

## **Ownership Structures and Dividend Policy - A Study of Bombay Stock Exchange-500**

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### **Abstract**

Indian Corporate Firms Ownership structures are characterized by large shareholders, like other emerging market economies. The dominance of large shareholders may affect the dividend payout in several ways. For the modern corporate firms, the agency problem i.e. the conflict of interest between the shareholders and managers has always been considered as potential weakness. Given their predilection for rewards and the security of their human capital, managers have a tendency to engage in unwarranted earnings retention and payout as little as possible if they have the prospect to do so. However, ownership concentration lessens these distortions, resulting in higher dividend payments. The main purpose in this paper is to study the impact of ownership structure defined as institutional shareholding, promoter's shareholding, and foreign institutional shareholding on Dividend Policy of Companies Listed at BSE 500. Since dividend policy is affected by many other variables, we have taken debt equity ratio, net profit ratio and cash flow as controlling variables in the study. The data has been sourced from Prowess database of the Centre for Monitoring Indian Economy (CMIE). The multiple regression analysis has been applied to the data to study the effect of shareholding pattern of the companies of BSE -500 on the dividend policy of respective companies. Only 457 companies could be studied due to lack of available information on one or the other variables in respective company. The result indicated that 6% of variation has been explained by the independent variables (promote, foreign institutional shareholding and institutional shareholding).

**Keywords:** Dividend policy, Promoters Shareholding, Institutional Shareholding, Foreign Institutional Shareholding.

## 1. Introduction

Dividend policy refers to payout policy that a firm follows in determining the size and pattern of distribution to shareholders over time. The ownership structure of the companies differs from the other countries like USA and UK. In case of India, large shareholders i.e. directors, promoters and corporate have ample incentive and ability to control the financing decisions of the companies other than small investors. In recent years, the research on factors affecting dividend policy of companies is quite fast and vast but very few literatures are available to see the effect of shareholding pattern and dividend payout. In order to fill up the research gap, this paper has attempted to answer the following question: Does shareholding pattern in a firm matter for dividend payout? It has been argued in the existing corporate theories that payment of dividend provides indirect benefit of control where the shareholders are not involved dynamically in observing the performance of the firm (Rozeff 1982).

Easterbrook (1984) contends that firms pay dividends to overcome the agency problems stemming from the separation of ownership and control in a firm with diffused ownership. Jensen (1986) makes a similar argument that managers have a self serving motive to expand the firm beyond its normal size because the larger size increases resources under their control and leads to higher compensation. Thus, managers could find suboptimal investment that benefit themselves but diminish shareholders wealth.

## 2. Literature Review

The heredity of the literature review relating to factors affecting dividend policy lies in the renowned paper of Lintner (1956) where he discovered that it is the changes in the earnings and the existing dividend rate are the crucial determinants of dividend policy of the firms. After this, another legendary paper came which belongs to Modigliani and Miller (1961). They proved that in the presence of perfect capital market, the dividend decision or the dividend policy of any firm is irrelevant and does not affect the value of the firm. Rozeff (1982) had commenced the acceptance of agency cost in dividend determinant. He tested the agency theory of Jensen and Meckling (1976) by building a model of optimal dividend payout in which increase in dividends led to decrease agency costs, but raise transaction costs. He demonstrates that dividend payout is negatively related to the percentage of stock held by insiders

Short et al., (2002) conduct a study considered the first example of using well established dividend payout models to examine the potential association between ownership structure and dividends policy. By using dividend models of Lintner (1956); Fama and Babiak (1968), conclude that a positive association between dividend payout policy and institutional ownership may go beyond increasing the dividend payout ratio.

They also found some evidence to support a negative association between dividend payout policy and managerial ownership.

Gugler (2003) used OLS technique to examine the association between dividend payment and ownership control structure. He used a panel of 214 non-financial Australian firms for the year 1991 to 1999. The result of his study stated that state owned firms were occupied in dividend smoothing whereas family controlled firms were not involved for the same. Besides, the state owned firms were most indisposed and family owned firms were keen to cut dividends. The research also experienced that firms with low growth opportunities optimally expel cash irrespective of who controls the firm.

### **3. Data and Methodology**

#### **3.1 The Study Sample and Data**

The research is diagnostic and empirical in nature and employs use of secondary data. The data has been sourced from Prowess database of the Centre for Monitoring Indian Economy (CMIE). The population of the study consists of all the companies listed in BSE -500 over the period of 2003-2012. The sample has considered only those companies which have paid cash dividend every year and have the data on shareholding pattern and other controlling variables in the study for the period i.e.2003-2012 (both years inclusive). Thus, out of the total 500companies, finally, 457 companies could have been selected which are providing the information as per the requirements.

#### **3.2 Variables**

This section consists of three sub-sections; the first identifies the dependent variable, while the second one presents independent or explanatory variables and the third section defines the controlling variables.

##### ***3.2.1 Dependent Variable***

Company's dividend policy is taken as dependent variable in this study. Dividend paid to equity shareholders as a percentage of Profit after Tax represents the company's dividend policy.

##### ***3.2.2 Independent Variables***

**Promoters and Foreign Institutional Shareholding:** It is the percentage of holdings of Indian promoters, foreign promoters and persons acting in concert in a company.

**Institutional Shareholding:** Financial Institutional ownership refers to the sum of percentage of the banks, insurance companies, investment firms, pension funds and other large scale financial institutions out of total capital shares of the firm.

### 3.2.3 Controlling Variables

To investigate the relationship between ownership structure and dividend policy without extraneous effects, we control for all other factors believed to influence dividend policy. For this, cash flows, net profit ratio and debt equity ratio are representing as controlling variables in this study.

**Debt Equity Ratio:** Debt has a negative influence on the amount of dividends paid. This is because firms with higher fixed charges pay lower dividends in order to avoid the costs of external finance.

**Net Profit Ratio:** This factor indicates that greater the profit of a firm, higher will be the dividend payout. Therefore, profitability is positively related to dividend decision.

**Cash Flow:** A company in shortage of cash and facing a liquidity problem is unlikely to have high dividends payout. Thus, many studies explained that corporate payout is dependent on the availability of cash flows rather than profit.

## 4. Analysis of Result

**Table 1:** Regression Result.

	$\beta$	t value	F value	R2 change	p-value
			3.945	.06	.001
Constant		3.581			.000
FII's Shareholding	0.074	3.773			.000
Indian Promoters shareholding	0.049	2.491			.013
Institutional Shareholding	0.061	3.613			.000
Cash Flow	.001	.079			.937
Debt Equity Ratio	-.021	-1.277			.202
Net Profit Ratio	.007	.458			.647

The above analysis shows that the independent variables explain only 6% of variation in the dividend policy. The F value is 3.945 which is significant at 5% level of significance (p value < .05). It is also clear that all the independent variables (FS, PS, and IS) are positively related to dividend policy decision and also stastically significant (p value < .05). but it can be seen that controlling variable namely cash flow and net profit ratio has a very weak positive relationship with the dividend policy and the same is not stastically significant at 5% level of significance whereas the other controlling variable debt equity ratio has a negative association with the dividend policy but again the same is not significant (p value > .05).

## 5. Conclusion

The present study has majorly taken the promoter shareholding, foreign institutional investors and institutional shareholding as its independent variable and dividend payout ratio as dependent variable. Though controlling variables have also been taken into study but it was found they have an impact on dividend policy but it is not statistically significant. Thus, our analysis shows that all shareholding patterns have an impact on the dividend policy of the companies on the companies under study.

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