter and Kosedag et al. (2002)\textsuperscript{72} conducted a study on the perception of dividend by financial decision-makers through a survey instrument form 954 German firms listed on different stock exchanges in Germany using factor analysis and hierarchical grouping techniques. They found that there were similarities of perception on few principles of dividend policies but significant differences between two groups were also found where more growth oriented firms had progressive views about importance of self generated capital and less for stable dividend policy.

Reddy (2002)\textsuperscript{73} conducted a study on analyzing the trends and determinants of dividend policy of Indian corporates from 1990-2001. The study exposed the fact that percentage of companies paying dividend had declined from 60.5 percent in 1990 to 32.1 percent in 2001.

Al-Deehani and Talla (2003)\textsuperscript{74} undertook a study in Kuwait to find out the determinants of dividend policy with the motive of extracting senior manager's perception of the dividend policies. The study concluded that dividend policy did matter and that managers believed they were frequently motivated to pay dividends by factors that belonged basically to three groups of determinants.

Kumar (2003)\textsuperscript{75} explored the association between the corporate governance and the dividend payout policy for a panel of Indian corporate firms over the period 1994- 2000. The study made an attempt to explain the observed behavior with the help of well-established dividend models of Linter (1956)\textsuperscript{76} and Fama and Babiak (1968)\textsuperscript{77}. The study
brought out the existence of a positive association of dividends with earnings and dividends trend. Debt equity ratio was found to be negatively associated, whereas past investment opportunities exerted a positive impact on dividends. Ownership by the corporate and directors was positively related with dividends payout in level, and corporate ownership was negatively related in square. Institutional ownership had inverse effect on dividends in comparison to corporate ownership in levels as well as in its squares.

Pandey (2003)\textsuperscript{78} examined the corporate dividend behavior of 248 companies listed on the KLSE (Kuala Lumpur Stock Exchange) Main Board as at 31 December 2000. The results showed the influence of industry on payout ratios. The results revealed that the dividend behavior of the Malaysian companies was sensitive to the changes in earnings. Using Lintner’s framework and panel regression methodology, the researcher found evidence of less stable dividend policies being pursued by the Malaysian companies.

Anand (2004)\textsuperscript{79} undertook a study to analyze the factors influencing the dividend policy decisions of corporates in India using the results of 2001 survey of 81 CFOs of bt-500 companies. The study concluded that most of the firms had target dividend payout ratio and dividend changes followed shift in the long-term sustainable earnings. Also, the findings on dividend policy were in agreement with Lintner's study on dividend policy.

Benzinho (2004)\textsuperscript{80} made an attempt to study how the corporations that trade in the Lisbon Stock Exchange (Euronext Lisbon), set their dividend policies in a different institutional environment and research empirically whether they followed stable cash dividend
policies as in developed markets where dividend smoothing is a management tendency. For testing dividend stability and institutional effects, the dividend policy model of Lintner (1956) was used. The empirical results showed that the Euronext Lisbon corporations followed a relatively stable cash dividend policies and the main factors that determined the dividends was the earnings of the firm in that year and the lagged dividends.


Pandey and Bhatt (2004) conducted a study on dividend behavior of Indian companies under monetary policy restrictions. The final sample of the study consisted of 571 manufacturing firms and the observations were taken from 1989-1997. The Lintner’s model was used to test the dividend stability in Indian firms. The results reflected that the Indian firms had lower target ratios and higher adjustment factors.

Sarma and Kuin (2004) examined the corporate dividend behavior of Malaysian companies through the application of Lintner’s stock adjustment model for the time period 1998-2001. The results of the study were found to be consistent with the Lintner’s model and also the evidence was available that the companies preferred stable dividend
policies. The empirical results showed that the main determinants of dividend policy were lagged dividends and current earnings.

Skinner (2004)\(^{85}\) in the study concluded that the firms, which were paying dividends, reflected a strong relationship between current and future earnings as compared to firms, which were not paying dividends.

Naceur Samy Ben et al. (nd)\(^{86}\) conducted a study on the determinants and dynamics of dividend policy of 48 firms listed on Tunisian Stock Exchange during 1996-2002. The study demonstrated that Tunisian firms relied on both the current earnings and past dividends but the weight age was more for current earnings. The study also concluded that profitable firms pay larger dividends.

Baker, Mukherjee and Paskelian (2006)\(^{87}\) conducted a study on how Norwegian Managers view dividend policy. The study reflected that most important determinants of a firm’s dividend policy were the level of current and expected future earnings, stability of earnings, current degree of financial leverage, and liquidity constraints. However, no significant correlation was found to exist between the overall rankings of factors influencing dividend policy between Norwegian and U.S. managers.

Caskey and Hanlon (2005)\(^{88}\) investigated the reflection of dividend on quality of earnings and tried to find out whether dividends reflected honesty. The sample consisted of firms accused and firms not accused of accounting frauds by Securities Exchange Commission
and consisted of 189 firms. The study evidenced dividend as an important indicator of earnings quality.

Jahur and Nazneen (2005) conducted an empirical study on four industries viz. Textile and clothing, Pharmaceuticals and Chemicals, Cement, Engineering and Electrical products in Bangladesh to find out the determinants of dividend policy of 28 companies using factor analysis. The study demonstrated five common factors: Dividends, yield and pay-out ratio, Profitability and capital structure, Dividend and earnings volatility, Returns, profitability ratios and behavior of share prices and Firm’s profitability, changes in size and composition of firm’s capital size.

Liu and Hu (2005) made an attempt to empirically analyze the dividend policy of Chinese listed companies by studying how cash flow impacted on cash dividend by considering twelve variables. The study concluded that the payment of cash dividend was usually less than accounting profit in Chinese listed companies; payment of cash dividend in Chinese listed companies was relevantly positive for current return per share and total assets but negative for debt to asset ratio.

Mahakud (2005) examined the influence of shareholding pattern on dividend pay-out ratio of the Indian companies in the manufacturing sector and listed on Bombay Stock Exchange from 2001-04 and was conducted using panel data analysis. The study concluded the positive association of dividend and lagged dividend, earnings, sales and company’s size.
Sarma and Panda (2005)\textsuperscript{92} made an attempt to identify the factors that determine the dividend behavior of Indian corporate sector. For this purpose, an optimal dividend equation in the form of exponential function was constructed. The study reflected that among the financial variables, profits, capital structure, sales change and lagged dividend showed significant result.

Mollah et al. (2007)\textsuperscript{93} conducted a study to identify the effect of dividend policy on stock price behaviour in the emerging market of Bangladesh. The empirical results suggested that Brittain's (1966)\textsuperscript{94} dividend behavior model offered satisfactory explanation of dividend behavior of the listed companies on the Dhaka Stock Exchange. The empirical results also suggested that dividend decisions were primarily governed by current profitability for measuring the capacity of the companies to pay dividends as well as dividends paid in the previous years, i.e., lagged dividends.

2.1.3 Summary of Findings of Review of Literature (Research Gap)

\textit{You can swim all day in the Sea of Knowledge and still come out completely dry. Most people do.}”

- Norman Juster

The perusal of literature review revealed that dividend is a widely researched area with contributions from number of researchers and academicians for the past so many decades. Further it has been found out that majority of the researches have focused on:
1. Very few studies have been conducted underlying the human aspect of dividend policy, that is, management considerations and perceptions governing the dividend decision. Even within those studies, the focus was only on few of the variables like on profitability and investment, to name a few.

2. Past reviews indicated the presence of number of factors affecting dividend decision of the companies. But the variations in the variables were found with differences in the scope of the study.

3. With respect to examine the validity of known dividend models, majority of the past researches have examined the same in context of Lintner model of Dividend only.

4. On the statistical research methodology front, majority of the past researches have used regression technique for analyzing and interpreting the data related to various aspects of dividend policy.

5. Numerous studies have shown consensus with the fact that there exists relationship between dividend and value of firm while some researches have given contrary results. But, on whole majority of the studies have reported the existence of relationship between the dividend decision of the company and its value.

2.2 NEED FOR THE STUDY

“You cannot solve a problem until you acknowledge that you have one and accept responsibility for solving it”.

-Zig Ziglar
The perusal of review of literature revealed the existence of various schools of thoughts on dividend policy, its determinants and the management beliefs about it. In order to gain insight into the one of the greatest puzzles of modern finance: the love of dividends by shareholders and the practice of dividend payments, number of researches have been undertaken till date. But no universal accepted answer could be found. On the other hand, it is also true that one cannot understand and generalize the motivation and perception of people by analyzing market data. The best and suitable way to understand the dividend puzzle is to find out what human perceptions are and giving them a chance to express their opinion. Why do firms pay dividends? Is there, or should there be a corporate “dividend policy”? The answer to these questions has always been there in the spotlight of management decisions. Along with this, a set of decisions in the form of a proper dividend policy should also be explained from the viewpoint of an economic man. Also in order to find the universal acceptable dividend model, the academicians and researchers forgot the point that dividend behavior across firm changes due to firm specific changes. That is why; even today the study of dividend is termed as ‘Dividend Puzzle’. However, Glen et al. (1995, p.24) concluded that

*The evidence presented here provides insight into the dividend policies of emerging market firms, but it also illustrates the complexity of this issue and leaves many unanswered questions. A better understanding of dividend behavior in these countries will require much additional research, both at the aggregate and firm levels.*
A number of studies on Dividend have been conducted in Indian as well as foreign context addressing the issue of dividend behavior of companies and its determinants. The question arises as to why there is a need to study the subject, which has widely been researched. This can be answered by putting forth the following arguments:

1. No set of consistent variables could be found which can address the dividend behavior of the companies. The set of variables differ from researcher to researcher and also vary in the foreign and Indian studies. Therefore, it would be worthwhile to make an attempt to consider all the possible and important set of variables, which govern the corporate dividend policy.

2. Another research gap has been identified in terms of the management considerations while declaring dividends. Although, the past researches have covered this aspect but still a need is felt to enquire into the issue to study the changes in the management considerations with the advancement of time.

2.3 SCOPE OF THE STUDY

"My eyes are an ocean in which my dreams are reflected."

Anna M. Uhlich

The current study has covered four industrial sectors viz. Engineering, FMCG, Information Technology and Textile. An attempt has been made to select the representative sample on the parameters of contribution to GDP and employment, mix of traditional and modern, strong base of an economy and giving promising opportunities
for growth. The concerned sectors had been identified on the basis of following summarized facts:

1. Engineering sector is one of the largest segments of Indian industry and is the backbone for all other industries. This industrial sector provides a strong base for other industries in India. This sector mainly consists of heavy engineering and light engineering industry. India is a major exporter of heavy and light engineering goods.

2. FMCG sector caters to the retail segment of India and is considered as support of Indian economy. This sector caters to the consumers who are considered as king in the modern competitive world. This sector is considered as one of the most promising sectors in terms of return generation.

3. Information technology sector of India has become one of the growing industrial segments. This industry is one of the modern industries and is in the booming stage. This sector’s contribution is increasing in terms of exports revenue and employment generation.

4. The textile sector is one of the traditional industrial sectors of India accounting for utmost output and second largest employment generator. Also this sector is the second largest in world after China.

The industrial sectors have covered 172 companies. The list of the companies covered under the study has been given in Appendix C. The time period covered was from 2004 to 2008. The sample was selected on the basis of following criteria:
a) The company must be listed with Bombay Stock Exchange.

b) The company must have paid dividend for the years 2004-08.

2.4 RESEARCH OBJECTIVES

“All you have to do is know where you’re going.
The answers will come to you of their own accord”.

-Earl Nightingale

The study aimed at examining the managements’ considerations in the formulation of dividend policies by the managements of the companies under study and the determinants of dividend policies. This broad objective has further been delineated into the followings:

1. To identify the major management considerations governing the formulation of dividend policy.
2. To identify the dominant variables affecting dividend policies of selected companies.
3. To examine the validity of known dividend models among the selected companies.
4. To examine the relationship between dividend policy and the value of firm.
5. To make suggestions for formulation of effective dividend policy and further research.
2.5 RESEARCH HYPOTHESES

“So wonder on, till Truth make all things plain.”

--William Shakespeare

In order to achieve the proposed objectives of the research study, the following null hypotheses have been framed:

Hypothesis 1: Managements of the companies do not have any definite considerations while framing dividend policy.

Lintner (1956)\(^96\) concluded that managers prefer increase in dividends. Black (1976)\(^97\) could found no convincing explanation of why companies pay cash dividends to their shareholders. Khurana (1985)\(^98\) studied that managers are more concerned about lagged dividend while taking a dividend decision. Further, Kaur (1997)\(^99\) found that managers considered dividend as primary decision of corporate financial policy. However, numerous studies have been conducted by various researchers regarding the management concerns while taking dividend decision. But the results varied with the scope of the study (Baker, Veit and Powell, 2001)\(^100\). The same fact was supported by the study of Frankfurter et al. (2002)\(^101\) and Baker, Mukherjee and Paskelian (2005)\(^102\).

\(H_01\): The dividend decision is taken by a company after considering various decisive factors like type and desires of shareholders, need for future expansion, nature and type of business, age of a company, current profitability, liquidity position etc. However, the extent of the influence of these factors varies from a company to
company. Hence, a company is required to study these factors while framing the suitable dividend policy. Thus, the hypothesis has been framed that the managements of the companies do not have any definite considerations while framing dividend policy.

**Hypothesis 2: Known Dividend Models do not fit into Indian conditions.**

Mookerjee (1992)\(^{103}\) in the study concluded that Lintner model, a well-known dividend model, fits into Indian conditions. The results were further supported by the study of Mahapatra and Sahu (1993)\(^{104}\). Kaur (1997)\(^{105}\) has examined the validity of some known dividend models like Lintner model, Pettit model, Watts’s model, Charest model and Aharony and Swary model and has concluded that Lintner model is the best among all the models and fits very well in Indian conditions. However, other models only provided satisfactory explanation. Besides these, studies the validity of various well-known models have been made in context of foreign countries. On the basis of findings of the previous studies, the hypothesis has been framed.

\(H_02\): Various known dividend models are there depending on various dividend theories and aspects. The validity of the models varies in various researches. Thus, in order to examine the validity, the hypothesis has been framed that known dividend models do not fit into Indian conditions.

**Hypothesis 3: There exists no relationship between dividend policy and the value of firm.**
Gordon (1962)\textsuperscript{106} and Lintner (1962)\textsuperscript{107} suggested that there is a positive correlation between a firm’s dividend policy and the market value of this firm. This outcome was further supported by the studies conducted by Asquith and Mullins (1983)\textsuperscript{108}, Srivastava (1984)\textsuperscript{109} and Anand (2004)\textsuperscript{110}. Bhat and Pandey (1994)\textsuperscript{111} put forth that managers do consider the existence of positive relationship between dividend and value of firm. However, Miller and Modigliani (1961)\textsuperscript{112} claimed, in a perfect world, the value of a firm is unaffected by the distribution of dividends and is determined by the earnings ability of the firm and the risk of holding assets. If the firm pays dividends, each share will be worth less because new shares must be issued to finance the cash outflow. Also, investors can obtain cash by selling their shares in the market (Miller and Modigliani, 1961\textsuperscript{113}; Brealey and Myers, 2000\textsuperscript{114}). Therefore, firms need not worry about their dividend policy (Brealey and Myers, 2000)\textsuperscript{115}. The absence of relationship between dividend and value of firm was strengthened in the researches conducted by Harris and Kemsley (1999)\textsuperscript{116} and Uddin (2003)\textsuperscript{117}. Survey evidence by Baker and Powell (1999)\textsuperscript{118} and Baker, Powell, and Veit (2001)\textsuperscript{119} showed that most of their respondents believe that dividend policy affects firm value.

\textbf{H}_0: Theoretically, it is assumed that dividends serve as an indicator of the firm’s present and future performance and potential risk level by lending credibility to management claims, and as such may help determine the market price of the stock. However, academic literature suggests that dividend payments should have no impact on shareholders value in the absence of taxes and market imperfections. Hence, companies should invest excess funds in the positive net present value projects.
instead of paying out them to the shareholders. It is also assumed that market valuation of stocks depends on the expected future dividends. If company pays out all of the earnings, funds for future investment will decrease and dividend may not increase in the future. Moreover, when dividend is taxable, paying out more cash would increase the shareholders tax liability. Despite these theoretical arguments for not paying dividends, companies often pay cash dividends to their shareholders possibly to signal information about the future earnings prospects. Thus, there is no consensus in the theory as to impact of dividend on the value of the firm. Hence, it has been assumed that there exists no relationship between dividend policy and the value of firm.

2.6 RESEARCH METHODOLOGY

“If you wish to find, you must search.

Rarely does a good idea interrupt you”.

-Jim Rohn

The proof of the pudding is in eating, and the validity of a theory is the scale of its uniformity with pragmatic authenticity. A properly conducted research will take into account the empirical implications of all the theories and then testing them simultaneously.
2.6.1 Research Design

The present research work was conclusion oriented with special respect to descriptive, causal and empirical research as it covered the study of managements’ perception and factors affecting dividend decision. Since the study aimed at identifying the existence of relationships between various variables in the study, the causal research design has been used.

2.6.2 Sampling Plan

The universe for the current research was all the listed companies in India and the sample universe or the target population for the study was four industrial sectors: Engineering, FMCG, Information Technology and Textiles. The sample was selected for the study on the basis of following criteria:

a) The company must be listed with Bombay Stock Exchange
b) The company must have paid dividend in the years 2004-08

The sample companies for collecting primary data were 31 companies in all (Annexure B). The final sample for secondary data was of 172 companies viz. 63 in Engineering industry, 39 in FMCG industry, 40 in IT industry and 30 in Textile industry (Annexure C). The sample was selected on the basis of stratified random sampling. The sample unit for the research was a listed company on Bombay stock exchange from the four sample sectors viz. Engineering, FMCG, Information Technology and Textile where the element for the research was CEO/CFO/CS of the sample respondent company.
2.6.3 Data Base and Analysis

2.6.3.1 Secondary Data Base and Methodology

Data Base

The secondary data represents the already available information. In the present research, secondary data has been collected through external secondary data sources. For such purpose, computerized database has been used. The secondary data for the selected variables affecting the companies’ dividend policy has been extracted from the computerized data base: Prowess which is maintained by Centre for Monitoring Indian Economy. It is a firm-level database of over 20,000 Indian companies that provides colossal details on the performance. It contains detailed normalised data collected from the audited annual accounts, stock exchanges, company announcements, etc covering 1,500 data items and ratios per company.

Secondary Study Sample

The secondary sampling was carried out in three stages and was quite complex, involving purposive, stratified and random sampling. In the first stage, a list of 1513 companies in Engineering, FMCG, IT and Textile sector was generated by Prowess data base.

In the second stage, sampling units were screened on the basis of two criteria: one, the company must be listed with Bombay stock exchange and second, it must have paid dividend in last five years (2004-08). The companies not fulfilling the criteria (1271) were removed.
In the third stage, the companies with missing data (70) were removed thus, yielding 172 companies for final sample. The final sample included 63 companies in the Engineering sector, 39 companies from the FMCG sector, 40 companies from IT sector and 30 companies in the Textiles sector. The Table 2.1 gives the details of how the final sample for secondary data collection for the current research has been selected.

**Table 2.1: Data Cleaning Steps for Secondary Data**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Companies listed on BSE generated by Prowess for four selected industrial sectors</td>
<td>1513</td>
</tr>
<tr>
<td>2</td>
<td>Less: Companies not fulfilling the criteria of regular dividend payment for the years 2004-08</td>
<td>1271</td>
</tr>
<tr>
<td>3</td>
<td>Less: Companies with missing data</td>
<td>70</td>
</tr>
<tr>
<td>4</td>
<td>Final Sample</td>
<td></td>
</tr>
<tr>
<td></td>
<td>-Engineering</td>
<td>63</td>
</tr>
<tr>
<td></td>
<td>-FMCG</td>
<td>39</td>
</tr>
<tr>
<td></td>
<td>-Information Technology</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>-Textile</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td></td>
<td>172</td>
</tr>
</tbody>
</table>

**Selected Variables for the Study**

Perusal of review of literature had identified a set of variables that were considered for selecting the sample variables for the study. Since, the research design was causal in nature; the identified variables have been divided in different categories to identify the cause and effect relationship. The different categories of the variables were:

**a) Independent Variables:** It refers to those variables that are open to manipulations and the researcher tries to measure the impact of these variables on other set of variables. The independent variables in the study were: Dividend per share to par value, Dividend per share to book value and Dividend payout ratio.
b) **Dependent Variables**: It refers to those variables that are influenced by the manipulations in the independent variables. Basically, their role is to study the impact of independent variables on the test units, that is, the respondent unit under examination, a selected sample company in the present study. The various dependent variables were: Growth in earnings per share, Growth in working capital, Current ratio, Debt-equity ratio, Solvency ratio, Free cash flow, Cash holdings, Share price behavior, Lagged dividend per share, Lagged profits, Return on capital employed, Return on Net worth, Age of company, Net profit to Net worth ratio, Net profit ratio, Investment opportunity set, Tobin’s Q and Uncertainty in earnings, Market value to book value and Market value to par value.

### 2.6.3.2 Primary Data Base and Methodology

**Basic Questionnaire Development**

In order to unfold the management considerations while taking dividend decision, the information was sought from the persons actually involved in the same task. This entailed conducting an extensive study to address the research questions. For this purpose, the requirement of collecting the fresh data was felt. As the respondents were huge in number and were scattered geographically, questionnaire was assumed to be the best means for collecting the data.

Keeping in view the objectives to be achieved from primary data collection, the survey was carried out through a non-disguised structured questionnaire having close-ended,
dichotomous and likert-scale based questions that were prepared in a multi-stage process. First, prior studies on Management considerations and factors affecting dividend policy were reviewed to identify its various facets along with the interrelationships that existed between various such facets. This process generated various perceptive factors regarding dividend by the companies’ management.

The basic questionnaire used in this study was framed on the basis of the survey instruments developed by Baker, Farrelly, and Edelman (1985)\textsuperscript{120} and Farrelly, Baker, and Edelman (1986)\textsuperscript{121}, later modified by Baker and Powell (1999)\textsuperscript{122}, Baker and Powell (2000)\textsuperscript{123}, Brav et al. (2003)\textsuperscript{124} and Baker et al. (2005)\textsuperscript{125}. Secondly, based on the identified facets of dividend policy decision, some factors were identified, on the basis of which questionnaire was given a final shape.

**Scaling**

In order to provide realistic picture of the results obtained and to establish the relationships between the responses sought, measurement and scaling techniques have been used. Under the scaling, both comparative and non-comparative scaling techniques have been used.

\textbf{a) Comparative Scaling: Rank Order Scaling}

In order to indicate the relative importance of the various aspects to be measured, ordinal scale has been used. Such types of scales are quite commonly used for measuring attitudes and perception. One of the objectives of the study was to
check the management considerations on dividend decision, in which only the relative positions of the aspects were sought rather than the magnitude in difference of various aspects. This resulted in selection of ordinal scale or rank order scale to be used in the study (Q8, Q9 and Q12).

b) Non-Comparative Scaling: Likert Scale

In order to identify the managements’ perception with various factors affecting dividend and policy, interval scale has been used as each object has to be measure independently of the others. For this purpose, rating scale has been used. As the scale has number of items to be measured with individual brief description, where the respondents were required to select the best that describes the object being rated, itemized scaling technique, 3-point, 4-point and 5-point likert scale have been used. This scale has been used to examine the various aspects on dividend policy and influence exercised by various factors on the dividend decision. For this purpose, 3-point likert scale has been used to check the usage of different aspects of dividend policy (Q3, Q7 and Q10), 4-point likert scale (Q2 and Q6) and 5-point likert scale on Influence has been used on a list of 20 factors to examine the management considerations while framing dividend policy. (Q13) as has been depicted in table 2.2. Each statement was assigned a numeric number and was measured on the degree of influence. The numerical score was in the range of 5 to 1, where “5” represented Highly influential and “1” represented Uninfluential response.
In order to evaluate the agreement on various aspects and dimensions of dividend policy, again 5-point likert scale has been used to measure the rater’s agreement. For this purpose, total 36 statements have been considered (Q14). Each statement was assigned a numeric number and was measured on the degree of agreement. The numerical score was in the range of 5 to 1, where “5” represented Highly Agreed and “1” represented Highly Disagreed response.

The variables relating to management considerations while framing dividend policy mentioned in the questionnaire have been categorized into four factors as given in Table 2.3.

Table 2.2: Factors of Management’s Financial Considerations while Framing Dividend Policy

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Factors</th>
<th>Scale</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Profitability</td>
<td>5-point Scale</td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Baker et al. (2007)</td>
</tr>
<tr>
<td>2</td>
<td>Capital Structure</td>
<td>5-point Scale</td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td>3</td>
<td>Organisational Policy</td>
<td>5-point Scale</td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td>4</td>
<td>Sensex Movements</td>
<td>5-point Scale</td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td>5</td>
<td>Environmental Factors</td>
<td>5-point Scale</td>
<td>Baker et al. (2005)</td>
</tr>
</tbody>
</table>
Table 2.3: Factors of Management’s General Considerations while Framing Dividend Policy

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Factors</th>
<th>Scale</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Investors’ Preferences</td>
<td>5-point Scale</td>
<td>Baker et al. (2007)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Brav et al. (2004)</td>
</tr>
<tr>
<td>2.</td>
<td>Dividend Policy Formulation</td>
<td>5-point Scale</td>
<td>Baker et al. (2007)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Brav et al. (2004)</td>
</tr>
<tr>
<td>3.</td>
<td>Dividend Impact and Value</td>
<td>5-point Scale</td>
<td>Baker et al. (2007)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Brav et al. (2004)</td>
</tr>
<tr>
<td>4.</td>
<td>Earnings Distribution other than Cash Dividend</td>
<td>5-point Scale</td>
<td>Baker et al. (2007)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Baker et al. (2005)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Brav et al. (2004)</td>
</tr>
</tbody>
</table>

Scale Evaluation

In order to ensure the accuracy and applicability of the scale and to avoid measurement errors, it is required to be evaluated on three parameters, namely: reliability, validity and generalizability. In the current study, all genuine efforts have been made to ensure the accuracy and generalizability of the results by relying on the validity and reliability techniques.

- **Reliability and Validity:** In order to ensure that the scale produces same results if measured consistently at different point of time and to establish the association between scores of different time periods, the scale used in the present study has been evaluated using *internal consistency reliability*. For conducting internal consistency reliability, co-efficient or *Cronbach alpha* has been used. *Validity* refers to the scale that accurately represents the concept of interest. Validity represents the extent to which a measure correctly represents the concept of study.
Many authors (Churchill, 1979\textsuperscript{126}; Peter, 1981\textsuperscript{127}) stated that a multi-item scale should be evaluated for accuracy and applicability and emphasis should be on developing measures, which have desirable reliability and validity properties. According to Churchill (1979)\textsuperscript{128}, the recommended measure of the internal consistency of a set of items is provided by Coefficient alpha. Nunnally (1978)\textsuperscript{129} suggested a value of .70 as a lower acceptable bound for alpha. According to Peter (1981)\textsuperscript{130}, construct validity pertains to the degree of correspondence between constructs and their measures; construct validity is a necessary condition for theory development and testing. Theoretically correlation techniques have been frequently employed as the measures of the index of item discrimination. In such situations each item is correlated against the internal criterion of the total score that is each item is validated against the internal criterion of the total score. This is called item-total correlation which is regarded by most of the experts as the best index of discrimination. Churchill (1979)\textsuperscript{131} stated that items producing a substantial or sudden drop in the item-to-total correlations should be deleted.

2.6.3.3 Pilot Study

For ensuring the validity of the scale in the survey instrument used in the present research work, content validity has been resorted to. Also referred to as face validity, an attempt has been made to examine whether the chosen scale covered the entire perspective of the dividend and the related aspects. In order to ensure the content validity of the questionnaire in order to identify and eliminate the potential problems, it was pretested in two stages. In stage one, three professors from the field of financial management and
research studies evaluated the questionnaire. Based on their feedback, some modifications were made in the questionnaire. In stage two, a ‘pilot survey’ was conducted in case of five respondents. Data was collected from April 2009 to May 2009. After the pilot survey, certain modifications again were introduced in the questionnaire and finally modified questionnaire was used for the detailed study.

*Profile of the Sample for Pilot Study*

The profile of the sample drawn for pilot study has been depicted in Table 2.4 where the sample companies in the sample have been presented according to type of industry, age of company, stage of business, CEO’s background and code of corporate governance.

<table>
<thead>
<tr>
<th>Demographic Attributes</th>
<th>Respondents (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Industry</strong></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>80</td>
</tr>
<tr>
<td>Services</td>
<td>20</td>
</tr>
<tr>
<td><strong>Age of Company</strong></td>
<td></td>
</tr>
<tr>
<td>Less than 10 years</td>
<td>0</td>
</tr>
<tr>
<td>10-20 years</td>
<td>20</td>
</tr>
<tr>
<td>20-30 years</td>
<td>40</td>
</tr>
<tr>
<td>30-40 years</td>
<td>0</td>
</tr>
<tr>
<td>More than 40 years</td>
<td>40</td>
</tr>
<tr>
<td><strong>Stage of Business</strong></td>
<td></td>
</tr>
<tr>
<td>Introduction</td>
<td>0</td>
</tr>
<tr>
<td>Growth</td>
<td>100</td>
</tr>
<tr>
<td>Maturity</td>
<td>0</td>
</tr>
<tr>
<td><strong>CEO’s Background</strong></td>
<td></td>
</tr>
<tr>
<td>Business Executive</td>
<td>80</td>
</tr>
<tr>
<td>Academician</td>
<td>20</td>
</tr>
<tr>
<td>Public Servant</td>
<td>0</td>
</tr>
<tr>
<td>From Financial Institution</td>
<td></td>
</tr>
<tr>
<td><strong>Code of Corporate Governance</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
</tbody>
</table>
Results of pilot study on scale validation for Management Considerations, led to some modifications in the scales used for the final study. In the present research, the reliability of the Management Considerations on varied dimensions of dividend policy scale was determined by using Cronbach’s Coefficient alpha as shown in the Table 2.5.

<table>
<thead>
<tr>
<th>Table 2.5: Reliability Coefficients in the Pilot Study</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s General Considerations on Dividend Policy</td>
</tr>
<tr>
<td>Number of Items</td>
</tr>
<tr>
<td>36</td>
</tr>
<tr>
<td>Cronbach Alpha ((\alpha))</td>
</tr>
<tr>
<td>0.597</td>
</tr>
</tbody>
</table>

The reliability value of the scale should be at least 0.6, in the current study initially, it had come out to be 0.597 and 0.59 for Management’s General and Financial Considerations respectively.

Then again reliability analysis was undertaken to check cronbach alpha if an item is deleted by examining the items that negatively correlate. Thus, again the reliability was undertaken by examining the item to total correlation to get a set of reliable scale items that finally yielded a set of 14 statements on Management’s Financial Considerations and 28 statements on Management’s General Considerations with reliability value of 0.7893 and 0.7170 respectively. The results for the final stage of reliability analysis have been depicted in Table 2.6.
2.6.3.4 Final Study

The final study was carried out after the results were obtained from the pilot study. The details of the final study have been described as under:

Questionnaire for the Final Study

The final questionnaire contained 21 questions in total, of which 14 questions were on Earnings Distribution and Dividend Policy and 7 questions covered the demographic profile of the respondents. The first aspect of the questionnaire covered basic information in which 4 questions (Q1 to Q4) were based on the basics of earnings management. It was followed by the management considerations on dividend decision process and factors affecting dividend decision in the second part, consisting of 9 questions (Q5 to Q13). For identifying hidden management considerations on dividend decision, a list of 14 factors has been considered as mentioned in Table 2.7. This part of the survey instrument intended to measure the influence of various factors on the dividend decision on five-point likert scale which was: 1 = highly influential, 2 = influential, 3 = neutral, 4 = least influential, and 5 = uninfluential.

Table 2.6: Final Reliability Coefficients

<table>
<thead>
<tr>
<th></th>
<th>Management’s General Considerations on Dividend Policy</th>
<th>Management’s Financial Considerations on Dividend Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Items</td>
<td>28</td>
<td>14</td>
</tr>
<tr>
<td>Cronbach Alpha (∝)</td>
<td>0.7170</td>
<td>0.7893</td>
</tr>
</tbody>
</table>
Table 2.7: Factors Influencing Management’s Agreement on Varied Dimensions of Dividend Policy

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Factors</th>
<th>Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Profitability</td>
<td>1,2,3,5</td>
</tr>
<tr>
<td>2.</td>
<td>Organisational Policy</td>
<td>4,6,9,10,11,14</td>
</tr>
<tr>
<td>3.</td>
<td>Environmental Factors</td>
<td>7,8,12,13</td>
</tr>
</tbody>
</table>

The third part covered the basic attributes of dividend policy (Q14) as mentioned in Table 2.8. This part of the survey asked the respondents to indicate their level of agreement or disagreement with each of 28 closed-end statements based on a five-point response scale which was: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, and 5 = strongly agree. The entire set of 28 statements covered dimensions of dividend policy involving investor/shareholder preferences, factors influencing dividend policy formulation, impact of dividend on value, and earnings distribution other than cash dividends.

Table 2.8: Factors of Management’s Agreement on Varied Dimensions of Dividend Policy

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Factors</th>
<th>Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Investors, Preferences</td>
<td>1,2,3,4,5,6,7,15</td>
</tr>
<tr>
<td>2.</td>
<td>Dividend Policy Formulation</td>
<td>8,9,10,11,12,13,14,16,18,19,20,24,26,27</td>
</tr>
<tr>
<td>3.</td>
<td>Dividend Impact and Value</td>
<td>17,21,22,23,25,28</td>
</tr>
</tbody>
</table>

The second aspect of the questionnaire covered the identification and classification information covering the socio-economic and demographic profile of the respondents. The survey contained a code number to identify the respondents. The Appendix A contains a copy of the survey questionnaire.
Primary Data Sample for Final Study

The sample companies were identified on the basis of convenience sampling. In order to collect the primary data, a combination of personal and telephonic interviews along with e-mail was used. Dillman (1978) suggested that if the letters are personalized to the respondents, the response rate would be higher. However, the mailing list obtained from Prowess database contained the basic contact information only and did not provide the information about the Chief Financial officers (CFO) or the Company Secretaries (CS) of the companies. In such situation, only two alternatives were there, one, to send personalized letters to the CEO with request to forward them to CFOs or CS and second, to send non-personalised letters to the company’s mail id. In this research, both means have been used.

In the beginning, during June and July 2009, the survey instrument with cover letter was sent to the top financial officers of the 10 companies through e-mail. The cover letter informed potential respondents that any information involving individual companies will not be disclosed. Further, to enhance the interest of the respondents, the cover letter outlined the objectives of the research and the managerial implications. Besides e-mail, personal interviews and telephonic interviews were also held to get the questionnaires filled. Despite of the necessary follow-ups and the reminders, the response rate was quite low and only 3 questionnaires were received. Due to low response rate, the e-mail method was abandoned and 30 respondents were approached through personal interviews and 10 through telephone interviews. The process resulted in 25 questionnaires through personal interviews and 9 from telephonic interviews with the Officials of various sample
companies. During editing stage of the responses, it was found that some of the questions in the questionnaire were incomplete and in some cases, there was no response and thus was not included in the study. Finally only 31 respondents viz. 3 from e-mails, 22 through personal interviews and 6 through telephone interviews, were retained for the purpose of analysis. The total response rate was 62%. The Table 2.9 depicts the steps followed in this study to select the sample for the purpose of primary data collection.

<table>
<thead>
<tr>
<th>Method of Data Collection</th>
<th>Total Sent</th>
<th>Total Received</th>
<th>Usable</th>
<th>Response Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>E-mail</td>
<td>10</td>
<td>3</td>
<td>3</td>
<td>30</td>
</tr>
<tr>
<td>Personal Interviews</td>
<td>30</td>
<td>25</td>
<td>22</td>
<td>73.33</td>
</tr>
<tr>
<td>Telephone Interviews</td>
<td>10</td>
<td>9</td>
<td>6</td>
<td>60</td>
</tr>
<tr>
<td>Total</td>
<td>50</td>
<td>37</td>
<td>31</td>
<td>62</td>
</tr>
</tbody>
</table>

**Sample Profile for Final Study: Descriptive Statistics**

The descriptive statistics aim at summarizing large quantities of data in order to highlight the most important numerical feature of data. The purpose of descriptive statistics is to collect data and then convert it into useful information. This type of statistics describes sample data and helps in subsequent analysis. Though the variability of target population can be indicated through descriptive statistics but no conclusions can be drawn from these statistics. Among the characteristics frequently used are the totals, percentage, mean and standard deviation. The descriptive statistics of the sample in terms of the demographic profile used in this research has been summarized in the Table 2.10.
Table 2.10: Demographic Profile of Respondent Companies for Primary Data Collection

<table>
<thead>
<tr>
<th>Demographic Attributes</th>
<th>Respondents (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Industry</strong></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>96.8</td>
</tr>
<tr>
<td>Services</td>
<td>3.2</td>
</tr>
<tr>
<td><strong>Age of Company</strong></td>
<td></td>
</tr>
<tr>
<td>Less than 10 years</td>
<td>0</td>
</tr>
<tr>
<td>10-20 years</td>
<td>16.14</td>
</tr>
<tr>
<td>20-30 years</td>
<td>29.03</td>
</tr>
<tr>
<td>30-40 years</td>
<td>19.35</td>
</tr>
<tr>
<td>More than 40 years</td>
<td>35.48</td>
</tr>
<tr>
<td><strong>Stage of Business</strong></td>
<td></td>
</tr>
<tr>
<td>Introduction</td>
<td>0</td>
</tr>
<tr>
<td>Growth</td>
<td>87.10</td>
</tr>
<tr>
<td>Maturity</td>
<td>12.90</td>
</tr>
<tr>
<td><strong>CEO's Background</strong></td>
<td></td>
</tr>
<tr>
<td>Business Executive</td>
<td>87.10</td>
</tr>
<tr>
<td>Academician</td>
<td>9.68</td>
</tr>
<tr>
<td>Public Servant</td>
<td>3.20</td>
</tr>
<tr>
<td>From Financial Institution</td>
<td>0</td>
</tr>
<tr>
<td><strong>Code of Corporate Governance</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>100</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
</tbody>
</table>

The perusal of the Table depicted that majority of the respondents (96.8%) represented the manufacturing industries. Of the total 31 respondent companies, majority respondent companies (35.48%) were having the experience of more than 40 years, that is, they represented the experience and long-term standing of their companies in the market.

Further, on the aspect of the stage of business cycle, majority of the sample companies (87.10%) were passing through the growth stage of the business life cycle representing the bright future chances in the market. On the aspect of the management of the companies, majority (87.10%) of the CEOs were the Business Executives. All the companies accepted the fact that they are implementing the corporate governance code in carrying out the business activities.
2.6.3.5 Tools for Data Analysis

Data collected had been analyzed and interpreted to prepare the thesis. Depending upon the nature and availability of data, various statistical and data analysis techniques were applied. To arrive at pertinent analysis, the collected data was put to plan statistical analysis using SPSS package. For analyzing the primary data, the techniques used were Ranking and Scaling Techniques like Friedman ANOVA, Coefficient of Preference Analysis and Factor Analysis. For measuring and analyzing the responses on ordinal scale, percentiles and medians can be used in descriptive statistics, Friedman ANOVA and Coefficient of Preference in case of inferential statistics. Depending on the rule of thumb techniques, Friedman ANOVA and Coefficient of Preference have been used to identify the factors affecting dividend policy as perceived by the management of the respondent companies. For analyzing comparative scale and testing the hypothesis, one-way ANOVA has been used. And for analyzing secondary data, Factor Analysis and Multiple Linear Regression analysis has been used. After scoring the questionnaire the data was tabulated for each variable being studied separately for each stratum in the selected sample companies. The computation of the data was done in order to do the following statistical analysis through SPSS package:

- **Descriptive Analysis**: It was basically done to describe the basic features of the data in a study, with an objective of analyzing the mean scores and the standard deviation scores. Descriptive Statistics form the basis of virtually every quantitative analysis of data for the companies under study.
• **Inferential Analysis**: The inferential statistics included the Analysis of Variance (ANOVA) and Multiple Comparison to determine whether significant differences existed between the perceived management considerations and varied dimensions of dividend policy on the various dimensions.

• **Coefficient of Preference Analysis**: Coefficient of Preference analysis represents the relationship between maximal and minimal preferences as compared to the observed phenomena representing the relationship between the categories of answers with either categorical or ordinal data in order to achieve a unique value, i.e. coefficient, which shows preference regarding the observed phenomenon.

• **Factor Analysis**: The factor analysis had been undertaken to explore the presence of dominants factors affecting the dividend decision of the companies.

• **Multiple Regression Analysis**: The multiple regression analysis was done to determine the relative contribution of the independent variables of Dividend to the value of the company and to examine the validity of known dividend models.

2.6.4 Limitations of the Research

“Honest error is to be pitied, not ridiculed”.

-Chesterfield, Lord

2.6.4.1 Primary Data

For understanding and studying management considerations while framing dividend policy, data has been collected using survey method. The responses which are purely solicited on perception basis, varies from individual to individual. Ensuring all fairness, surveys have been criticized in the literature for their many obvious weaknesses. For
instance, Baker and Powell (1999)\textsuperscript{133} have mentioned that survey methods possess following caveats, which were assumed to be present in the current research also:

- Represents the opinion of one person.
- Limitation on length of the survey instrument.
- Misinterpretation of statements.
- Non-response bias: In order to tackle this limitation, conventional practice was followed in the present research work through follow-up mailings to non-respondents in order to “increase the response rate and reduce potential non-response bias” (Baker and Powell, 1999, p.23)\textsuperscript{134}. The response rate for the study was 62 per cent.

Besides above-mentioned caveats, survey method used in this research might be criticized on following grounds:

- The risk of “loaded” statements.
- Statements that obviate an answer

Further, the responses provided by the sample respondents may not be truthful. Brav et al. (2003, p.3)\textsuperscript{135} quoted this problem as:

\textit{they “measure beliefs and not necessarily actions”}. 

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Also in order to ensure the responses, the questionnaire was limited to the most important aspects of dividend policy and some aspects have to be overlooked as it would have resulted in a lengthy and time-consuming questionnaire.

Another potential problem for questionnaires about dividend policy was identified by Baker, Farrelly and Edelman (1985)\textsuperscript{136} regarding the restrictive nature of only obtaining views from one person only, when it is likely that more than one person will decide on distribution policy. The present thesis work also has a presence of same limitation. As Baker, Farrelly and Edelman, (1985, p. 83)\textsuperscript{137} pointed out,

\begin{quote}
Chief Financial Officers are “not the only individuals involved in dividend policy decisions”.
\end{quote}

Because the primary data sample is limited, only 31 companies could be tapped and analysed. This is considered to be a very small data sample especially for purposes of multivariate data analysis. Nevertheless, the performed data analysis does not violate the rule of thumb regarding the size of the data sample for the parametric and non-parametric tests. Furthermore, the performed tests do not show any severe violation of the evaluation assumptions. But factor analysis could not be resorted to for primary study since the data sample is considered to be small for such analysis.

However, a genuine effort has been made in order to minimise the impact of above-mentioned limitations and to eliminate them, as far as possible.
2.6.4.2 Secondary Data

The secondary data has been collected through computerized data that minimizes the chances of error. Though, it is believed that the secondary data in the current research might have suffered because:

- There might be other variables also influencing the dividend but considering the scope of the study, they have not been included.

- The factors and the views about dividend policy could differ on the basis of industries. Research by Michel (1979)\textsuperscript{138} and Baker (1988)\textsuperscript{139} among others suggested that a positive relationship exists between industry classification and dividend policy. Baker and Powell (2000)\textsuperscript{140} concluded that industry type appears to influence the importance that U.S. managers place on some determinants of dividend policy, but some of these differences have diminished over time. Frankfurter and Wood (2003)\textsuperscript{141} found no evidence of a systematic relationship between dividend policy and industrial classification. They suggested that variations in dividend policy by industry might be the sole effect of firm size.

The remaining thesis is organized as follows. Chapter 3 discusses the introduction to Indian industries with special reference to Engineering, FMCG, IT and Textile sectors. Chapter 4 elaborates results of survey of management considerations of Indian companies while framing dividend policy. Chapter 5 makes use of Factor Analysis to identify factors affecting dividend decision of Indian companies. Chapter 6 is devoted to the testing of various known dividend models, developed abroad, in Indian conditions. Chapter 7
makes an attempt to explore the impact of dividend on the value of the firm. Finally, Chapter 8 presents the summary, conclusions and concludes with the contributions and suggestions, and directions for future research.

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Lintner, J., 1956, op.cit


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