Beyond the Balance Sheet: Decoding the Profitability-Dividend Relationships in the Corporate Sector

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Abstract

Dividends are the part of profits that should be distributed among the shareholders for their capital contribution. It is one of the costs of capital on the part of the company as it is given as a reward to the owners. The investor's major aim is to receive maximum return on capital to maximise wealth. Dividend policy differs from organisation to organisation based on various factors, mainly its future visions. Dividend policy influences the value of the firm. This study attempts to bring to light the relationship between dividend payout and profitability. This study is mainly based on the information available from all the segments listed in NIFTY50. The share prices and financial variables are obtained from the NSE website, the prowess database of CMIE and the Official websites of companies. The major variables used are Earnings Per Share and Dividend Per Share, which were analysed using Pearson's Correlation. The analysis showed a significant relationship between the dividend per share(DPS) and the earnings per share of companies. When the earnings per share increases, the dividend per share also increases. This study covers different sectors such as Services, Consumer Goods, Financial Services, Automobile, Energy, Telecom, Pharma, Metals, Cement & Cement Products, IT, Construction, Fertilisers & Pesticides, Media & Entertainment. The findings would bring portrayal to corporate managers, investors, share market dealers, agencies, financial institutions and financial consultants.

Keywords: Dividend, DPS, EPS, NIFTY, Profitability.

Introduction

The capital market may be defined as an organised mechanism for the effective and efficient transfer of money from the investing parties to the entrepreneurs engaged in the business, either in an economy's private or public sectors. Simply put, a Stock Market is a segment where the trading of company stock, both listed and unlisted securities, takes place. It is different from the stock exchange because it includes all the national stock exchanges of the country.

Dividends are usually defined as the portion of net earnings or profits after deducting tax and retain earning are shared among the shareholders of the firm in fraction of their ownership. In the corporate world, companies do not have any obligation to distribute the dividend among shareholders. Still, it should be the responsibility of the corporate manager to share the profit in the form of dividends. The dividend is the major financial decision for the board of directors, which chooses between distributing the profit to the shareholders or ploughing them back into the business. Dividends have distinct features in their arena as they are allocated from earnings only; they should be in the form of real assets; in practice, most companies pay in the form of cash and distribute to all stakeholders according to the proportion of shareholdings.

Here, the researcher is trying to find out the relationship between the dividend policy and earnings per share of companies listed in NSE.

Review of literature

Many studies have examined the relationship between dividend payout and profitability. The dividends communicate the value of firms, and other financial variables fail to communicate by examining the various variables of financial factors determining the dividend Newman (2002). In this case, earning patterns are highly irregular while dividend payout is regular and stabilised; dividends can better portray the profitability potential of the firms to market participants. Das (2006) attempted to study the dividend policy used in ACC Ltd for the years 1985-2005. He further tested the conservative policy followed by the management and other financial variables like dividend per share, retained earnings, EPS and capital employed by adopting the 68-correlation technique. He found that the co-efficient of correction between DPS, EPS, and capital employed showed a high degree of variation towards the announcement of dividends, and certain financial variables do not influence the dividend value; it depends upon the earnings and management decisions. Puah et al. (2008) studied and explained the trends in dividend announcements; the author selected a sample of 100 firms in Bursa Malaysia. He used the coefficient of correlation method to determine the share price movement. The author selected various variables such as growth prospects, profitability, firm size, risk, debt capacity and share pattern. The results show that signalling theory has no impact or significant relationship between dividend rise and future earnings prospects. The author concluded that dividend-paying companies earn more profit, are stable, and are less risky in business than non-dividend-paying companies.

Another study investigated the determinants variable of dividend payout decisions in the biggest stock exchange of Pakistan, formally called the Karachi Stock Exchange (KSE) Abdul Rehman (2012). The impact of Debt-to-equity ratio, Operating cash flow and profit capability, market-to-book value ratio, current ratio and corporate tax on dividend payout ratio was examined for the year 2009 for 50 firms that announced dividends made in the year 2009. The author concluded that firms' profitability position, debt to equity, and 77 market-to-book ratios are the important variables to determine the dividend payout ratio. The interlink of the current ratio, debt-to-equity ratio, corporate tax and profitability positively impacted the dividend payout ratio, while operating cash flow and market-to-book value ratio have a negative relationship with the dividend payout ratio. Siew et al. (2012) studies focused on dividend signalling in Malaysia; there are several related confirmations to dividend changes in the firm's profitability. In this study, a total of 2,396 dividend changes were made by companies listed in Bursa Malaysia over the period 1998-2007. This study analysed the relationship between dividend changes and the impact on firms' future profitability. The author found that dividend changes are strongly related to changes at the times of earnings; furthermore, within one year, a large number of weekly changes in earnings are identified, but earnings do not change beyond one year after the past information. Further, they state that weak data motive to move the size of dividend changes towards future profitability. Authors suggested that dividend constancy may be directly linked with information content on future profitability. Alayemi's (2013) research paper attempted to analyse the relationship between dividend payout and stock price movement. The dividend policy mentions that the allocation of profit should be shared with shareholders in the form of cash. The author tested two hypotheses: there is no significant relationship between profit and market stock price, and there should be a relationship between profit and market stock price. For the purpose of this study, secondary data was gathered from the available financial reports of the companies under circumstances to support against bias and manipulation of the result. A quantitative technique analysis using the StataSE tool was employed to find the study results. The study is interesting because it focuses on the relationship that exists between any dividend announcement and the reaction of market share.

On the other hand, the author examined the relationship between profitability and market share price. The study concluded that there was a negative relationship 79 between share price and profitability and a positive relationship between market value and dividend payment.

Statement of the Problem

EPS explicitly informs stakeholders how much earnings the company makes for each share. So, it is a mechanism for knowing the corporate value. The question of whether Earnings Per Share (EPS) affects companies' dividend policy still remains unresolved. Its results vary significantly across different countries based on research, so researchers have a huge space to explore this issue in different countries. Previous studies were conducted in some particular sectors and less developed countries, but this is still a matter of confusion. Shareholders' wealth and the firm's market value have special consideration in the mind of potential investors, so it is vital to study the impact of the EPS on the dividend payout and firm performance.

Objective

To study the relationship between the profitability of firms (EPS) and the dividend payout (DPS)

Scope of the Study

This study attempts to bring to light the relationship between the EPS and Dividend payout. The findings would bring portrayal to corporate managers, investors, share market dealers, agencies, financial institutions, and financial consultants in finding the factors that are determining dividend policy and endeavouring to impact share price towards the dividend announcement. The scope of the study is limited to those companies listed in NIFTY50. Profitability and dividend payout as factors which have an impact on the market value of shares are covered in this study. This study covers sectors such as Services, Consumer Goods, Financial Services, automobiles, Energy, Telecom, Pharma, Metals, Cement and cement Products, IT, Construction, Fertilisers and pesticides, and Media and entertainment.

Methodology

This study is empirical and analytical in nature. It examines the relationship between the EPS and dividend policy (DPS). Secondary data is used for the study. This study is mainly based on the information from all the segments listed in NIFTY50. The share prices and financial variables are obtained from the NSE website and prowess, the database of the Centre of

Monitoring Indian Economy (CMIE), Official websites of particular companies, annual reports and Journals. The data used to accomplish each objective was made apt for analysis as per the research methodology. Thus, the data collected from the Prowess database has been organised and utilised with due care and caution as per the necessity of the study. The data collection period covered by the study is 2 years, from August 2017 to August 2019.

The present study is confined to NSE-listed firms only because all the listed companies have to follow SEBI's norms and regulations. It is also observed that Companies listed under BSE have more domination in the Indian stock market, and they represent more different segments. They also hold the tenth position in Asia’s top stock exchanges. The universe of the present study consists of all the listed companies in India. The dependent variable of the study is Dividend Per share, and the independent variable is Earnings Per Share. The samples were selected from different segments to study intra-segment variations. The sample of the study was collected based on the following criteria

1. The company must be listed on the Indian Stock Exchange
2. The company must have paid dividends in the year 2017-2019

The companies selected for the study and their sectors are given in Table 1.1

Table 1.1

Sample Companies

Sector	**Company**	**No. of Times dividend declared**
Automobile	Hero MotoCorp Ltd.	4
	Maruti Suzuki India Ltd.	3
	Bajaj Auto Ltd.	2
	Eicher Motors Ltd.	2
	Mahindra & Mahindra Ltd.	2
Cement & Cement Products	Grasim Industries Ltd.	3
	UltraTech Cement Ltd.	2
Construction	Larsen & Toubro Ltd.	2
Consumer Goods	Asian Paints Ltd.	4
Energy	Oil & Natural Gas Corporation Ltd.	7

	Indian Oil Corporation Ltd.	6
	GAIL (India) Ltd.	5
	NTPC Ltd.	5
	Power Grid Corporation of India Ltd.	5
	Bharat Petroleum Corporation Ltd.	4
	Reliance Industries Ltd.	2
Fertilisers & Pesticides	UPL Ltd.	2
Financial Services	India Bulls Housing Finance Ltd.	9
	Housing Development Finance Corporation Ltd.	5
	Bajaj FinServ Ltd.	3
	HDFC Bank Ltd.	3
	Kotak Mahindra Bank Ltd.	3
	Bajaj Finance Ltd.	2
	ICICI Bank Ltd.	2
	IndusInd Bank Ltd.	2
	Yes Bank Ltd.	2
	Axis Bank Ltd.	1
IT	HCL Technologies Ltd.	9
	Tata Consultancy Services Ltd.	8
	Infosys Ltd.	6
	Tech Mahindra Ltd.	2
	Wipro Ltd.	2
Media & Entertainment	Zee Entertainment Enterprises Ltd.	2
Metals	Coal India Ltd.	3
	Hindalco Industries Ltd.	3
	Vedanta Ltd.	3
	JSW Steel Ltd.	2
	Tata Steel Ltd.	2
Pharma	Hindustan Unilever Ltd.	4
	Britannia Industries Ltd.	3

	ITC Ltd.	3
	Sun Pharmaceutical Industries Ltd.	3
	Cipla Ltd.	2
	Dr Reddy's Laboratories Ltd.	2
	Titan Company Ltd.	2
Services	Adani Ports and Special Economic Zone Ltd.	2
Telecom	Bharti Infratel Ltd.	4
	Bharti Airtel Ltd.	3
Total		162

Source: Secondary Data

Empirical Results: The Relationship Between Profitability of Firms and The Dividend Payout

Objective: To study the relationship between the profitability of firms and the dividend payout

H0: There is no significant relationship between the profitability of firms and dividend payout

Table 1.2

Pearson's Correlation of Dividend Per Share and Earnings Per Share

	EPS		DPS		Pearson Correlation	
Sector	Mean	SD	Mean	SD	r	p-value
Services	12.19	0.56	1.10	0.91	-1.000	0.000
Consumer Goods	10.50	10.61	4.80	2.14	0.278	0.013
Financial Services	25.20	29.97	6.96	5.29	0.190	0.000
Automobile	228.83	212.44	60.62	33.33	0.812	0.000
Energy	8.75	11.98	4.33	3.99	0.085	0.029
Telecom	3.39	6.96	5.78	3.95	0.025	0.773
Pharma	20.17	23.69	9.61	7.26	0.663	0.000
Metals	16.99	23.44	7.96	6.68	0.098	0.116

Cement & Cement Products	28.96	31.98	8.14	2.42	0.727	0.000
IT	32.23	33.40	7.07	6.89	-0.367	0.000
Construction	43.05	4.64	17.00	1.01	1.000	0.000
Fertilisers & Pesticides	9.37	1.43	8.00	0.00	*	
Media & Entertainment	18.57	1.36	3.20	0.30	-1.000	0.000
All companies	36.78	86.58	11.07	18.30	0.830	0.000
* Cannot be computed because at least one of the variable is constant.						

Source: Computation of the Researcher

Analysis discovered that there is a significant relationship between the dividend per share and the earnings per share. When the earnings per share increases, the dividend per share also increases. Hence, H0 is rejected. For further details, refer to Table 1.2

Findings

- There is a significant relationship between the dividend per share and the earnings per share. When the earnings per share increases, the dividend per share also increases.
- In the case of the service sector, IT sector and Media and entertainment sector, the Dividend per share decreases when the earnings per share increase. There is an inverse relationship between EPS and DPS. For all the remaining companies, Dividend Per Share is directly related to Earnings Per Share.

Recommendation

Companies can either increase or maintain dividend payout even when earnings fall. This is possible by using ploughing back of profits. This will create confidence among the stakeholders to invest even if the company is making a loss, which may ultimately lead to better market values. There are high chances for companies to increase DPS when EPS increases. Similarly, chances are very high that companies would reduce DPS when EPS falls.

Conclusion

It was found that there is a significant relationship between the Earnings Per Share and Dividend Per Share. When it comes to different sectors, a sectoral difference exists in terms of dividend declaration. A dividend payout policy is a major tool in financial decisions to determine the firm's profit and wealth maximization. Managers, Investors and stakeholders should understand the behaviour of dividends in multi-dimension aspects before taking an optimal investment decision. This research tries to path break the significance of dividend payout during high and low EPS. The ultimate goal of this research is to provide a comprehensive framework to assist firm managers, Investors and stakeholders about the relationship of dividends in the capital market.

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