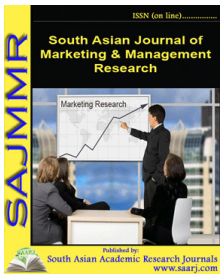
Published by: South Asian Academic Research Journals

SAJMMR:
South Asian Journal of Marketing & Management Research



HOW FIRM CHARACTERISTICS AFFECT DIVIDEND POLICY: AN EMPIRICAL STUDY OF LISTED BEVERAGE FOOD AND TOBACCO COMPANIES IN SRI LANKA

Ms. S. Balagobei*

*Lecturer,
Department of Financial Management,
University of Jaffna,
Sri Lanka.

ABSTRACT

Dividend policy remains one of the most controversial issues in corporate finance. For more than half a century, financial economists have engaged in modeling and examining corporate dividend policy. This research aims to examine the firm's characteristics which affect dividend policy for listed Beverage food and Tobacco companies in Sri Lanka. In particular, the research investigates the extent to which firm's characteristics such as firm size, profitability; leverage and tangibility affect corporate dividend policy for the period from 2008 to 2011. Pearson's correlation and multiple regression models are used to analyze the data. Based on the sample of 10 listed Beverage food and Tobacco companies, it is found that some of the firm characteristics have influenced more on the dividend policy decision among listed Beverage food and Tobacco companies in Sri Lanka. The results reveal that firm size and profitability have the positive impact on dividend policy. Further Leverage has the negative impact on dividend policy.

***KEYWORDS**: Dividend policy, Firm size, Profitability, Leverage, Tangibility.*

INTRODUCTION

Dividend policy is one of the most intriguing topics in financial research. The behaviour of dividend policy is the most debatable issue in the corporate finance literature and still keeps its prominent place both in developed and emerging markets. Many researchers try to uncover the issue regarding the dividend behaviour or dynamics and determinants of dividend policy but they

still don't have an acceptable explanation for the observed dividend behaviour of firms (Black, 1976; Allen and Michaely, 2003 and Brealey and Myers 2005). In developed economies, the decision whether paying dividends or keep as retained earnings has been taken very carefully by both investors and the management of the firm (Glen et al. 1995). Several studies suggest that the dividend policy of the companies varies from country to country due to various institutions and capital market differences.

The issue of dividend policy is important for several reasons. Firstly, the firm can use dividends as an instrument for financial signaling to the outsider vis-a-vis the stability and growth prospects of the firm. Secondly, dividend plays a significant role in a firm's capital structure. According to the "residual dividend" theory, a firm pay dividend only if does not have any opportunity of profitable investment. However, many researchers have established a relationship between firm dividend and investment decisions. Firms normally do not like to reduce the dividend payments; firm's stock price also affected by dividend patterns, more dividends can also increase the stock price of the firm.

According to Black (1976) a firm's dividend is referred to as a dividend puzzle. This is because a firm's investment, capital structure and dividend policies are interrelated. Also, there are contradictory results obtained by various researchers on the determinants of dividend payments. Based on the research of Aivazian, Booth and Geary (2003) a firm's dividend policy is affected by profitability, size, debt, risk, tangibility and growth. In addition to this, Horace Ho (2003) claimed that dividend policies are affected positively by size in Australia and liquidity in Japan and negatively by risk in Japan only. Therefore, this raises the question on how the dividend payments are determined in listed Beverage food and Tobacco companies in Sri Lanka.

There are many studies of firm's characteristics which have an impact on the dividend policy. These include profitability, firm size, debt level and tangibility (see Danis et al., 2008; Al- Najjar & Hussainey, 2009a). This study is designed to examine the impact of firm characteristics on dividend policy of listed Beverage food and Tobacco companies in Sri Lanka. This study aims to contribute to the debate on dividend policy by examining the determinants of dividend payment of listed Beverage food and Tobacco companies. In addition, it is expected to help financial managers and stock market participants gain an understanding of the dividend policy and their determinants in Sri Lanka.

There are many researchers conducted on determinants of dividend policy and most of the articles are concerned with the Western countries. But no studies are in listed Beverage food and Tobacco companies in Sri Lanka. Therefore this study is undertaken to examine the effect of Firm's Characteristics on Determining the Dividend Policy in listed Beverage food and Tobacco Companies in Sri Lanka for the period from 2008 to 2011.

OBJECTIVES OF THE STUDY

The main objective of this study is to examine the effect of firm's characteristics on determining the dividend policy in the listed Beverage food and Tobacco companies in Sri Lanka. The research is aimed to know whether firm characteristics are taken into consideration when dividend decisions are made by Beverage food and Tobacco companies in Sri Lanka.

REVIEW OF THE LITERATURE

Large numbers of studies have discussed various theories which are relevant to dividend policy. Firm size is expected to be an acceptable determinant of the company decision to pay dividends to its shareholders (Al-Najjar and Hussainey, 2009a). Eddy and Seifert (1988), Jensen et al. (1992), Redding (1997), and Fama and French (2000) indicated that large firms distribute a higher amount of their net profits as cash dividends, than do small firms. Several studies have tested the impact of firm size on the dividend-agency relationship. Lloyd et al. (1985) were among the first to modify Rozeff's model by adding "firm size" as an additional variable. They considered it an important explanatory variable, as large companies are more likely to increase their dividend payouts to decrease agency costs. Holder et al. (1998) revealed that larger firms have better access to capital markets and find it easier to raise funds at lower costs, allowing them to pay higher dividends to shareholders. This demonstrates a positive association between dividend payouts and firm size.

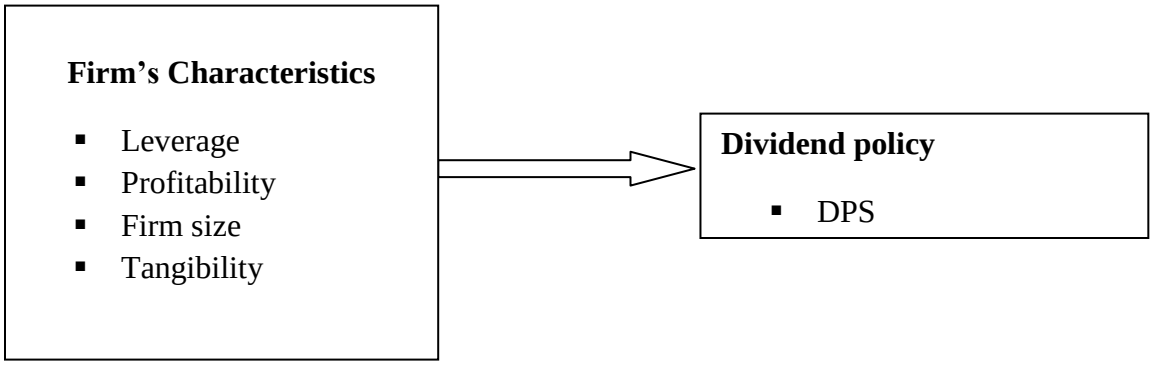
Debt ratio measures the extent to which a firm is financed by external funds (Al-Najjar & Hussainey 2009a). It is argued that firm debt ratio is one of the main reasons which determines whether a firm will pay dividends or not (Jensen et al., 1992; Aivazian et al., 2003). They emphasized that a firm with a low debt ratio is likely to pay dividends. A growing number of studies have found that the level of financial leverage negatively affects dividend policy (Jensen et al., 1992; Agrawal and Jayaraman, 1994; Crutchley and Hansen, 1989; Faccio et al., 2001; Gugler and Yurtoglu, 2003; Al-Malkawi, 2005). Their studies inferred that highly levered firms look forward to maintaining their internal cash flow to fulfil duties, instead of distributing available cash to shareholders and protect their creditors.

The financial literature documents that a firm's profitability is a significant and positive explanatory variable of dividend policy (Jensen et al., 1992; Han et al., 1999; Fama and French, 2000). Adaoğlu (2000), who stated that the main determinant in the amount of cash dividends in the Istanbul Stock Exchange was earnings for the same year. Any variability in the earnings of corporations was directly reflected in the cash dividend level. A similar result was reported by Pandey (2001) for Malaysian firms. Al-Malkawi (2007) identified the profitability ratio as the key determinant of the corporate dividend policy in Jordan.

Asset structure is calculated as the tangible assets divided by total assets (Al-Najjar and Hussainey 2009a).Koch and Shenoy (1999) argued that the firm which has more fixed assets and a lower reported debt level has tax benefits and is more likely to use dividends policy to support the asymmetric information. As a result, there is a positive relationship between firm tangibility and dividend policy.

CONCEPTUAL FRAMEWORK

This framework shows the relationship between independent variable (Firm's Characteristics) and dependent variable (Dividend policy).



Source: Developed by researcher

Dividend policy involves the determination of the payout policy that management follows in determining the size and pattern of cash distributions to shareholders over time (Lease et al 2000:1). ROE measures the profitability of the firm as a whole in relation to total equity employed. Size of the firms is measured by using log value of total assets.

HYPOTHESES

Based on the conceptual framework with the literature survey's support the following hypotheses are formulated to carry out the research.

H_1: There is significant negative relationship between leverage and the dividend policy.

H_2: There is significant positive relationship between profitability and dividend policy.

H_3: There is significant positive relationship between firm size and dividend policy.

RESEARCH DESIGN AND METHODS

The secondary data was used for the present study during the period from 2008 to 2011. The data was collected from the hand books of listed companies published by Colombo Stock Exchange (CSE), annual reports of the companies, journals and books. The data required for the study includes firm size, profitability, leverage, tangibility and dividend per share.

The scope of the study is the listed Beverage food and Tobacco companies in Sri Lanka. Now, there are twenty two listed Beverage food and Tobacco companies operated in Sri Lanka. From these companies by using convenient random sampling method, 10 companies were selected to carry out the research. The following measurements are used to assess the variables:

- Leverage = Total Debt / Total Assets.
- Tangibility ratio= Fixed assets / Total Assets
- ROE = Net profit before tax / Total equity

- Firm size = log(Total assets)
- Dividend per share = Total dividend / No of ordinary shares.

Secondary data for the study was drawn from audited accounts (Income statement and balance sheet) of the concerned companies as fairly accurate and reliable. Therefore these data might be considered reliable for the study. Necessary checking and cross checking were done while scanning information and data from the secondary sources. Descriptive and quantitative analysis, Pearson's correlation and regression analysis are used to analyze the data for this research.

MODEL

According to the hypotheses proposed above, this study constructs regression model for carrying out empirical analysis.

$$DPS = \beta_0 + \beta_1 LE + \beta_2 PR + \beta_3 size\ t + \beta_4 TA + E$$

Where

DPS - Dividend per share

LE - Leverage

PR - Profitability

Size – Firm Size

TA – Tangibility

E - Error term

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4$ – Model coefficients

RESULTS AND DISCUSSION

DESCRIPTIVE ANALYSIS

TABLE 1 presents the descriptive statistics for the variables, related to firms' characteristics, included in the model to examine the dividend policy of listed Beverage food and Tobacco Companies in Sri Lanka from 2008 to 2011.

TABLE 1: DESCRIPTIVE STATISTICS

DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
Leverage	40	.01	.82	.4440	.25446
Profitability(ROE)	40	-.88	3.12	.3212	.72307
Firm Size	40	6.02	9.08	7.3268	1.07191
Tangibility	40	.00	.70	.2728	.24480
DPS	40	.00	35.00	6.5725	10.57173
Valid N (listwise)	40				

Source: Survey data

The above table shows that minimum value of leverage ratio is 0.01 and maximum value is 0.82 with mean the value 0.4440 which indicates the value of the total debt on total assets. It is indicated that around 44% of total assets is represented by debt capital. Return on Equity (ROE) has a wide range from -0.88 to 3.12. The mean of the ROE (0.3212) indicates that 32% of return had been earning by the companies on equity. The minimum and the maximum range of the firm size are respectively 6.02 and 9.08 with standard deviation of 1.07. The mean value of tangibility ratio is 0.2728 which indicates that 27% of fixed assets is represented by the total assets. DPS has a range from 0.00 to 35. The mean of the DPS is 6.5725.

CORRELATION ANALYSIS

Table 2 presents the Pearson correlation coefficients between dependent variable and independent variables separately. SPSS software was used to determine the degree of significance and correlation level between the firm's characteristics and Dividend policy.

TABLE 2 : CORRELATION MATRIX

CORRELATION BETWEEN FIRM'S CHARACTERISTICS AND DIVIDEND POLICY						
		Leverage	**ROE**	**Firm Size**	**Tangibility**	**DPS**
Leverage	Pearson Correlation	1				
	Sig. (2-tailed)					
Profitability(ROE)	Pearson Correlation	.131	1			
	Sig. (2-tailed)	.421				
Firm Size	Pearson Correlation	.076	.518**	1		
	Sig. (2-tailed)	.639	.001			
Tangibility	Pearson Correlation	.442**	-.223	-.219	1	
	Sig. (2-tailed)	.004	.166	.175		
DPS	Pearson Correlation	-.385*	.625**	.347*	-.324*	1
	Sig. (2-tailed)	.014	.000	.028	.041	
**. Correlation is significant at the 0.01 level (2-tailed).						
*. Correlation is significant at the 0.05 level (2-tailed).						

Source: Survey data

The above table shows that there is a negative significant relationship ($r=-0.385$, $p<0.05$) between leverage and dividend per share. On other hand, ROE has positive correlation ($r=0.625$, $p<0.01$) and is highly significant with the dividend per share. Further firm size has a positive significant correlation ($r=0.028$, $p<0.05$) with the dividend per share. At the same time there is a negative significant relationship ($r=-0.324$, $p<0.05$) between tangibility and dividend per share.

REGRESSION ANALYSIS

Regression analysis is used to examine the impact of firm's characteristics in determining the dividend policy of the listed Beverage food and Tobacco companies in Colombo Stock Exchange.

TABLE 3: RESULTS OF REGRESSION

REGRESSION

Model	Beta	Standard Error	Significant
Constant	15.273	3.326	.000
Leverage	-24.108	5.801	.000
Profitability (ROE)	.099	.018	.000
Firm size	.101	.015	.006
Tangibility	2.638	5.377	.627
R^2= .616			

Dependent Variable: DPS

Source: Survey data

Table 3 shows the results of the multiple regressions for this study. According to this result the coefficient of leverage is -24.108 which denotes that there is a negative relationship between leverage and dividend per share and is significant at 1% level. Therefore this result is supported for the acceptance of H1. Coefficient of ROE is 0.099 which means there is a positive relation between ROE and dividend per share and is significant at 1% level. So H2 is accepted. The beta value of firm size is 0.101 which is also significant and positive relationship between firm size and dividend per share. Therefore H3 is also accepted. The Co-efficient of Determination (R^2) is 0.616, indicates that 62% of the observed variability on dividend per share could be explained by firm's characteristics and remaining 38% of the variability was not explained in this model.

CONCLUSION

This study explored the impact of firm's characteristics on determining the dividend Policy in listed Beverage food and Tobacco Companies in Sri Lanka. A multiple regressions analysis was used to find out the associations between firm's characteristics and the dividend policy. It is concluded that there is statistically negative relationship between leverage and dividend per share. This result of the study supports with the prior studies Chang and Rhee (1990), Jensen et al., 1992; Agrawal and Jayaraman, 1994; Crutchley and Hansen, 1989; Faccio et al., 2001; Gugler and Yurtoglu, 2003; Al-Malkawi, 2005).

Further it was found that there is a significant positive relationship between firm size and dividend per share. This result is consistent with the result of Mollah 2002; and Al-Malkawi, 2007. Finally it is concluded that there is a significant positive relationship between profitability and dividend per share. This finding is in the line with the result of Al-Malkawi (2007). The study does not consider all other corporate governance factors, which impact the dividend policy

of the companies. Therefore it is recommended to investigate the other explanatory factors which determine the dividend policy of Sri Lankan firms.

BIBLIOGRAPHY

Adaoglu, C., 2000, Instability in the Dividend Policy of the Istanbul Stock Exchange (ISE) Corporations: Evidence from an Emerging Market, Emerging Markets Review 1, 252-270.

Agrawal, A. and N. Jayaraman, 1994, The Dividend Policies of All-equity Firms: A Direct Test of the Free Cash Flow Theory, Managerial and Decision Economics 15, 139-148.

Aivazian, V., Booth, L. & Cleary, S. (2003) "Do Emerging Market Firms Follow Different Dividend Policies from U.S. Firms?" The Journal of Financial Research, Vol. 26: 371-87.

Al-Najjar, B. and Hussainey, K. (2009a), "The Association between Dividend Payout and Outside Directorships", Journal of Applied Accounting Research, Vol. 10, No. 1, pp. 4-19.

Allen F., and R. Michaely, 2003, Payout Policy, Handbook of the Economics of Finance.

Al-Malkawi, H. N., 2007, Determinant of Corporate Dividend Policy in Jordan, Journal of Economic and Administrative Since 23, 44-71.

Black, F. (1976) "The Dividend Puzzle" The Journal of Portfolio Management, Vol. 2: 5-8.

Brealey R. & Myers, S. (2005) "Principles of Corporate Finance (8th edition): London: McGraw-Hill. Black F., 1976, 'The Dividend Puzzle', Journal of Portfolio Management, Vol. 2 (2): 5-8.

Chang, R. and Rhee, S. (1990), "The Impact of Personal Taxes on Corporate Dividend Policy and Capital Structure Decisions" Financial Management, Vol.19, No. 2, pp.21-31.

Crutchley, C. and R. Hansen, 1989, A Test of the Agency Theory of Managerial Ownership, Corporate Leverage and Corporate Dividends, Financial Management 18, 36-46.

Faccio, M. and L. Lang, 2002, The Ultimate Ownership of Western European Corporations, Journal of Financial Economics 65, 365-395.

Gugler, K. and B. Yurtoglu, 2003, Corporate Governance and Dividend Pay-Out Policy in Germany, European Economic Review 47, 731-758.

Eddy, A. and B. Seifert, 1988, Firm Size and Dividend Announcements, Journal of Financial Research 11, 295-302.

Fama, E. and K. French, 2001, Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay?, Journal of Financial Economics 60, 3-43.

Glen, J., Karmokolias, Y., Miller, R. and Shah, S. (1995) "Dividend Policy and Behavior in Emerging Markets" IFC Discussion Paper No. 26, www.ifc.org

Han, K., S. Lee, and D. Suk, 1999, Institutional Shareholders and Dividends , Journal of Financial and Strategic Decisions 12, 53-62.

Jensen, G., D. Solberg and T. Zorn, 1992, Simultaneous Determination of Insider Ownership, Debt, and Dividend Policies., Journal of Financial and Quantitative Analysis 27, pp 274-263.

Hussainey, K . and Al-Najjar, B. (2009), " Future-Oriented Narrative Reporting: Determinants and Use", Working paper, Stirling University.

Hussainey, K. and Walker, M. (2009), "The Effect of Voluntary Disclosure and Dividend Propensity on Prices Leading Earnings", Accounting and Business Research, Vol. 39, No. 1, pp. 37-55.

Koch, P and Shenoy, C. (1999), "The Information Content of Dividend and Capital Structure Policies", Financial Management, Vol. 28, No. 4, pp. 16-35.

Lease, R.C., John, K., Kalay, A., Loewenstein, U. & Sarig, O.H. 2000. Dividend Policy: Its Impact on Firm Value. Boston: Harvard Business School Press.

Pandey, I., 2001, Corporate Dividend Policy and Behaviour: The Malaysian Experience, Working Paper No. 2001-11-01, Indian Institute of Management, Ahmadabad.

Redding, L., 1997, Firm Size and Dividend Payouts., Journal of Financial Intermediation 6, 224-248.