Ownership Structure and Dividend Policy: Indian Evidence

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Abstract—Dividend decision being a crucial area of corporate finance, has always received high attention from academics as well from practitioner. It is always assumed that the companies with higher shareholding by its owner distribute more dividends. Even it is also taken as a phenomenon that the companies with higher institutional shareholding distribute more dividends to please them. This contradiction encouraged researcher to undergo the study.

This study attempts to address the concern of magnitude of impact of ownership structure on dividend policy of the corporate. By taking BSE – 100 companies as sample with data of 10 years i.e. form 1st April 2003 to 31st March 2013, this study inclines towards finding whether owners’ and institutional shareholding make significant difference on dividend payouts or not. In order to achieve aim of identifying determinants of dividend policy, Dividend Payout Ratio was taken as dependent variable. Foreign shareholding, Directors’ shareholding, Institutional shareholding, Return on Equity and Debt Equity Ratio were taken as independent variables.

It was observed in the study that the companies with higher foreign and owners’ shareholding were tend to pay better dividends. Moreover, the companies with higher profitability (ROE) have also paid better dividends.

Keywords—Owners’ Shareholding, Foreign Shareholding, Dividend Payout Ratio.

I. INTRODUCTION

DIVIDEND decision is always in the center and one of the critical decisions for finance manager. It is always a challenge for the finance manager to satisfy the expectations of investors through dividend decision. There can be so many factors impacting it. According to Walter and Gordon the dividend decision is relevant to the market price of the share and market value of the firm. On the other hand, there is a school of thoughts (MM Approach) which says that dividend decision is irrelevant to the firms’ valuation.

In practice it’s not ROI (Expected Return on Investment Opportunity) and Ke (Cost of Equity) only that makes manager comfortable to decide upon dividend decision, but there are several other factors that also have significant impact on this decision. In recent time, when corporate governance has taken everyone’s key attention, the factors that lead finance manager to take dividend decision are also been much emphasized upon.

In market it is found that all the category of investors is always looking for companies that pay higher dividends. This tendency of investors induces finance manager to become investors responsive by gratifying their expectation in terms of dividend. In turn finance manager deviates from the theory and instead of making decision based upon available investment opportunity; they become keen to make their stock hot in the market. It is needless to say that any market, functions upon demand and supply paradigm. Higher demand generated by this stock, results into higher liquidity. In turn, this also factors in generating better returns. Subsequently, stock becomes traders’ favorite.

With this background a question always comes into light that what makes finance manager paying higher dividend? Is it just market leverage or, several other factors? Many studies are conducted addressing this issue, in conclusion of these studies found that one of the key variables while deciding dividend policy is ownership structure.

II. LITERATURE REVIEW

Researchers have taken keen interest in identifying impact of ownership structure on dividend policy of the firms’ world over. There is no dearth of quality literature on the topic.

Black (1976) very rightly cited the phenomenon, “The harder we look at the dividend picture, more it seems like puzzle, with pieces that just don’t fit together.” This seems to be very apt while studying all literatures on the ownership structure and dividend policy. The reasons for the dividend puzzle can be attributed to a wide range of factors like, uncertainties, psychological / behavioral economic issues, tax-related matters and asymmetric information, (Ruben, 2002).

Shleifer and Vishny (1986) have conferred that intense institutional ownership can create the incentives to monitor management of the firm. Following the active participation of shareholders in decision making, managers will always be more inclined towards the extending better dividends.

Kinkki (2001), highlighted the traditional contradiction that dividend policy of firm is viewed by considering firm as a single unit while the maximizing overall value of the firm is the actual aim of any management. On the other hand, agency cost approach recognizes firm with conflict of interest where groups that manage firms and owned firms are different and both have self-seeking motives. This throws a question of promotion of individual interest while deciding
dividend policy as against maximizing shareholders’ wealth. Dividend policy is influenced by conflict between manager and shareholder vis-à-vis ratio of equity holding by board (Jensen and Meckling, 1976). On the other hand Crutchely-Hansen (1989) put forward a strong argument of agency cost influenced by equity ownership of board, proportion of debt and dividend payments. This makes it clear that leverage and ownership structure play sound role in determining dividend policy of the firm.

Short, Zhang and Keasey (2002), in the backdrop of UK firms, studied positive and statistically significant associations between institutional ownership and dividend payout ratios.

Kumar (2003) has studied ownership structure and dividend policy in India. He attempted examining the association between ownership structure, corporate governance and dividend payout policy for this purpose used time window of 6 years between 1994 and 2000 to study 2575 companies and concluded a positive trend between earnings and dividends. Also found out inverse effect of institutional ownership on dividend policy and could not find any association between foreign ownership and dividend payout growth.

Harada and Nguyen (2006) attempted analyzing the effect of ownership concentration on the dividend policy. They conducted study in Japanese backdrop. They inferred the positive relationship between firms with high ownership concentration and lower dividends (Khan, 2006).

Cook and Jeon (2006) made a study on the determinants of foreign and domestic ownership and a firm’s payout policy. The results supported the agency model. Found association between high foreign ownership and greater dividend payout in this study. Harjito (2009) examined the influence of agency factors on dividend payout ratio. The results of the study revealed negative effects of directors’ ownership on dividend policy.

Bichara (2008) examined the link between dividends and institutional ownership in the US. Also observed the monitoring capacity of institutional investors impacting better management and smooth running of the firms. Following mindset of investors to buy stocks with better dividend payouts and rebalancing their portfolios the firms can initiate more dividend payouts to please their investors.

Shah, Ullah and Hasnain (2011) studied Pakistani firm where leverage and size of the firm were taken as independent variables. They inferred that in developed markets, where ownership is highly varied, the market power may stress the management to distribute dividends and to meet the demands of the investors. Also found higher cash dividend level where the owners’ presence in the board of directors is higher.

Al- Gharaibeh, Zurigat and Al-Harahsheh (2013) have studied Jordanian companies to investigate the impact of ownership structure on dividend policy of the firms, used two empirical models, viz., full adjustment model and partial adjustment model to test this relationship. It was found that institutional ownership provides incentives for board to extend their influence to reduce the use of funds in the projects with low returns in turn distributing better dividends.

III. RESEARCH METHODOLOGY

The broader objective of this research is to study the relationship between ownership structure and dividend policy of the Indian firm. The researcher assumes that the companies with higher shareholding by its board (owners) tend to offer better dividends. To test this phenomenon, BSE – 100 (Bombay Stock Exchange top 100 companies) companies are taken as sample in this research and the data were analyzed for past 10 years i.e. 01.04.2003 to 31,03.2013 turning into total 921 observations. The required data were sourced through Capitaline database. BSE – 100 companies are blue chip companies that adequately represent the population. Moreover, these companies have aptly followed governance standards laid down by various authorities.

For the purpose of the study, Dividend Payout Ratio (DPR) the most significant variable is taken as dependent variable which represents the portion of total earnings distributed as dividends. To test the manner in which ownership structure influences dividend policy of the firm, Directors Shareholding (DIRE), Foreign Share Holding (FORE) and Institutional Shareholding (INST) are taken as independent variables.

Dividend distribution is result of not only shareholding pattern, but it is also influenced by profitability and proportion of leverage in capital structure of the firm. These two variables are also taken as independent variable making impact on dividend policy (Dividend Payout Ratio) of the firms.

Dividend Payout Ratio (DPR) was taken as dependent variable.

INST, DIRE, FORE, ROE, DEBTEQ were taken as independent variables.

INST is Institutional Shareholding
DIRE is Shareholding by board
FORE is Foreign Shareholding
ROE is Return on Equity
DEBTEQ is Debt Equity Ratio

Following the OLS regression method, the equation is as follows:

\[ DPR = f (\text{INST, DIRE, FORE, ROE, DEBTEQ, U}) \]

IV. ANALYSIS AND INTERPRETATION

It was observed from table 1 that in Indian companies, Directors’ shareholding is tend to be higher. On an average Directors’ holding was 57 percent in the sample companies. On the other hand foreign shareholding is also seen on the higher side, i.e. 21 percent holdings. According to most of the
literature reviewed, dividend policy is highly influenced by directors’ and institutional shareholding that can also see in the Indian scenario that tends to be on higher side i.e. 29 percent.

Calculated statistics from table no 2 suggest that corporate profitability (ROE) has higher correlation (0.613) with Dividend Payouts. Directors’ shareholding (-0.094) and Foreign shareholding (-0.061) are negatively correlated with Dividend Payouts. It is general phenomenon that institutional shareholding is largely affecting dividend policy of the firm. Here, it was observed that institutional shareholding has a considerable impact on Dividend Payouts. It was also observed that portion of debt in capital structure and corporate profitability has negative correlation. This may lead a firm to pay lesser dividends to its investors. It concludes that the higher leverage results into less Dividend Payouts.

Statistics table no 3 of R Square (0.446) suggest confidence that can be put on the model and hence the inferences derived in the study are more applicable.

The table no 5 suggests that Institutional shareholding (0.636) and ROE (0.692) are the most significant variables of dividend policy. It is also observed that high institutional holding tend to pay high dividend. It is always observed that institutional investors take keen interest in the management of the form to take care of their interest, that may result in high dividends pay out.

V. CONCLUSION

Ownership structure and dividend policy is always a matter to ponder upon. This study addressed the impact of ownership structure on dividend policy. It was observed that dividend payout in Indian companies was 29 percent. Directors’ shareholding (56 percent) and foreign shareholding (29 percent) were seen making very high impact on dividend payout of the firm. While on the other hand it was observed that institutional holdings (0.636) and ROE (0.692) were making high impact on Dividend Payout this result is in line with the results of Shah, Ullah and Hasnain and Bichara and the result observed in the Jordanian study. These inferences are almost in line with majority of the literature reviewed. Corporates having high shareholding by its board are generally seen paying better dividends and vise-a-versa.

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<tr>
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REFERENCES


