



Determinants of Dividend Pay-Out Ratios - A Study of Pharmaceuticals Companies

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ABSTRACT

Profitability has always been considered as a primary indicator of dividend pay-out ratio. There are numerous other factors other than profitability also that affect dividend decisions of an organization namely cash flows, corporate tax, sales growth and market to book value ratio. Available literature suggests that dividend pay-out ratio is positively related to profits, cash flows and it has inverse relationship with corporate taxes, sales growth and market to book value ratio. This paper is an attempt to empirically analyze the determinants of dividend pay-out ratio of Indian Pharmaceuticals industry. The current study focuses on the determinants of dividends and its performance of select pharmaceutical companies in India. This study evaluates the performance of various pharmaceutical companies and their annual compound growth rate.

KEYWORDS : Dividend - dividend pay-out ratio – annual compound growth rate - Pharmaceuticals industry

INTRODUCTION

Dividend payout has been an issue of interest in financial literature. Academicians & researchers have developed many theoretical models describing the factors that managers should consider when making dividend policy decisions. By dividend policy, we mean the payout policy that managers follow in deciding the size and pattern of cash distribution to shareholders over time. In seminal paper, Miller and Modigliani (M&M) (1961) argue that given perfect capital markets, the dividend decision does not affect the firm value and is, therefore, irrelevant. Most financial practitioners and many academics greeted this conclusion with surprise because the conventional wisdom at the time suggested that a properly managed dividend policy had an impact on share prices and shareholder wealth.

Dividend decision, one of the important aspects of company's financial policy, is not an independent decision. Rather, it is a decision that is taken after considering the various related aspects and factors. There are various factors influencing a firm's dividend policy.

BASIC FACTORS AFFECTING DIVIDEND DECISION

Theoretically, over the past number of years, it has been believed by the academicians that the dividend decision is influenced by number of factors. Some of the factors that affect the dividend decision of a firm are listed as follows:

1. Legal Provisions: Indian Companies Act, 1956 has given the guidelines regarding legal provisions as to dividends. Such guidelines are required to be followed by the companies whenever the dividend policy is to be formulated. As per the guidelines, a company is required to transfer a certain percentage of profits to reserves in case the dividend to be paid is more than 10 percent.

2. Magnitude of Earnings: Another important aspect of dividend policy is the extent of company's earnings. So, if the profits of a company increase, it will directly influence the dividend declaration as the latter may also increase. Thus, the dividend is directly linked with the availability of the earnings with the company.

3. Desire of Shareholders: The decision to declare the dividends is taken by Board of Directors but they are also required to consider the desire of the shareholders, which depend on the latter's economic condition. The shareholders, who are economically weak, prefer regular dividend policy while the rich shareholders may prefer capital gains as compared to dividends. However, it is very difficult for the board to reconcile the conflicting interests of different shareholders yet the dividend policy has to be framed keeping in view the interest of all the interested parties.

4. Nature of Industry: The nature of industry in which a company is operating, influences the dividend decision. Like the industries with stable demand throughout the year are in a position to have stable

earnings, thus, should have the stable dividend policy and vice-versa.

5. Age of the Company: A company's age also determines the quantum of profits to be declared as dividends. A new company should restrict itself to lower dividend payment due to saving funds for the expansion and growth as compared to the already existing companies who can pay more dividends.

6. Taxation Policy: The tax policy of a country also influences the dividend policy of a company. The rate of tax directly influences the amount of profits available to the company for declaring dividends.

7. Control Factor: Yet another factor determining dividend policy is the threat to loose control. If a company declares high rate of dividend, then there is the possibility that a company may face liquidity crunch for which it has to issue new shares, resulting in dilution of control. Keeping this threat in view, a company may go for lower level of dividend payments and more ploughing back of profits in order to avoid any such threat.

8. Liquidity Position: A company's liquidity position also determines the level of dividend. If a company does not have sufficient cash resources to make dividend payment, then it may go for issue of bonus shares.

9. Future Requirements: A company while framing dividend policy should also consider its future plans. If it foresees some profitable investment opportunities in near future then it may go for lower dividend and vice-versa.

10. Business Risk: Business risk is a potential factor that may affect dividend policy. High levels of business risk make the relationship between current and expected future profitability less certain. Consequently, it is expected that firms with higher levels of business risk will have lower dividend payments. Many researchers argued that the uncertainty of a firm's earnings may lead it to pay lower dividends because volatile earnings materially increase the risk of default.

LITERATURE REVIEW

The size of a firm's profit has been a long standing determinant of dividend policy. Directors normally recommend the payment of dividend when the firm has made sufficient profit to warrant such payments. Profitability is among the main characteristics that strongly and directly influences dividend policy, Al-Kuwari (2009). Pruitt and Gitman (1991) conclude that current and past years' profits, the year-to-year and prior years' dividend are important factors that influence dividend policy. Consequently, it is expected that profitable firms are likely to pay dividend as compared to non-profitable firms (Eriostis and Vasiliou, 2003; and Ahmed and Javid, 2009).

Firms that experience recent growth in revenues tend to pay lower

dividends (Chen and Dhiensiri,2009). If the firm is growing rapidly, there will be a high demand of capital. The pecking order theory states that firms should finance new projects first with least information-sensitive sources i.e. retained earnings. Consequently, firms with high growth opportunities are likely to retain a greater portion of their earnings to finance their expansion projects as against returning these dividends to shareholders.

This would especially be true if the rate of returns the firm earn on its assets was in excess of what the individual shareholders could expect to receive by asking dividend and investing these funds elsewhere. This view is supported by Higgins (1981), who noticed that there is a direct link between growth and financing need: rapidly growing firms have external financing needs because working capital needs normally exceed the incremental cash flow. Higgins (1972) show that payout ratio is negatively related to a firm's need for funds to finance growth opportunity.

RESEARCH METHODOLOGY

The present study is a study on selected companies to meet the specified objectives. The dividend can be determined by the internal and external factors. The independent variables like current year sales, current year interest, current year depreciation, current year provision for tax, current year net profit previous year net profit previous year dividend per share previous year retained earnings per share and current year liquidity ratio and dividend per share. The dividend determinants play a vital role in issuing the dividends and for the reinvestment. The current approach is about the concept of determinants of dividends and its performance analysis through the annual compound growth rate method of various determinants of demand of select pharmaceutical companies.

OBJECTIVE

The current study main objective is to analyze the profitability, and the growth rate of selected Pharmaceutical companies.

SOURCES OF DATA

For the current analysis data is secondary data and were collected from the financial reports of the selected pharmaceutical companies from the year 2010-2014 from internet (www.moneycontrol.com).

Table No: 1 Annual Compound Growth Rate of PBIT (in %)

S. No	Company Name	PBIT (in crs)		ACGR of PBIT
		Beginning year (2010)	Ending year (2014)	
1	P&G	261.56	466	12.24
2	Dr.Reddy Lab	1,342.50	2,913.20	16.76
3	GlaxoSmithkline	6.57	152.48	87.55
4	Cipla	1,506.64	2,269.81	8.54
5	Sun Pharm	1,017.50	-2,699.15	-221.54
6	Torrent	361.21	1016.76	23
7	Sanofi India	237.58	783	26.93
8	AjanthaPharma	54.48	321.28	42.68
9	FDC	161.06	220.01	6.44
10	IPCA	338.10	704.34	15.81
11	Indoco Remedies	45.84	90.91	14.68
12	Suven Life Science	9.63	213.25	85.80

Source: Annual Reports of select Pharma companies

INTERPRETATION

From the above table the annual compound growth rate of PBIT ranges from 6.44 % to 87.55 % for the selected Pharmaceutical companies. The P & G Hygiene and health care had a growth rate of 12.24% from 2010 to 2014. GlaxoSmithkline is having least growth rate (6.51 %) in PBIT among the selected companies where as the Sun Pharma has the lowest growth rate of -221.54 % among the companies selected.

Sun Pharma is having less operating profit compared to other companies where as the GlaxoSmithkline has more operating profit and has a superior in annual growth of PBIT. PBIT of Suven Life Science increased from 9.63crs to 213.25crs from the year 2010 to 2014. Sanofi India has a moderate annual compound growth rate of 26.93 % and the PBIT ranges from 237.58crs to 783crs.

Table No: 2 Annual Compound Growth Rate of PAT (in %)

S. No	Company Name	PAT (in crs)		ACGR of PAT
		Beginning year (2010)	Ending year (2014)	
1	P&G	179.77	302	10.93
2	Dr.Reddy Lab	846.10	1,932.80	17.96
3	GlaxoSmithkline	4.5	96.54	84.62
4	CIPLA	1,081.49	1,388.34	5.12
5	Sun Pharm	898.65	-2,828.52	-225.77
6	Torrent	207.37	762.34	29.74
7	Sanofi India	230.75	517	17.51
8	AjanthaPharma	28.54	220.86	50.56
9	FDC	148.82	134.42	-2.01
10	IPCA	271.73	477.57	11.93
11	Indoco Remedies	42.09	57.90	6.6
12	Suven Life Science	7.00	144.16	83.13

Source: Annual Reports of select Pharma companies

INTERPRETATION

From the above table the annual compound growth rate of Profit after tax (PAT) from the year 2010 to 2014 ranges from -225.77 % to 84.62 % for the selected Pharmaceutical companies. The Glaxo Smithkline has highest annual compound growth rate of 84.62% and its PAT ranges from 4.5 crs to 96.54crs from the year 2010 to 2014. Sun Pharm is having least PAT growth rate of -225.77% of PAT and it has a PAT of 898.65crs in the year 2010 and -2,828.52crs during the year 2014. FDC has a negative growth rate of -2.01 %. Dr.ReddyLab and Sanofi India have a similar growth rate with a minor variation of 0.45 %. Their ACGR of PAT is 17.96% to 17.51 % respectively. Glaxo Smithkline and Suven Life Science have annual compound growth rate of 84.62% and 83.13 % and are next to Ajantha Pharma in their PAT growth rates. Torrent is having a PAT growth rate of 29.74 % and its PAT increased from 207.37 crs to 762.34crs from the year 2010 to 2014. IPCA profit after tax increased from 271.73crs to 477.57 crs and it has an annual compound growth rate of 11.93 %. The annual compound growth rate of profit after tax for Indoco Remedies is 6.6 % and for the years 2010 to 2014 its PAT increased from 42.09crs to 57.90 crs

Table No: 3 Annual Compound Growth Rate of EPS (in %)

S. No	Company Name	EPS (in crs)		ACGR of EPS
		Beginning year (2010)	Ending year (2014)	
1	P&G	55.38	93.04	10.93
2	Dr.Reddy Lab	50.11	113.62	17.79
3	GlaxoSmithkline	0.92	48.95	121.41
4	CIPLA	13.47	17.29	5.12
5	Sun Pharm	43.39	-13.66	-20.63
6	Torrent	24.51	45.05	12.95
7	Sanofi India	100.19	80.81	-4.21
8	AjanthaPharma	24.37	62.83	20.85
9	FDC	7.99	7.56	-1.10
10	Ipca	16.75	37.83	17.70
11	Indoco Remedies	34.26	6.28	-28.77
12	Suven Life Science	.60	12.34	83.08

Source: Annual Reports of select Pharma companies

INTERPRETATION

From the above table there is a negative compound growth rate of EPS for the companies likeSun Pharm, Sanofi India, FDC and Indoco Remedies are-20.63, -4.21, -1.10and -28.77 respectively. Dr.ReddyLab and Sanofi India have a similar growth rate with a minor variation of 0.09 %. Their ACGR of PAT is 17.79% to 17.70 % respectively and their EPS of two companies are not similar. Glaxo Smithkline has highest growth rate of 121.41% and its EPS increased from 0.92 crs to 48.95 crs from the year 2010 to 2014. Ajantha Pharma EPS increased from 24.37 crs to 62.83 crs and is has a annual compound growth rate of 20.85% which is of moderate growth rate. P&G hygiene and health care has a growth rate of 10.93% and its EPS is increased from 55.38 crs and 93.04 crs from the year 2010 to 2014.

The negative EPS indicates that there is a loss in their Earnings per share in their compound growth rate. The negative compound growth rate doesn't mean that there is loss at per share earnings for every year it only represents the annual compound growth rate from 2010 to 2014.

Table No: 4 Annual Compound Growth Rate of DPS (in %)

S. No	Company Name	DPS (in crs)		ACGR of DPS
		Beginning year (2010)	Ending year (2014)	
1	P&G	225	275	4.10
2	Dr.Reddy Lab	225	360	9.86
3	GlaxoSmithkline	300	500	10.76
4	CIPLA	100	100	0
5	Sun Pharma	275	150	-11.42
6	Torrent	120	100	-3.58
7	Sanofi India	165	350	16.23
8	AjanthaPharma	35	200	41.70
9	FDC	175	225	5.15
10	Ipca	140	250	12.30
11	Indoco Remedies	70	70	0
12	Suven Life Science	25	200	51.57

Source: Annual Reports of select Pharma companies

INTERPRETATION

From the above table the annual compound growth rate of dividend per share for the selected pharmaceutical companies varies from -11.43% to 51.57%. There is a negative compound growth rate of DPS for the companies likeSun Pharm and Torrent are -11.42 and -3.58 respectively Suven Life Science has the highest annual compound growth rate of 51.57 % and its dividend per share increased from 25crs to 200crs from the year 2010 to 2014.Sun Pharma has a growth rate of -11.42 % which is the least growth rate among select pharmaceutical companies. Dr. Reddy's Labs and Glaxo Smithkline have a similar growth rates with a minor variation of 0.09 % and their growth rates are 9.86% and 10.76 % respectively. Cipla and Indo Remedies have no change in their DPS from the 2010 to 2014.

The highest DPS doesn't mean that the companies are performing well in all the areas. It depends on board decision, dividend pay-out ratio and several other factors.

CONCLUSION

Determinants of dividend will affect the profitability of different pharmaceutical companies. Annual compound growth rates of the dividend determinants give the profitability and the growth rate of select pharmaceutical companies. The negative annual compound growth rate doesn't mean that there is loss at per share earnings for every year it only represents the annual compound growth rate. The highest DPS doesn't mean that the companies are performing well in all the areas. It depends on board decision, dividend payout ratio and several other factors.

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