Research Paper Management

A review of Article on "Dividend Policy and Stock Price Behaviour in Indian Corporate Sector: A panel data approach"

Krunal K Bhuva PhD. Research Scholar, School of Management, RK University &Assistant Professor at JVIMS-MBA college

Dr. Vijay H Vyas Director, Department of Management Atmiya Institute (AITS) RAJKOT.

KEYWORDS

Dividend policy still remains an academic debate amid the clouding picture of its importance among the financial economists till today. There are few aspects of corporate financial policy where the gap between the academics and the practitioners is larger than that of the dividend policy. From Miller & Modigliani (1961), Gordon & Linter to Fama & French (2001) ,the research on the topic exhibits conflicting trends in dividend payments & firm value. The academic consensus shows that dividends really don't neither matter very much for the market nor is relevant, when firms pay dividend as a signal to the investors. Both corporate officials and investment analysts, still continue to insist that a firm's dividend policy matters a great deal for conveying the information to the stakeholders. One side of the argument on the basis of economic theory is, it doesn't matter or is irrelevant.

Author's views on Dividend Policy & Share prices

The dividend policy of a firm becomes the choice of financial strategy when investment Decisions are taken as given. It is also imperative to know whether the firm will go for internal or external source of financing for its investment project. There are a number of factors affecting the dividend policy decisions of a firm such as investor's preference, earnings, investment opportunities; annual vs. Target capital structure, flotation costs, signaling, stability & Government policies and taxation. In the presence of symmetric Information, signaling is one of the crucial factors that influence the market. Dividends may convey information about the company, so it suggests the possibility of its influence on the stock market. Paying large dividends reduces risk and thus influence stock price (Gordon, 1963) and is a proxy for the future earnings (Baskin, 1989)

Proposed Derived Model referred by the Author

In analyzing dividend and stock price behaviour, the most important point to begin with is an objective function representing a firm's preference regarding dividend-retention mix instead of taking only dividend yield or payout ratio. Because the objective function is related to firm's main motives & there has been a shift in its motives due to the dominance of joint stock corporations & the associated characteristics of separation of ownership & control. This shift can be characterized from the sole motive as maximization of rate of return on capital to other set of motives such as sales Maximization expansion of business. This set of motives contributing to an increase in the market value of the firm, also, is in consonance with the managing agency system of operation, which is a characteristics of Indian companies. Moreover, the separation of ownership & control also implies a difference in the objectives & preferences between firm's management & its shareholders. Nevertheless, the behaviour of the shareholders may be generalized as that they prefer stable dividend rates & that the effect of taxes is only on the preference of the Shareholders as the shareholders, who belong to the richer classes prefer low dividends and high retained earnings. The opposite is applicable in the case of middle income group of shareholders. On the other hand, the management behaviour can be relatively & conceptually distinguished between a „passive" & an „active" type. The motives of passive management are similar to those of the shareholders & it efforts to ensure stable dividend. But firm also requires sufficient profit retentions to satisfy the firm's long-term needs such as investment demand & liquidity needs etc. But the "active" management aims at increasing the market value of the firm & the market price of shares as well. So while its credibility requires to emphasize on the shareholders preference, it's general tendency would be to reduce dividends on the basis of different excuses like high tax rates on distributions, „tax shelter" benefits. Given the vast diversity of stockholders, it is not surprising that, over time, stockholders tend to invest in firm's whose dividend policies match their preferences. Stockholders in high tax brackets who do not need the cash flow from dividend payments tend to invest in those companies which either pay low or no dividends. By contrast, stock holders with low tax bracket will invest in companies with high dividends. This clustering of stock-holders in companies with dividend policies that match their preferences is called as clientele effect. So it suggests that firms get the investors they deserve since the dividend policy of a firm attracts investors who like it. Second, it means that firms will have a difficult time changing an established dividend policy, even if it makes complete sense to do so.

Sources of data and Sample Design used in Research Paper

To conduct the research the author has collected data from the Prowess database of the CMIE (centre for monitoring on Indian economy) in India in order to mitigate the above noted objectives. Since the present study aims at exploring the dividend and stock return volatility with the assumptions of "semi strong efficiency" in the stock market a sample of 500 companies from "A1" and "B1" group of shares is selected for the empirical analysis. All of them are spread across six different industries namely Electricity, Food and Beverage, Mining, Non-metallic, Textile and Service Sector. The first filtering criterion for selecting the stocks is their consistency with the dividend payment history for the study period 1996- 2006. The second filtering criterion used for the selection is that the market-capitalization of these companies should be more than ten crores. The third filtering criterion is that the scrip must be traded continuously without any interruption during the above mentioned period.

However, the study has conceptualized the dependent variable (i.e. market value of the firm) and the explanatory variables such as size of the firm, dividends to retain earning ra-

tio, and debt to equity ratio. The stock return is considered as proxies for the market value of the firm (dependent variable) and for other subsequent variable, Ln (total assets of the firm) have taken as a proxy. Stock Return: Market value of the firm which is the dependent variable of our interest is being represented by Stock Return .This can be calculated by taking closing share prices of each company. Stock returns should be calculated using the log return of the closing price of the stock, where the Closing price is defined as the last trade price of the stock.

Vit = ln (Pt/Pt-1).

Empirical Estimation and Results of the article

In this section the author has attempted to estimate their proposed model. The author has presented the results in two sections. In first the results of those industries that how the applicability of fixed effect models on the basis of hypothesis testing. And those industries that don't satisfy criterion in second sections. The results from the regression analysis are discussed in two sub-sections. The result of the regression result of one-way fixed effect model for Electricity, Food and Beverage and Non-Metallic Industry.

Conclusion of the Article

In this part author has concluded that the relationship of dividends and stock return by using a simple Specification of stock return as a function of net profit and dividend-retention ratio with two control variable such as size & debt-equity ratio of the firm. There was an attempt to test different structural tests before proceeding towards the final estimation through panel-data modeling. The exclusive tests of different model allow us to go for the use of panel-data modeling. The author has studied six different industry classifications for the study and has tested the proposed model for each industry separately with different combination of variables. The results display statistical significance and linearity when the industry classifications are given. The regression on aggregate data remains in significant. . In case of aggregate data which consists of all firms above from industry classifications, the regression lacks statistical significance, the null hypothesis that there is no relationship between the dependent variable and independent variable cannot be rejected. When the fixed firm effect regression is applied on sample firms of classified industry category-wise, the author observed some industry specific peculiarities. Firms of Electricity, Food and beverage and Non-Metallic Product show some robustness in the results of the regression. The signs of the coefficient and their value remain significant in the analysis. Other three industries, textile, mining and other services are exhibiting insignificant coefficients values and very low R2. This conflicting trend of these variables is also visible when the author has tried Pooled OLS and Random effect model. The result also showed relax the industry classification and with the same data set and variables, fixed effect model shows the regression is significant at 0.05 level of significance as the p value of getting a higher or equal value than calculated f-value is 0.0497, which is to reject the null hypothesis that all coefficients are equal to zero. Another important result is the sign of the leverage ratio and the coefficient remain as per prior expectation.

The negative sign of the debt-equity ratio implies the negative relationship between the stock-return and debt-equity ratio. As the firm will go for more debt, then its value is going to be affected by stock-return. Size of the firm remains consistently positive but in many cases it turns out to be insignificant. The author generalizes about the variable size & concludes that dividends have impact on the stock-return in Indian corporate sector, which is industry specific. The result also explores that the dividend paying companies are large, profitable and growth rate of the firm does not seems to dissuade the dividend payment. Although the regression is not showing high R2 but Net profit and Dividend and Retention Ratio remains significant in other services, mining and Textile industries.

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