Determinants of Dividend in Indian Fertilizer Industry

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Abstract

Investor's before investing in any company examines the dividend paid by the company and wishes to invest in company which declares higher rate of dividend. Dividend declaration of the company depends on numerous factors namely previous year dividend declaration rate, previous year cash flow, current year earning capacity, proportion of retained earning and the like. In this present study an attempt has been made to identify the factors influencing dividend declaration in Indian fertilizer industry. By employing correlation test, it is found that dividend declaration in Indian fertilizer industry is related with previous year dividend, Current year depreciation, Current year Profit after Tax, Current Year Sales and Previous Year Cash flow.

Keywords: Dividend; Fertilizer Industry; Cash Flow; Profitability.

Introduction

Dividend is an important part of the investment, dividend decision of the firm is yet another crucial area of financial manager. The important aspect of dividend policy is to determine the amount of earnings to be distributed to share holders and the amount to be retained in the firm. Retained earnings are the most significant internal source of financing which affects the growth of the firm. On the other hand, dividends may be considered desirable from shareholders' point of view as they tend to increase their current return. Dividends however, constitute the use of the firm's funds. Predictable dividend is especially desirable to financial analysts, because they make the business of security valuation easier. The dividend decision of the company splits into two viz., dividend and retained earnings. The amount to be distributed as dividend is declared after taking into account of several factors. Earnings are one of the most important factors that decide the quantum of dividend to be paid. In general higher the earnings, will result in higher would be the level of the dividends. Since large number of factors are influencing the level dividend of a company, the present study has made an attempt to identify the factors that affects the dividend in select companies which are belongs to chemical industry, in particular Fertilizer Industry.

Review of Literature

Kanwal Anil & Sujata Kapoor (2008) in their study finds that dividend decisions of an organization depends on cash flow, corporate tax, sales growth and market to book value ratio other than profitability. The study concludes that, the Indian IT firms have high liquidity and it is an important determinant of dividend payout ratio. **Duha Al-Kuwari (2009)** in her finds that dividend payments related strongly and directly to government ownership, firm size and firm profitability. **Amarjit Gill, Nahum Biger and Rajendra Tibrewala (2010)** in their study find that dividend payout ratio is the function of profit margin, sales growth, debt-to-equity ratio, and tax. **Amitabh Gupta and Charu Banga (2010)** in their study founds that leverage and liquidity are the important factors that determine the dividend policy for Indian companies. **Sudhakar.M (2010)** in his study concludes dividend payout depends on of profitability and depreciation in the current year as well as the dividend in the past. **Bose and Husain (2011)** examined that determinants of dividend policy depends on profits earning capacity of the firm.

Statement of the Problem

Dividend Decision of the Firm is a key area to the financial manager. Generally, dividends are dispensed out of profits. The substitute to the payment of dividends is the retention of earnings/profits. There exist reverse relationship between retained earnings and cash dividends: larger retention, lesser dividends; smaller retention, larger dividends. As a result, the alternative uses of the net earning - are competitive and conflicting. In this backdrop it is indispensable to identify, do

the companies maintain stable dividend policy? What are the trends in dividend policy? (**Lintner (1956)** identified that the dividend pattern of a firm in influenced by the current year earnings and previous year dividends. **Britain (1966)** was of the opinion that the capacity of a firm to pay dividends has been better explained in terms of cash flow (i.e.,) profit after tax plus depreciation as against the Lintner's profits net of taxes. At this juncture, it is worth to identify the factors that influence the dividend policy, even in the present globalized environment.

Objective of the Study

❖ To identify the factors that determines the dividend

Research Methodology

Data

The data used in this study are secondary in nature, The Financial data of the companies belonging to the Fertilizer industry are taken from the Capital line data base.

Period of Study

This study covers a period of 10 years from 2004 to 2013. Every year is taken to mean an Accounting year of the company consisting of twelve months.

Framework of Analysis

The collected data have been analysed by making use of Correlation. Level of significance chosen are one and five per cent level.

Data Analysis and Interpretation

In order to found nature of relation between dependent and independent variable correlation test is employed. Current year dividend is introduced as dependent variable. Previous year dividend, Current year depreciation, Current year Profit after Tax, Current Year Sales and Previous Year Cash flow are introduced as independent variables. Out of these five independent variables, all the variables are found to be significant. Previous year dividend, Current year Depreciation, Profit after Tax and Previous year cash flow are found to be significant at one per cent level and Current year sales are found to be significant at five per cent level.

TABLE 1

Determinants of Dividend

Variables	R	r_2
Dividend $_{(t-1)}$	0.970**	0.941
Deprecation $_{(t)}$	-0.613**	0.376
Profit After Tax $_{(t)}$	0.897**	0.805
△Sales	0.276*	0.076
CF $_{(t-1)}$	0.885**	0.783

* Significant at five per cent level   **Significant at one per cent level

Dividend (t-1)

Previous year dividend and current year dividend are positively related. This shows that when previous year dividend declaration is high, the company may declare high dividend during the current year. The coefficient of determination (r^2) shows that previous year dividend accounts for 94.10 per cent of the variation in the current year dividend.

Depreciation

Depreciation and dividend are negatively correlated. When deprecation decreases, the current year dividend rate increases. The coefficient of determination (r^2) that depreciation accounts for 37.60 variations in the current year dividend.

Profit after Tax

Profit after Tax and dividend are positively related. This shows that when profit after tax increases dividend also increases. The coefficient of determination (r^2) shows that profit after tax accounts for 80.50 per cent of the variation in the current year dividend.

Sales

Sales and dividend are positively related. This shows that when current year sales increase dividend also increases. The coefficient of determination (r^2) shows that sales accounts for 7.60 per cent of the variation in the current year dividend.

Cash Flow (t-1)

Previous Cash flow and current year dividend are positively related. This shows that when previous year cash flow increases current year dividend declaration also increases. The coefficient of determination (r^2) shows that previous year cash flow accounts for 78.30 per cent of the variation in the current year dividend.

Suggestions

❖ In general, every company irrespective of its industry nature is bound to concentrate on its current year earnings, since it plays an important role in shaping the behaviour of level of dividend. Since the level of earnings is the key factors in deciding the level of Dividend, every company has to work on the overall expenses of the company. In the competitive situation getting a higher price for their product is difficult hence everyone is compelled to have a control over the expenses, so that they can find a way for the enhancement of the level of dividend.

❖ Next to the current year earnings, the previous year dividend is an important factor that influences the level of dividend; hence every company should cultivate the habit of controlling the level of dividend over the years. Stable **dividend policy may helpful in maintaining the amount of dividend.**

❖ Previous year cash flow is also considered by large number of companies while deciding their rate of dividend. The cash flow is nothing but profit after tax plus Depreciation. It clearly indicates that the rate of tax is playing a key role in the dividend policies of the companies, hence companies have to throw some light on these factors as and when they work on the dividend decisions.

Conclusion

From the study it is found that dividend declaration is related with previous year dividend, current year depreciation, current year profit after tax, current year sales and previous year cash flow. Thus, companies in order to raise their market price of share have to declare nominal rate of dividend as expected by their investors and retain sufficient amount in order to maintain liquidity as well for future expansion of the business.

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