Research Paper

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Analysis of The Impact of Dividend Decision on Sail

Finance

KEYWORDS : Corporate Finance, Dividend Payout Ratio, Gross Profit Margin, Investment Decisions.

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ABSTRACT

The study of corporate finance is one of the major areas of finance which looks into the financial problems of firms and their solution. The primary goal of corporate finance is to maximize shareholder value thereby making Dividend Decision one of the important aspects of corporate finance. In the above context I have studied the relationship between the Dividend Payout Ratio, Gross Profit Margin, Net Profit Margin, ROCE and Return on Net worth of SAIL over a period of 2008 to 2012. The study is based on secondary data collected from the authentic websites of these companies. I have used Pearson's Correlation Coefficient (2 Tailed test, 5% Level of Significance) to see whether there is any significant correlation between the above mentioned variables. It also needs to be seen whether there are any major fluctuations in the above variables over the period of study and to what extent.

INTRODUCTION:

Corporate finance is the area of finance dealing with monetary decisions that business enterprises make and the tools and analysis used to make these decisions. The primary goal of corporate finance is to maximize shareholder value. The study of corporate finance is applicable to the financial problems of all kinds of firms. Short-term issues include the management of current assets and current liabilities, inventory control, investments and other short-term financial issues. Long-term issues include new capital purchases and investments. Thus corporate finance is associated with transactions in which capital is raised in order to create, develop, grow or acquire businesses. One of the major areas of Corporate Finance is Capital Investment Decision which looks into long-term corporate finance decisions relating to fixed assets and capital structure. Decisions are based on several inter-related criteria. (1) Corporate management seeks to maximize the value of the firm by investing in projects which yield a positive net present value when valued using an appropriate discount rate in consideration of risk. (2) These projects must also be financed appropriately. (3) If no such opportunities exist, maximizing shareholder value dictates that management must return excess cash to shareholders (i.e., distribution via dividends). Capital investment decisions thus comprise an investment decision, a financing decision, and a dividend decision.

LITERATURE REVIEW:

In their paper "Financing-Motivated Acquisitions", ***Isil Erel, Yeejin Jang, Michael S. Weisbach,*** evaluated the extent to which acquisitions lower financial constraints on a sample of 5,187 European acquisitions occurring between 2001 and 2008. Each of these targets remains a subsidiary of its new parent, so they observed the target's financial policies following the acquisition. They examined whether these post-acquisition financial policies reflect improved access to capital. They found that the level of cash target firms hold, the sensitivity of cash to cash flow, and the sensitivity of investment to cash flow all decline significantly, while investment significantly increases following the acquisition. These effects are stronger in deals more likely associated with financing improvements. These findings are consistent with the view that easing financial frictions is a source of value that motivates acquisitions.

Raghuram Rajan studied the nature of the firm and its linkage with financing in his paper "The Corporation in Finance ". To produce significant net present value, an entrepreneur has to transform her enterprise into one that is differentiated from the ordinary. To achieve the control that will allow her to execute this strategy, she needs to have substantial ownership, and thus financing. But it is hard to raise finance against differentiated assets. So an entrepreneur has to commit to undertake a second transformation, standardization, that will make the human capital in the firm, including her own, replaceable, so that outside financiers obtain control rights that will allow them to be repaid. He argued that the availability of a vibrant stock market helps the entrepreneur commit to these two transformations in a way that a debt market would not. This helps explain why the nature of firms and the extent of innovation differ so much in different financing environments.

Aswath Damodaran, in his paper 'Dividends and Taxes: An Analysis of the Bush Dividend Tax Plan' studied the implications of making dividends tax free to investors. Investors and corporate finance practitioners contemplated about this after President Bush proposed it as part of his economic package in early 2003. While much of the debate has concentrated on the consequences of the tax law change for the stock market and budget deficits, the real effects may be in how companies raise money (debt versus equity), how much cash they choose to accumulate and how they return this cash to stockholders (dividends versus stock buybacks). If the tax law changes occur as proposed, it will profoundly alter the terms of the debate and require us to rewrite much that we take for granted in corporate finance today. In particular, companies will become more (if not entirely) equity financed, a decrease in cash balances and a dramatic surge both in the number of companies that pay dividends and in how much they pay. This asymmetric treatment of debt and equity has formed the basis for much of the debate in corporate finance on whether firms should use debt or equity and how much firms should pay out to their stockholders in dividends. In this paper, he considered the implications of the tax law change for both valuation and corporate finance practice.

OBJECTIVE and METHODOLOGY of the STUDY:

In this paper I have analysed the relationship between the Dividend Payout Ratio, Gross Profit Margin, Net Profit Margin, ROCE and Return on Net worth of SAIL over a period of 2008 to 2012. The study is based on secondary data collected from the authentic websites of these companies. I have used Pearson's Correlation Coefficient (2 Tailed test, 5% Level of Significance) to see whether there is any correlation between the above mentioned variables. It also needs to be seen whether there are any major fluctuations in the above variables over the period of study and to what extent. The dividend decision of these companies has also been compared over the period of study.

Null Hypothesis 1: There is no correlation between Dividend Payout Ratio & Gross Profit Margin of the companies being studied.

Alternate Hypothesis 1: There is correlation between Dividend Payout Ratio & Gross Profit Margin of the companies being studied.

Null Hypothesis 2: There is no correlation between Dividend Payout Ratio & Net Profit Margin of the companies being studied.

Alternate Hypothesis 2: There is correlation between Dividend Payout Ratio & Net Profit Margin of the companies being studied.

Null Hypothesis 3: There is no correlation between Dividend Payout Ratio & ROCE of the companies being studied.

Alternate Hypothesis 3: There is correlation between Dividend Payout Ratio & ROCE of the companies being studied.

Null Hypothesis 4: There is no correlation between Dividend Payout Ratio & RONW of the companies being studied.

Alternate Hypothesis 4: There is correlation between Dividend Payout Ratio & RONW of the companies being studied.

ANALYSIS and RESULTS:

a) In the case of SAIL there is a significant positive correlation between Dividend Payout and Gross Profit Margin (-0.452). This makes it obvious that the Gross Profit & Dividend Payout move in the opposite direction over the years. This is evident from March 2008 to March 2010

There is a negative correlation between Dividend Payout and Net Profit Margin (-0.506). This may be because the fluctuations in the Net Profit Margin are very negligible. Thus the correlation is not that well defined. (Table 1 & Table 2)

There is a negative correlation between Dividend Payout and ROCE (-0.419). This makes it obvious that the Dividend Payout & ROCE move in the reverse direction over the years. This may be because the fluctuations in the Net Profit Margin are very negligible. Thus the correlation is not that well defined.

There is a negative correlation between Dividend Payout and RONW (-0.494). This makes it obvious that the Dividend Payout & RONW move in the reverse direction over the years. This may be because the fluctuations in the Net Profit Margin are very negligible. Thus the correlation is not that well defined.

There is very little fluctuation in the Dividend payout over the period of study similar to the marginal fluctuations in GP & NP Margin, ROCE & RONW. (Chart 1)

Thus the 4 Null Hypotheses are rejected as there is a correlation between Dividend Payout and Gross Profit Margin, Net Profit Margin, ROCE & RONW. Whether positive or negative there is a relation between the above. Thus GP, NP, ROCE & RONW affect the Dividend Payout Ratio. Thus the companies SAIL relate their Dividend decisions with their Profit margins, ROCE & RONW.

CONCLUSION:

Dividend decision is an important area of any Company especially while taking relevant corporate decisions or formulating critical corporate strategies. Through this study one can conclude that there is a correlation between Dividend Payout and Gross Profit Margin, Net Profit Margin, ROCE and RONW. The two companies studied out here look into this area effectively. The decisions of SAIL are somewhat similar being, their Dividend Payout increased with the increase in GP Margin, NP Margin, ROCE and RONW. Irrespective of the direction, one cannot rule out the correlation between the above. Also the Dividend payout had less variability for SAIL. The same can be said about their respective GP & NP Margin, ROCE & RONW. Thus one can conclude that Dividend decision being one of the important decisions of Corporate Finance is influenced by GP & NP Margin, ROCE & RONW of the company studied here SAIL.

TABLES & CHARTS

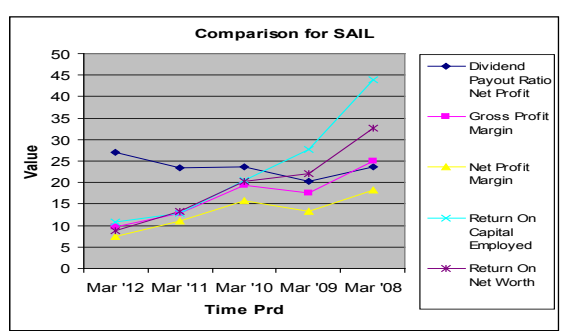
TABLE 1: DETAILS OF SAIL:

SAIL	Dividend Payout Ratio Net Profit	Gross Profit Margin	Net Profit Margin	Return On Capital Employed	Return On Net Worth
Mar '12	27.1	9.74	7.44	10.91	8.89
Mar '11	23.49	12.88	11.03	12.88	13.23
Mar '10	23.54	19.4	15.73	20.46	20.27
Mar '09	20.32	17.48	13.4	27.61	22.06
Mar '08	23.71	25.1	18.16	44.03	32.76

TABLE 2: CORRELATION FOR SAIL:

		Dividend Payout Ratio Net Profit
Dividend Payout Ratio Net Profit	Pearson Correlation	1
	Sig. (2-tailed)	
	N	5
Gross Profit Margin	Pearson Correlation	-.452
	Sig. (2-tailed)	.445
	N	5
Net Profit Margin	Pearson Correlation	-.506
	Sig. (2-tailed)	.384
	N	5
Return On Capital Employed	Pearson Correlation	-.419
	Sig. (2-tailed)	.483
	N	5
Return On Net Worth	Pearson Correlation	-.494
	Sig. (2-tailed)	.397
	N	5

CHART 1: COMPARISON FOR SAIL:



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