

# A Study to assess the Dividend Policy of Indian-listed Manufacturing Industries.

MS. Varsha Kag, Research Scholar, Malwanchal University.

Prof.Dr. Sachindr Kumar Gupta, Research Supervisor, Malwanchal University.

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## Introduction

It has always been a dynamic process, with companies deciding whether to distribute profits or save them for future growth. Various theories have attempted to explain this process. Since more than half a century, theoretical and empirical works have flourished. As a result, a large body of research exists to explain dividend behaviour, allowing for the modification of the dividend policy in accordance with changes in the financial condition of the company. One of the first such attempts was to describe a firm's worth as being independent of its dividend policy, and this was called "dividend irrelevance." In accordance with the Bird in hand theory, investors will make a trade-off between dividends paid today and the possibility of capital gains in the future, with a significant emphasis on the effect of dividend policy on the value of a company. It is explained by the agency cost hypothesis that dividends are important in reducing the agency cost to the firm and, as a result, in increasing its value. Life cycle theory, information asymmetry and signalling theory, and free cash flow hypotheses were all proposed later to try to explain the role of firm-level factors in deciding dividend policies. Firm-level variables such as age, size, ownership categorization, cash holdings, leverage, net working capital, risk, growth, and profitability were employed as the primary explanatory variables in order to experimentally validate the theories. Despite this, due to the assumptions associated with each theory, there has been no convergence on these ideas. According to the literature, there is considerable evidence that dividend policy is affected by a wide range of factors, including macroeconomic, industry, and firm-level variables. Previous research has generally focused on explaining the probability of dividend distribution using firm-level parameters as control variables, and has used a heterogeneous sample of firms drawn from predetermined indexes or sets of firms as a basis for its findings. Some studies also looked at differences at the sector and country levels to attempt and understand how corporations behaved when it came to paying dividends. However, when it came to analysing the dividend policies of the corporations, sectoral disparities between them were frequently neglected. This study aims to investigate the factors that influence dividend policy in the manufacturing and service sectors among companies that are listed on the Bombay Stock Exchange (BSE). In order to conduct this research, it was determined that there is a significant gap in how these two sectors operate. Unlike the manufacturing industry, which is heavily reliant on capital investments in plant and machinery, the service sector is more reliant on human capital, which requires a smaller initial capital outlay. During the last two decades, the service sector has experienced significant growth, defying the conventional wisdom that a firm's profitability is dependent on large-scale machinery and equipment. Firms in the service industry, on the other hand, remain exposed to several uncertainties regarding their long-term viability, life cycle, and profitability. During the same period of time, the manufacturing sector in India has experienced a slowing of its expansion. This is a crucial point to make because there is a significant degree of diversity between these sectors, which may result in differences between the dividend behaviour of these sectors in certain circumstances. With this research, we hope to learn more about the relative importance of financial elements in understanding the dividend behaviour of Indian manufacturing and service sector companies. The article is divided into seven sections, the first of which is an introduction to the article, followed by a review of the literature and the aims of the study, as well as the model provided, in the second and third sections, respectively, in the second and third sections..

## Methodology

According to our findings, the data for this study was derived from the Centre for Monitoring Indian Economy Prowess database, which is India's largest database for firm-level statistics on Indian corporations. It consists of firm-level information derived from annual reports, financial statements, and other publicly available publications for Indian corporations. The database has a collection of 27272 Indian companies from a variety of industries.

The research is carried out on manufacturing (transport equipment and machinery) and service sector enterprises (information technology and business consultancy) that are publicly traded on the BSE. The basis for selecting

the aforementioned sectors is the consistency with which they represent their respective industries in terms of their working behaviour. We collected information on 287 manufacturing companies and 200 service companies that were publicly traded on the Bombay Stock Exchange (BSE) throughout a three-year period from 2016 to 2019. The dividend is the dependent variable in the regression model suggested in the study, with the explanatory factors being size, age, ownership group, cash holdings, net working capital, risk, leverage, cash, and profitability.

The basic analysis is carried out using a simple linear OLS model, in which all of the independent variables are assumed to be exogenous and the error term is assumed to be not serially associated with the other independent variables. When any of the aforementioned conditions are not met, the linear OLS model will be biased in one direction. It is necessary to account for the aforementioned biases by employing an OLS estimator with fixed and random effects. The fixed effects model is characterised by the assumption that the intercept or slope of variables is time invariant but will differ among individuals, while the error term intercepts are considered to be temporal variant. In order to determine which model is most appropriate, the Hausman test for fixed and random effects was used in conjunction with the null hypotheses suggesting that the random model is most appropriate. Because of collinearity criteria and the time-variant influence on the independent variables, the age and ownership variables are excluded from the fixed effect model.

### Results and Discussion

Finally, utilising GMM, it was discovered that size and cash holdings are positively significant, whereas networking capital is adversely significant in the service industry. The outcome enhanced the fixed effects regression estimate, which stated that networking capital was positively related to the dividend paid, which looked to be at odds with the literature at the time of publication. For the manufacturing industry, data show that size and profitability are positively significant, but that networking capital is adversely significant when it comes to the dividend given by the company.

Following the data, it can be concluded that size, cash holdings, and net working capital are the only important variables in the service sector that have a positive association. It turns out that the regressors and the error term have a negative correlation ( $r = -0.7411$ ). The intra-class correlations between the firms are found to be ( $\rho = 0.5839$ ), which suggests that heterogeneity among the firms accounts for 51.22 percent of the total variance explained  $R^2$  (69.11 percent). Further findings from the manufacturing industry revealed that business size and profitability are positively significant, whereas risk and networking capital are adversely significant in affecting dividend decisions in the sector. The correlation coefficient between the error term and the independent variables is (0.118), and the intra-class correlation coefficient is ( $\rho = 0.71.22$ ), accounting for 71.22 percent of the total variance explained by  $R^2$  (24.11.24 per cent). The models for both sectors are shown to be statistically significant when the confidence intervals reach 97%.

We employ two criteria to determine whether or not our model is correctly specified: the Arellano and Bond test for zero autocorrelation and the Sargan test for over-identifying limitations, often known as j-statistics, to determine whether or not our model is correctly described. After doing the first test, we discovered that both the first order and the second order p values do not allow us to reject null hypotheses, which state that there is no autocorrelation in the model provided in both sectors. It is likewise rejected by the second test for over-identifying restrictions if the null hypotheses of over-identifying restrictions are true. As a result, we may conclude that the models employed for the analysis are appropriate and applicable to both sectors of industry.

### Conclusions

The findings of the study can be used by both companies and investors to better understand the dividend behaviour of industrial and service sector companies. The managers might focus their efforts on the factors that have a substantial impact on the investors' perceptions of profit distributions in order to maintain an equilibrium of investor attitudes. It will also aid in the understanding of the sectoral divergence dividend behaviour of corporations in various industries. India is a developing country, and the findings can be applied to other emerging nations with a similar structure of manufacturing and service sectors, such as those in South Asia, to better explain dividend behaviour. As a result of government measures such as foreign direct investment (FDI) or tax breaks, this study is limited in its ability to capture macroeconomic factors that contribute to a particular sector's rapid growth.

Future study may be undertaken by taking both microeconomic and macroeconomic aspects into consideration in order to better understand the effects of macroeconomic issues. In addition, multiple sectors might be included in the study to increase the implementation of the findings in the real world.

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