CHAPTER -2
LITERATURE REVIEW
CONTENT

2.1 Review of empirical Studies Conducted Abroad
2.2 Review of empirical Studies Conducted in India
Various studies on dividends and dividend policy have been conducted abroad and in India. Empirical study is divided into two sections:

2.1 Empirical studies conducted abroad

2.2 Empirical study in India.

2.1 REVIEW OF EMPIRICAL STUDIES CONDUCTED ABROAD:

1) (John Consler, 2011) The object of this paper was to make the comparison of relative power of operating cash flow and earnings in the prediction of dividends. 1902 dividends paying firms were analysed for study purpose. Quarterly CRSP and comp stat data has been taken for the year 2002 to 2006. Cash flow per share is shown to produce a better fit than earning per share based on selected model fit criteria. Author also suggested that investors and analysts predict dividends as a part of their stock valuation work.

2) (Fairchild, 2010) The aim of this paper was to analyse or to focus on the complex relationship between dividend policy, managerial incentives and firm value. A survey has been made by developing a theoretical model on dividend policy that combines signalling and free cash flow motives. Moreover, managerial communication and reputation effects are also considered into the model. Author said that for more investment in new value creating project firm may need to cut dividends. It is also found that investors are considered “dividend cut “as bad news and it effected to firms market value. To mitigate this problem managers communicate to the investors about the reason for dividend cut which could be helpful for improving managerial reputation effects. Author has also provided Real world examples to illustrate the complexity of dividend policy.

3) (Joshua Abor, 2010) The object of this paper was to observe the effects of investment opportunity and corporate finance on dividend policy. Survey has been made with a sample of 34 emerging market countries for 17 year period during 1990-2006. Fixed effects panel model is used for study purpose. Results showed significant negative relationship between investment opportunity set and dividend payout policy. However, it showed that various measures of corporate finance like financial leverage, external financing and debt maturity have insignificant effects on dividend
pay-out policy. Study also revealed that Profitability and stock market capitalizations also play an important role in dividend pay-out policy.

4) (Setia-Atmaja, 2010) Investigated the broad influence of debt and dividend policies of family controlled firms. Panel data of Australian publically listed firms were considered for survey purpose during the period 2000 to 2005. Panel regression was used for survey purpose. The study found that in comparison with non-family counterparts family controlled firms have higher levels of leverage and dividend pay-out ratios. The study also indicated that higher proportion of independent directors have positive impact on family control on dividend policy which reflected significant influence of independent directors on firm’s dividend policy, specifically for controlled firms. Author also found that independent directors and dividends have complementary government mechanisms. And Author also found little evidences which show the relationship between family control and debt moderates by board independence.

5) (Yahyaee, 2010) Investigated the stability of dividend policy by using a unique data set. Omani firms were used for study purpose. Author used Linter model to test the dividend smoothing behaviour. The specific econometric TOBIT regression was used for panel data. Author observed that Oman firms adopted a smoothing dividend policy. Author also observed that the prediction suggested by the high bank leverage, absence of taxes and variability of dividend payments in Oman does not suggested by stability of dividends. Author also observed the differences between dividend policies of Omani companies and developed markets companies. Author also said that while making their investment decisions potential investors are aware about these differences.

6) (Al-Najjar, 2009) The purpose of this paper was to investigate the dividend policy situation, dividends behaviour and dividend policy decision in Jordan emerging markets, by comparing the differences between developed markets and emerging markets in the dividend policy context. It also covers determinants of dividend policy. For study purpose, Jordanian non-financial firms were considered. The paper found that the dividend policy in Jordan, as a developing country is influenced by number of factors like leverage ratio, institutional ownership, profitability, business risk, asset
structure, growth rate and firm size. The study also revealed that Linter model is valid for Jordanian data and that Jordanian firm have target payout ratios and that they adjust to their target relatively faster than firms in more developed countries.

7) (Basil Al-Najjar, 2009) An attempt is made here in this paper to examine the association between dividend payout and outside directorships. 400 non-financial firms listed at London stock Exchange has been taken for the study purpose during the period 1991 to 2000. Author used Tobit and logit regression models to analyse the extent to which firms with a majority of outside directors on their boards experience significantly lower or higher dividend pay-out after controlling for insider ownership, profitability, liquidity, asset structure, business risk, firm size, firm’s growth rate and borrowing ratio. It was found that dividend pay-out is negatively associated with the number of outsider directors on the board of directors.

8) (Hoie jo, 2009) Investigated empirical association between managerial entrenchment and dividend policy. The study observed on entrenchment irrelevance hypothesis, the dividend signalling hypothesis and the optimal entrenchment hypothesis. Large numbers of US industrial firms were used for the study period during the period 1990 to 2003. Various LOGIT and TOBIT regression methods are used to investigate firm’s propensity to pay dividends. Findings of the study showed that firms with more entrenched managers are more likely to pay dividends. It also observed that large cash reserve can be used to deter hostile takeovers and paying dividends reduces cash holdings, leaving the firm more vulnerable to hostile takeovers.

9) (Khaled Hussainey, 2009) Examined the value relevance of voluntary disclosure and dividends signal future earnings for decline earnings growth firms. For study purpose, the behaviour of 33 non-financial UK firms after a decline of their sustained growth has been taken. Corporatized content used to analysis number of forward looking sentences in the annual report narratives. For examining the association with the abnormal future earnings, it shows changes in disclosures and dividends in the year of earning growth declines. The result showed that value relevant information about future earnings for declining earnings growth firms does not depend on increase in dividends.. But it is generally based on signalling theory and mentioned that
forward looking information in annual report is an important tool for signalling future earnings for these firms.

10) (Neil L. Fargher, 2009) The study investigated the cross-sectional differences in the profits, returns, and risk of high and low market to book ratio stocks before and after the initiation of regular cash dividend payments. Study has been conducted for the period of 1965-2000. For study purpose some parametric and non-parametric statistics was used. To test for differences in profits, returns and risk of high and low –market-to-book ratios stocks before and after dividend initiation ordinary regression was used. The study found that the low –market-to-book stocks positively connected with dividend initiation announcements. The study also showed that in comparison with low market to book stocks high market-to-book stock firms have large profits, cash levels and capital expenditure before and at the time of dividend initiation. The study also found that decrease in systematic risk is associated with excess returns earned by low market-to-book stock firms whereas high profitability is associated with high market-to-book stock firms.

11) (Pourheydari, 2009) The aim of this paper was to evaluate the CFOS (Chief Financial Officers) views on dividend policy of Iranian firms. Survey has been made Iranian firms listed on the Tehran stock exchange regarding the factors influencing dividend policy for the year 2006. Based on theoretical and empirical works on dividend policy author identified the factors that are most important for study purpose. The finding showed that stability of cash flow, the available profitable investment opportunities and stability of profitability are important factors that influenced the dividend policy.

12) (Temurshoey, 2009) The aim of this paper was to find out the problems related to overestimation of profits because of presence of cross-shareholding (CS) links among firms. Author used matrix Algebra to identify both direct and indirect financial interests. By comparing the industry, finding showed that retained earnings increases, while aggregate external shareholder’s returns decreases unless dividend ratios are all unity. The study also revealed that for all profits specifications, qualitatively there is no difference but quantitatively there is a difference. The author also said that if there
are extensive CS links present in industry dividend payment have to be taken in to account by analysing market performance.

13) (Harido Koemiadi, 2008) Investigated management earnings by studying whether stock dividends provides management with an incentive for manipulating earnings. For study purpose refined accrual model is used for controlling the performance effects in estimating the part of accrual subject to management discretion. It is found that discretionary accruals of stock dividend issuing firms are negatively correlated with the declines in both future earnings and abnormal stock returns.

14) (Nalinaksha Bhattacharyya, 2008) This paper analysed the present and tests a model of the association between dividend payout and executive compensation. Study has been made on Canadian firms during the period 1993-95. The author used Bhattacharya model which is based on two best fit world, where managerial quality is not observed by shareholders and because of that first-best contracts are not possible and as per the second best world compensation contracts motivate high quality managers for retaining and investing in firms' earnings. Whereas low quality managers are motivated to distribute the income among the shareholders. Survey found that with the prediction of Bhattacharya model, dividend payout is positively associated with executive compensation.

15) (Bhattacharyya, 2007) The Study aimed here to review in brief the principle theories of dividend policy and to summarize empirical evidence on these theories. For study purpose author has reviewed and identified major theoretical and empirical papers on dividend policy. It is found that still some dividend puzzles are not solved. Some empirical evidences are of ambiguous and the search for new explanation for dividends continues.

16) (Douglas, 2007) The object of this paper was to study the explicit links with corporate social responsibility to the dividend flow. It aimed to examine that whether the corporate investment in social responsibility affects to expected dividends or not. For an analysis purpose 17670 US firms were undertaken for the period of 1991-2007. Univariate and Multivariate techniques are used for study purpose. It is found that matured firms are more interested to invest in corporate social responsibility. The
study showed that investment in CSR and dividends trend increasing together. In short the study observed that CSR investment tend to be affected by the companies who can afford them and it does not lowering the value by lowering investors expected payout.

17) (H. Kent Baker, 2007)The broad objective of this paper was to examine the survey results on the perceptions of dividends by Canadian managers. For survey purpose 291 dividends paying Canadian firms listed on Toronto Stock Exchange (TSX) has been taken and their view has been taken. The survey found that dividend policy is to be influenced by the level of current and expected future earnings stability of earnings and the pattern of past dividends. Canadian managers believed that dividend policy affects firm value. They expressed their strong support for the signalling and life cycle explanation for paying dividends, but not for the bird-in-hand, tax preference and dividend clientele, agency cost or catering explanation and expressed little agreement with the theory of a residual dividend policy. The author also said that Canadian dividend paying firms are significantly larger and more profitable.

18) (Abeyratna Gunasekarage, 2006)The main aim of this paper was to analyse the long-run financial and return performance of UK companies following joint dividend earnings announcements. For analysis purpose, both stock market’s share price performance and companies’ detailed analysis by using financial ratios are for the period of five years have been for the study. It is found that there are positive relations between share returns and company’s dividends and earnings. Author also said that dividend news does not signalling the long term future company performance. The study also revealed that those companies who cut the dividends and reported lower earnings; they can achieve largest excess return over next five years. Financial used for assessing company performance revealed the same pattern. In short, the author said that most of the future long term share performance was attributable to the earnings rather than to the dividend news.

19) (John Goddard, 2006)The purpose of this paper was to test the validity of the smoothing and signalling hypothesis of dividend determination. Author used VAR framework for examination of the dynamic behaviour of share prices, dividends and
earnings. Causality test is used for obtaining signalling hypothesis. For study purpose, 137 UK manufacturing and service companies are observed during the period 1970-2003. Author observed a strong relationship between prices, dividends, and earnings. Author also observed a little bit diversity in the casual relationship between prices, dividends and earnings.

20) (Mohammed Amidu, 2006) This paper studied the determinants of dividend payout ratios. For analysis purpose, firms listed on Ghana stock Exchange have been taken for six years period. Ordinary Least square model is used to estimate the regression equation. Author used institutional holding as s proxy for agency cost. Growth in sales and market to book value were also used as proxies for investment opportunities. Study observed positive relationship between dividend pay-out ratios and profitability, cash flow and tax and negative association between dividend pay-out and risk institutional holding, growth and market to book value. Study also showed that profitability, cash flow, sales growth and market to book value are significant variables.

2.2 REVIEW OF INDIAN EMPIRICAL STUDIES:

1) (Prof. Ranpreet Kaur, 2014) Investigated the concept and scope of dividend policy and to study the irrelevance theory (Modigliani-Miller Model) dividend theory and to know the relationship between dividend policy approach and share prices (companies listed in CNX Dividend opportunities Index was chosen as population universe) and for sample 5% companies listed in index was considered. Analysis has been made by using secondary data and simple random sampling is used during period 2013-2014. The study found that there is neither positive nor negative relationship between the market price of shares and dividend payout. Author said that due to other factors share-prices are affected. It can be concluded that irrelevance theory shows true picture in current scenario in comparison to relevance theory in short time period.

2) (Dr. T. Sobha Rani, 2013) The purpose of this research paper was to evaluate the profitability and its growth rate in selected pharmaceuticals companies in India. secondary data used for study purpose during the period 2002-2011. For an analysis purpose annual compound rate, Profit before interest and tax, profit after tax, earnings
per share, dividend per share variables were used. The study found that the profitability of pharmaceutical companies are affected by determinants of dividend and it also revealed that annual compound growth rates of dividends determination give the profitability and growth rate. Author also suggested that decisions regarding companies’ performance depend not only on highest dividend per share but more on broad decision, dividend payout ratio and several other factors.

3) (Gayathridevi & Mallikarjunappa, 2012) The aim of this paper was to analyse the trends and determinants of dividend decisions. For survey purpose NSC listed 114 Indian Textiles companies have been taken during the period 1989-2009. The simple Regression model was used to evaluate the study. Study revealed that most of the dividends paying companies are profit making companies. The study also showed that absolute value of dividends and dividend paid-up capital shows the significant and positive relationship between dividend policy and lagged earnings belonging to common shareholders, profit after tax, earnings belonging to shareholders cash flows, size, cash dividends and lagged dividends. It also showed that current Ratio and capital structure have insignificant influence on dividend policy.

4) (N. R. Parasuraman, 2012) The aim of this research paper was to study the effectiveness of Linters’ model for dividend payout. Analysis made on BSE Sensex firms during the period 2002-2011. For study purpose Linter model and another three basic models were used. Multiple regression were used to test the variables namely, cash earnings, basic earnings, lagged dividends and capital expenditure. By using Linter model as a base, it is found that the payout decision of Sensex firms depends on the factors like earnings, cash earnings, lagged dividends and capital expenditure. It can also be found that Linter Model holds good to a large extended in case of Sensex firms. In short the study support prevalence and relevance of Linter model of dividend policy. This simply suggested that managers can’t ignore the variables like earnings capacity and lagged dividends while designing dividend policy.

5) (Pasricha, 2012) Investigated links between the dividend policy and value of firms. For survey purpose 20 sample companies of information technology and pharmaceuticals industries of India have been taken during the period 2001 to 2010. The sample has been chosen from S&P CNX Index on the basis of their Net-
Worth. The data mainly used for study purpose has been obtained from prowess database of the Centre for monitoring Indian Economy (CMIE) India. Multiple Regression model used for study purpose and graphical pictorial previews were used for presenting data. The study concluded that the dividend payouts having considerable bearing and positive and significant relationship with the value of firms.

6) (Pasricha D. A., 2011) The objective of this study was to test the applicability of dividend models in Indian context with special reference to engineering Industry. Regression model was used to test the study. It is found that the Linter model provided a good fit and other four models developed by Dobrovolsky, Brittain do not offer appropriate explanation of dividend behaviour in majority companies.

7) (Amitabh Gupta, 2010) Re-examined the various factors that influenced the dividend decision of firms. The study has been conducted on BSE listed Indian companies for the period 2001-2007. Depending on the literature review author has found fifteen variables for framing dividend policy. Author used factor analysis for extracting prominent factors from various variables. And then multiple regression analysis has been conducted. The result of the factor analysis showed that leverage, liquidity, ownership structure and growth are major factors. The study revealed that after applying regression leverage and liquidity are the major determinants of dividend policy for Indian companies. The study also found that non-financial factors such as foreign collaborators’ shareholding, attitude and behaviour of management, company policy etc. may also influence the dividend decision of firm.

8) (Packkirisamy, 2010) The object of this paper was to evaluate the link between corporate leverage and the dividend policy of firms across industries in India in respect of size of corporate firms. Survey has been conducted from 73 different companies of different industries namely cement, chemical and fertilizers, IT, oil and Gas, Pharmaceutical, Shipping and Textiles, Which was listed on NSC in India during the period 1996-2007. Multiple Regression technique (OLS Method) is used for survey purpose. The study revealed that dividend pay-out of small size, large size and overall corporate firms across industries in India is dependent on the level of debt in capital structure.
9) (Parua A. a., 2009) The main aim of this study was to find out the trends in dividend payment and determinants of dividend decision. 607 listed Indian companies have been considered for the study purpose during the period from 1993-94 to 2004-05. The study found that while setting dividend policy current-profit, past-profit and expected future profit have play significant positive role and cash position and cash flow has significant negative relationship with only dividend rate. Whereas interest expenses, capital expenditure, tax ratio and share price behaviours were not related to matter of dividend payment. The author also said that for any managers stability of dividends is the primary concern.

10) (Pani, 2008) The object of this paper was to analyse the possible links between dividend policy and stock-price behaviour in Indian corporate sector. For study purpose 500 listed companies on BSC had been taken during the period 1996-2006. The survey made on six different industries namely electricity, food and beverage, mining, Non-metallic, Textile and service-sector. Fixed effect model had been used for study purpose. The variables like size and long term debt-equity ratio has been taken for analysing the relationship between dividend retention ratio and stock-price behaviour of the firm by using panel data approach. The study result based on fixed effect model. The result of this model indicated that there is possible links between dividend policy and stock price behaviour. The author said that in some industries it shows the possibility of “clientele effect.

11) (Dr. Jasvir S. Sura, 2006) The object of this paper was to evaluate the factors influencing dividend policy decisions in banking sector. This study examined the re-applicability of Linter’s (1956) and Britain (1966) path breaking analyses of dividend policy. For, study purpose banks listed on National stock exchange have been taken. Survey has been made by using cross sectional analysis during the period 1996-2006. The study found that commercial banks in India generally followed stable dividend policy. The study also found that lagged dividends and current earnings are major determinants of dividends. The study also supported the argument of ‘information content of dividends’ with reference to dividend proceeds. Hence, author suggested that the management of the bank can use dividend policy as signalling device.
12) (Sanjeev Mittal, 2006) Investigated the dividend behaviour of NSC and BSC firms. The article studied the dividend behaviour of selected firms during the period 2001-2005 and divides them into payers and non-payers groups. To know the relationship of dividend paid with investment opportunities, Growth cost of equity and ownership structure regression analysis was used. The study found that payer firms to have large size, less investment opportunities and high cost of retained earnings and the opposite in case of non-payers. Author also found that by reducing agency costs promoters can increase in dividend with increase in equity ownership.

13) (Balyan) This paper attempted to know the relationship between earnings and dividends particularly for top five selected companies from steel sector in India for finding out the difference practices. For analysis purpose variables like earnings per share, dividend per share, dividend payout ratio and dividend yield has been taken. For study purpose one-way ANOVA and an independent sample t-test has been used. The study found that companies belonging to steel industry who have declared dividend do not follow a similar pattern while declaring dividends to shareholders in relation to earnings.
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