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Determinants Analysis of Corporate Dividend: With Special Reference To Indian IT Industry

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Abstract

The dividend pay-out policy is one of the most debated topics within corporate finance and some academics have called the company's dividend pay-out policy an unsolved puzzle. Even though an extensive amount of research regarding dividends has been conducted, there is no uniform answer to the question: what are the determinants of the companies' dividend pay-out ratios? We, therefore, decided to conduct a study regarding the determinants of the companies' dividend pay-out ratios on large and medium cap on Stockholm Stock Exchange.

The purpose of the study is to determine if there is a relationship between numbers of company selected factors and the companies' dividend pay-out ratios. A second purpose is to determine whether there are any differences between large and medium caps regarding the impact of the company selected factors. We, therefore, reviewed previous studies and dividend theories in order to conclude which factors that potentially could have an impact on the companies' dividend pay-out ratios.

Key Words: Return on capital employed, Current Ratio, Debt equity ratio, Interest coverage Ratio, Earning per share, IT Industry

I. Introduction

When a company makes a profit there are mainly two alternatives in which the company can make use of the profit. The first alternative is to retain the earnings within the company in order to improve or develop something internally. The second alternative is to pay out the profit to the shareholders and if the company chooses this approach there are two alternative ways in which the company can distribute the profits to the shareholders. The two most common forms of dividend are cash and stock dividends.

Even though this research paper is about dividends we have not said anything about dividends or explained what a dividend is? We, therefore, think that it is important to provide a brief introduction to dividends in order to give the reader the necessary background knowledge before we start with the discussion of the different dividend theories. When speaking in terms of dividend most people refer to cash dividends which as the name suggests are cash payments to the shareholders. However, dividends are not always paid in cash and another form of payments to shareholders are stock dividends. A stock dividend is relatively similar to a stock split because the number of outstanding shares is increasing but the company's assets remain the same

(Keown et.al 2007, p.426). Consequently, a stock split is just slicing a pizza and it does not matter how many pieces the pizza is cut into because the total size is still the same. In this thesis, we will solely focus on cash dividends and all other forms of dividends are excluded from the research.

A company's dividend policy is usually decided upon by the company's board but there are some exceptions to this rule which is important to mention. In some countries such as Chile and Brazil companies are forced to pay a minimum portion of their earnings to the shareholders by law

(Brealeyet.al 2008, p.444). Another exception is that the lenders (bondholders) may impose covenants in the bond contract which states that a company is obligated to pay the lenders (bondholders) before increasing the dividend payments (DeFond & Jiambalvo, 1994).

Apart from the exceptions discussed in the section above, a company's dividend is usually decided upon by the board of directors at the declaration date (Brealey et.al 2008, p.442). A couple of days after the declaration date the transfer of the stock books are closed at the record date and the investors who own stocks at this date will receive dividends. But a problem with the record date is that if a trade is made one day before the record date, time will not allow the trade to be revealed on the stockholder list and the new shareholder will not receive dividends. Therefore, brokerage firms have changed the right of ownership until two days before the date of record and this date is called the ex-dividend date and all investors who buy shares after the ex-dividend date will not receive dividends (Keown et.al 2007, p.426).

II. Current Scenario of Indian I.T Industry

India is the world's largest sourcing destination for the information technology (IT) industry, accounting for approximately 67 percent of the US$ 124-130 billion market. The industry employs about 10 million workforces. More importantly, the industry has led the economic transformation of the country and altered the perception of India in the global economy. India's cost competitiveness in providing IT services, which is approximately 3-4 times cheaper than the US, continues to be the mainstay of its unique selling proposition (USP) in the global sourcing market. However, India is also gaining prominence in terms of intellectual capital with several global IT firms setting up their innovation centers in India.

The Indian Information Technology (IT) sector is expected to grow 11 per cent per annum and triple its current annual revenue to reach US$ 350 billion by FY 2025, as per National Association of Software and Services Companies (NASSCOM).

India, the fourth largest base for new businesses in the world and home to over 3,100 tech start - ups, is set to increase its base to 11,500 tech start-ups by 2020, as per a report by NASSCOM and Zinnov Management Consulting Pvt. Ltd.India's internet economy is expected to touch Rs 10 trillion (US$ 151.6 billion) by 2018, accounting for 5 percent of the country's gross domestic product (GDP), according to a report by the Boston Consulting Group (BCG) and the Internet and Mobile Association of India (IAMAI).India's internet user base reached over 350 million by June 2015, the third largest in the world, while the number of social media users grew to 143 million by April 2015 and smart phones grew to 160 million.

Public cloud services revenue in India is expected to reach US$ 838 million in 2015, growing by 33 per cent year-on-year (y-o-y), as per a report by Gartner Inc. In yet another Gartner report, the public cloud market alone in the country was estimated to treble to US$ 1.9 billion by 2018 from US$ 638 million in 2014. Increased penetration of internet (including in rural areas) and rapid emergence of e-commerce are the main drivers for the continued growth of data centre co-location and hosting a market in India.

III. Statement of the Problem

In India few studies have analyzed the impact of dividend policy on IT industries. The dividend should be distributed to the shareholders in order to maximize their wealth as they have invested their money in the expectation or being made better or financially strong. Therefore the present study mainly analyses how far the level of determinants of

dividend policy affect the IT industries as well as investors wealth.

IV. Importance of Study

This research paper examines payment of stakeholders' dividends and how policies, practices are set. The company dividend policy provides guidance on when not to pay stockholders dividend or when not to pay the dividends and use profits for other purpose and how the determinants affect the dividend policy of the IT industries.

V. Objectives of Study

1. To study the impact of determinants that affect the dividend policy on IT industries.
2. To analyze the impact of variation in dividend policy on shareholders wealth of dividend paying and non-paying companies in India.
3. To analyze the impact of retained earnings and past performance in the presence of dividend policy of IT industry.

VI. Limitations of Study

1. **Scarcity of Data:** There is no organized database by any of the government agencies or regulatory bodies. A few private corporate bodies are providing data but getting those data is very difficult especially academic purpose.
2. **Financial Variables:** This study is related to financial variables and some of the financial variables are not considered due to unavailability of data.
3. **Industry Limitation:** The present study has some specific industry limitation.
4. **Frequent Changes:** The study is related to the time span of six years, i.e. 2010 to 2015. The researcher may not be able to consider all the changes and therefore there will be a gap of time span for further studies in future.
5. **Secondary Data:** Study solely depends upon the published financial data, so it is subject to all limitation that is inherent in the condensed published financial statement.

VII. Determinates Of Dividends

1. **Profitability:** The key determinant of dividend payments is the current earnings which represent the capacity of a firm to pay dividends. Profitability has a positive relationship with dividends. Research studies have used PAT, ROE, and RONW as proxies for the profitability of the company.
2. **Cash Flow:** Brittain (1966) suggested that cash flow (net current profit after tax + depreciation) is a more appropriate measure of the company's capacity to pay a dividend. Further, the regulations and accounting practices regarding depreciation allowance keep on changing and as such cash flow may be a better indicator of true earnings than net profit.
3. **Debt Equity Ratio:** The demand for external finance usually arises in a company on account of constraints imposed by its internal resources. Higher the internal flows, given the investment requirements, lesser will be the demand for borrowings and vice-versa. That is, higher the dividend, larger the demand for borrowings and higher is the debt-equity ratio. Firms with high debt ratios ought to pay lower dividends as they have already pre-committed their cash flows to make debt payments. Though lower dividend payout firm may avoid borrowing more capital.
4. **Liquidity:** A firm may have adequate earnings to declare dividends, but it may not have sufficient cash to pay the same. The liquidity position of a company is expected to be positively related to the dividend payment. Current ratio and the quick ratio have been used as a proxy to measure liquidity position of the company by various researchers.

5. **Share Price Behaviour:** Researchers have proposed negative relationship of lagged share prices with current year dividends and positive relationship of current year share prices with a dividend distributed during the current year. This relationship suggests dividend policy decisions have an impact on shareholders wealth which is mirrored by share prices of a company.
6. **Retained Earnings:** A firm that plans to finance future investment opportunities from retained earnings would distribute lesser profits as dividends. Thus, retained earnings of the current year are negatively associated with the dividend paid.
7. **PE Ratio:** There is a debate in corporate finance literature that out of PE ratio and Dividend Pay-out ratio which is the cause and which is the effect. However, in the present study, a positive relationship between PE ratio and dividend payout has been assumed.
8. **Size of the Firm:** Studies have used natural log of total assets and market capitalization as a surrogate for the size of the firm. In particular, larger firms have easier access to external capital markets and can borrow on better terms. Moreover, larger firms tend to be more diversified and their cash flows are more regular and less volatile. Thus, larger firms should be more willing to pay higher dividends. A positive relationship is expected between Dividend pay-out ratio and firm size as larger firms face lower issuing cost.
9. **Interest Coverage Ratio:** It measures the debt servicing capacity of the firm. A positive relationship is expected between ICR and dividend payout ratio.

VIII. Research Methodology

The purpose of this study is to contribute towards a very important aspect of financial management known as dividend policy with reference to Indian Information Technology sector. This study is analytical work, based on secondary data from various sources for the fulfillment of truthfulness of analysis and interpretation and then to ensure the quality of research study. It shows the various determinants of dividend policy as per this study, six private sectors of IT companies are selected which are operating in India according to the availability of data. Data are collected from various Companies which are listed on the stock exchange for a period of five years from 2011-2015. In this study, various statistical tools and techniques have been used like arithmetic mean, standard deviation and coefficient of variation etc.

IX. Data Analysis & Interpretation

This study is focused, to identify the variables that affect the dividend policy of the IT industry in India. For which we have used a statistical method like mean, standard deviation and coefficient of variation and also used financial ratios for determining of dividend policy.

Table 1: Dividend Policy Determinants of Wipro

Wipro	2015	2014	2013	2012	2011	Avg.	SD	CV(%)
Return On Capital Employed (%)	26.85	29.47	26.72	22.04	22.44	51.008	3.178322	6.2310
Current Ratio	2.16	1.98	1.55	1.94	1.72	1.87	0.237697	12.7111
Debt Equity Ratio	0.17	0.15	0.17	0.22	0.22	0.186	0.032094	17.2546

Interest Cover	30.09	26.64	21.45	10.77	42.95	26.38	11.79379	44.7073
Earnings Per Share	33.18	29.95	22.94	19.05	19.73	24.97	6.301377	25.2358

Source: Computed from published annual report of Wipro (IT industry) from 2010 to 2015

The average of return on capital employed is 51.008 during the study period and its standard deviation is 3.178322 and its coefficient of variation is 6.2310% approximately during the five of years study period. As per above table 1, average current ratio of the industry is 1.87 during the study period and its standard deviation is 0.237697 and its coefficient of variation is 12.7111% during the period. The debt-equity ratio in 2015 and 2013 is same 0.17,0.17 and in the year 2014 it is 0.15 which is low and in the year 2011 and 2012 is more as compared to 2015, 2013 ie,..0.22,0.22. From the above table, average interest cover of the industry is 26.3 during the study period and its standard deviation is 11.79379 and its coefficient of variation is 44.7073% which is very high during the study period.

Further as per above table, earning per share of the company is 24.97 during the study period, which is very high and favorable for shareholders and investors of the company. Its standard deviation is 6.301377 and its coefficient of variation is 25.2358% during the period.

Table 2: Dividend Policy Determinants of HCL Technology

HCL Technologies	2015	2014	2013	2012	2011	Avg.	SD	CV(%)
Return On Capital Employed (%)	39.92	47.3	41.71	33.64	20.74	36.662	10.14774	27.6792
Current Ratio	3.13	2.44	1.82	1.38	1.95	2.144	0.668229	31.1674
Debt Equity Ratio	--	--	0.06	0.11	0.14	0.103333	0.040415	39.1108
Interest Cover	127.95	91.6	59.22	25.27	13.72	63.552	47.17335	74.2280
Earnings Per Share	45.14	85.5	53.16	28.13	17.4	45.866	26.21766	57.1614

Source: Computed from published annual report of HCL technology (IT industry) from 2010 to 2015

The average of return on capital employed is 36.662 during the study period and its standard deviation is 10.14774 and its coefficient of variation is 2.76792% approximately during the five years study period.

As per the above table 2, the average current ratio of the industry is 2.144 during the study period and its standard deviation is 0.668229 and its coefficient of variation is 31.1674% during the period.

According to table 2, the debt ratio for 2011 was 0.14, which is continuously reducing in the year 2012, 2013 i.e., 0.06, 0.11, respectively and again it is zero in the year 2014, 2015, which shows that the company has a very bad and adverse sign regarding the debt and equity relationship. The total average debt equity of HCL technology industry is 0.103333, the standard deviation of debt-equity ratio is 0.040415 and the coefficient of variation of debt-equity ratio is 39.1108% approximately, which is extremely low, during the entire study period.

From the above table, average interest cover of the industry is 63.552 during the study period and its standard deviation is 47.17335 and its coefficient of variation is 74.2280% during the study period year 2011-2015.

From the above table, earning per share of the industry is 45.866 during the study period and its standard deviation is 26.21766 and its coefficient of variation is 57.1614% during the period.

Table 3:Dividend Policy determinants of TATA Consultancy

TATA Consultancy	2015	2014	2013	2012	2011	AVG.	SD	CV(%)
Return on Capital Employed	52.77	53.39	48.07	53.63	44.45	50.462	4.055924	8.0376
Current Ratio	2.78	3.18	2.85	2.48	2.45	2.748	0.299449	10.8970
Debt Equity Ratio	0.01	--	0.01	0.01	0.01	0.01	0	0.0000
Interest Cover	302.89	1,006.74	513.84	816.02	435.8	615.058	288.8027	46.9554
Earnings Per Share	98.31	94.17	65.23	55.97	38.62	70.46	25.44054	36.1064

Source: Computed from Published Annual Report of TATA Consultancy (IT industry) from 2010 to 2015

The average of return on capital employed is 50.462 during the study period and its standard deviation is 4.055924 and its coefficient of variation is 8.0376% approximately during the five years study period.

From the above-mentioned table 3, the average current ratio of the industry is 2.748 during the study period and its standard deviation is 0.299449 and its coefficient of variation is 10.8970% during the period.

As per above-mentioned table, the debt equity ratio is same in the year 2011, 2012, 2013, 2015, i.e. 0.01 and in the year of 2014 the debt equity ratio is zero. The total average debt equity of TATA consultancy industry is 0, the standard deviation of debt equity ratio is also 0 and the coefficient of variation of debt equity ratio is also zero approximately, which is negligible during the entire study period. From the above-mentioned table, average interest cover of the industry is 615.058 during the study period and its standard deviation is 288.8027 and its coefficient of variation is 46.9554% which is high during the study period.

From the above-mentioned table, earning per share of the industry is 70.46 during the study period and its standard deviation is 25.44054 and its coefficient of variation is 36.1064% which shows a good sign for the future.

Table 4: Dividend Policy determinants of TECH Mahindra

Tech Mahindra	2015	2014	2013	2012	2011	AVG.	SD	CV(%)
Return On Capital Employed (%)	23.04	32.61	17.51	16.05	16.18	21.078	7.050501	33.4496
Current Ratio	2.3	2.11	0.95	0.98	1.58	1.584	0.623723	39.3764
Debt Equity Ratio	--	--	0.26	0.33	0.53	0.373333	0.140119	37.5319
Interest Cover	334.63	36.92	8.5	9.46	8.41	79.584	143.095	179.8037
Earnings Per Share	23.48	115.02	50.93	36.13	55.31	56.174	35.21987	62.6978

Source: Computed from Published Annual Report of TECH Mahindra (IT industry) from 2010 to 2015

The average of return on capital employed is 21.078 during the study period and its standard deviation is 7.050501 and its coefficient of variation is 33.4496% approximately during the five years study period.

From the above table, average current ratio of the industry is 1.584 during the study period and its standard deviation is 0.623723 and its coefficient of variation is 39.3764% during the period.

From the above-mentioned table, average interest cover of the industry is 79.584 during the study period and its standard deviation is 143.095 and its coefficient of variation is 179.8037% which is very high during the study period of the company. From the above-mentioned table, earning per share of the industry is 56.174 during the study period and its standard deviation is 35.21987 and its coefficient of variation is 62.6978%which is good during the study period of the company.

Table 5: Dividend Policy Determinants of Mphasis

MphasiS	2015	2014	2013	2012	2011	AVG.	SD	CV(%)
Return On Capital Employed (%)	17.66	8.15	19.82	19.61	25.02	18.052	6.170686	34.1828
Current Ratio	2.5	2.3	1.55	1.36	1.73	1.888	0.490479	25.9788
Debt Equity Ratio	0.03	--	--	0.07	0.07	0.056667	0.023094	40.7541
Interest Cover	124.57	741.15	54.64	64.06	410.7	279.024	296.3582	12.7111
Earnings Per Share	26.32	10.62	25.68	29.08	37.23	25.786	9.6452	37.4048

Source: Computed from Published Annual Report of Mphasis (IT industry) from 2010 to 2015

The average of return on capital employed is 18.052 during the study period and its standard deviation is 6.170686 and its coefficient of variation is 34.1828% approximately during the five years study period.

As per the above-mentioned table, average current ratio of the industry is 1.888 during the study period and its standard deviation is 0.490479 and its coefficient of variation is 25.9788% during the period. From the above-mentioned table-5, average interest cover of the industry is 279.024 during the study period and its standard deviation is 296.3582 and its coefficient of variation is 12.7111%, which is low during the study period.

From the above-mentioned table, earning per share of the industry is 25.786 during the study period and its standard deviation is 9.6492 and its coefficient of variation is 37.4048% during the period.

Table 6 : Dividend Policy Determinants Of Mindtree

Mindtree	2015	2014	2013	2012	2011	AVG.	SD	CV
Return On Capital Employed (%)	34.15	35.23	31.71	23.57	18.41	28.614	35.14956	122.8404
Current Ratio	2.38	2.57	2.39	1.8	2.55	2.338	2.618243	111.9864
Debt Equity Ratio	--	--	0.02	0.05	0.01	0.026667	0.043663	163.7377
Interest Cover	6,878.00	1,447.75	424.6	472.4	359.5	1916.45	4429.283	231.1192
Earnings per share	63.81	108.23	81.59	53.94	30.75	67.664	93.76143	138.5691

Source: Computed from Published Annual Report of Mindtree (IT industry) from 2010 to 2015

The average of return on capital employed is 28.614 during the study period and its standard deviation is 35.14956 and its coefficient of variation is 122.8404% approximately during the five years study period.

From the table-6, average current ratio of the industry is 2.338 during the study period and its standard deviation is 2.618243 and its coefficient of variation is 111.9864% during the period. From the above-mentioned table, average interest cover of the industry is 1916.45 during the study period and its standard deviation is 4429.283 and its coefficient of variation is 231.1192% which is extremely very high and a good sign for the company during the study period.

From the above-mentioned table, earning per share of the industry is 67.664 during the study period and its standard deviation is 93.76143 and its coefficient of variation is 138.5691% during the period.

X. Summary of Findings and Conclusion

Dividend policy plays a pivotal role in the management of company's earnings. So decisions related to dividend policy have a significant role on IT sector, its share prices and its future growth. The valuation of any company depends on its earnings. Due to decentralization of ownership and management in company's organizational structure, it is obvious that they should decide the dividend policy in which the trusts of shareholders are to be maintained.

Moreover the study has also shown the influence of profitability on dividend payout ratio for different IT companies. Apart from this, the study also shows how the fluctuations in dividend payout ratio take place, year by year due to variation in different independent variables. Study based on qualitative analysis has shown different views and beliefs of shareholders regarding dividend policies.

Generally, higher debt equity ratio may negatively influence the dividend pay-out of company. But in case of IT firms the proportion of debt in the total capital structure of the company is relatively low as they are very low debt or zero debt companies. IT sector is a human intensive sector and do not require huge capital asset base like manufacturing companies for their operations. The major asset of this sector is manpower. The funds required for recruitment and retention of manpower is comparatively less than funds required for purchasing capital assets. So these firms can easily release funds for payment of dividends.

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