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Role of Ratio Analysis to Ensure the Impact of Dividend Policyon Firm Performance

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Abstract: *In the present study the researcher explain the several theories about the influence of dividend policy on performance of firms. Researchers were examined such theories in the perspective of the firms which are undergo virtually by the discussion in order to determine the key drivers which show a vital role on determining the firms performances. Would be served merely an individual factor which has as whole influenceon financial performance of the company and it can be the number of dividends that may have a collectiveinfluence of the as whole performance of the firms. In this work, the researcher tried to determine the main indicators of their influence on performances of the company and is also embedded in the dividends policy of the company. The effect may be negative or positive according to the nature of the determinant. In this work, researcher took the sample of 400 firms, and the data is secondary. Ratios were calculated for all companies in that basically determining the dividend policy and therefore the correlation tests have been running for observe if the results are relevant or not. In conclusion, researcher told the variables which play asignificant role in examining the performances of enterprises.*

Keywords:*Ratios, Dividend policy, Firm performance*

I. Introduction

"There are many theories and discussions in the past about the relationship between the dividend policy and firm performance. In addition, there are numerous articles that have discussed about the impact of dividend policy on performance, while others have discussed about the impact of the performance of companies on the dividend policy. Both theories have different implications and justifications that have been little discussed in the literature. Dividend policy no doubt depends primarily on the decision of the management of any company, but the preference of outside investors, i.e. shareholders have an impact in shaping the behavior of management about the dividend policy. With regard to the capital structure of many companies prefer internal source of financing for new or upcoming projects rather than going for external financing, i.e. the debt or investors. Thus, retained earnings may provide an internal financing, but only on the expanse of dividends or shareholder of the highest payouts in the case of dividends, the level of retained earnings would not serve the purpose. On the contrary, there is also a negative picture regarding the theory useful not distributed, that the management when the gains enough is retained, at times engage in unnecessary additional prerequisites management. This also includes any time invest in projects with negative net present value only because the company has sufficient cash flows and is able to assume the risks that would otherwise might not have taken the case of dividend payout ratio is high.This document will try to focus on the effects that the dividend policy have on business performance and vice versa. Researcher will try to reach a consensus between the different theories and research discussions on the relationship between cause and effect relationship between the dividend policy and corporate performance. Researcher also tries to find the main factors that influence and are influenced by the policies of the dividends declared by the management of any company. There is no doubt that there may be many factors which are both part of the company's performance in terms of both financial performance and the creation of market value of the company, but researcher will try to take advantage of the variables that play an important role in the performance of the taping of the company and has the highest ratio with the dividend policy of the undertaking".

Problem Statement

Going through previous research conducted in this argument it has been observed that there is a lack of consensus between the theories is that the dividend policy have an impact on the performance of the company or the performance of the company does not have an impact on the dividend policy. In this article I have included the variables that measure the performance of companies and the same should be included as the major determinants of dividend policy.

Problem statement of this study is "what are the key determinants of the dividend policy of the company that have a significant impact on its performance"

Objectives of the study
The main objective of this paper:

1. To find out the variables those have a significant impact on the performance of the firms.
2. To find out the determinants of dividend policy that have a major impact on the firm performance.
3. To find out the fact that to what extent does the performance of the firm mold the dividend policy of the companies and this dividend policy is appreciated by either the management of the company or the shareholders of the company.

Significance of the study
In this work, I tried to see the correlation between the variables that produce the dividend policy of the company and the firm's performance. In recent papers the performance of its forms including market value, profitability and perceptions of the holder of the share. researcher have tried to highlight the factors that have a major impact in influencing the dividend policy of the company and having a significant correlation between these variables, these can be included in the formulation of the actual dividend policies of companies.

II. Literature Review

Dividend policy can not only report the current performance and future prospects of the company, but also addresses the agency problems between managers and outside investors. Both of the above factors argue much of the empirical fact that the increase of the dividends is a kind of good news with a consequent increase in the prices of shares (Fairchild, 2010). Can not find a negative relationship between investment opportunities and the policy of dividend distribution. The ratio of external financing, the use of leverage and debt maturity on the dividend policy is found insignificant. Profitability and market capitalization found to influence the ratio of profit distribution in a very positive way. Firms with profitability trend tend to support their shareholder with high dividends whereas well-developed markets tend to support the policy of low dividend payout. (Abor and Bokpin, 2010)

Dividends may be either in the form of cash or consequential gains depending on the point of view of investors. Now the decision rests with the management of any company whether to declare dividends in the form of cash expenditures or capital gains, but it is the investors' preference really matters to the management that has a strong reputation as a market investor View Point.

In the point of view of the management, distribution of dividends more means less retained earnings, which is the lowest cost source of capital. So says high dividend payout may cost higher cost of capital, as they have lower retained earnings after dividends and, therefore, taking up the acquisition cost of capital in the form of higher interest rates, through debt financing or the highest rate of return through equity financing (Pakkirisamy and Ramachandran, 2010). The main reason for any business enterprise is to maximize its value, either through policy dividend payout ratio to increase or maintain the earnings after tax and mainly depends on the business strategy that must be made by management. But even if management policy is to maximize the wealth of the owner sharing through the distribution of dividends, this decision also depends on various factors such as past performance, growth and future profitability of the company's ability to pay to keep the 'picture of the wealth of the owner of the increasing share of the market and the cash flows of the various projects, because i'm talking about cash dividends that requires enough cash rather than stock dividends (Adelegan 2009).

There are numerous cases in which the return on assets rose before the announcement of dividends and decreased after the announcement for several years. This fact decreases the beliefs that are associated with positive dividends are associated only with greater future profitability. It 'also find that the majority of companies pay cash dividends only to expel the excess cash to shareholders, regardless of the fact that there is a significant profitability of the company (Fargher and Weigand, 2009). The profitability of the company, whether related to dividend policy will also depend on factors that determine the development of such policies and there are several factors that influence the dividend policy. These factors mainly include cash flows, investment opportunities and consistency of earnings in recent years (Pourheidari, 2009)

Firms with a higher return on equity increased amount of dividends declared and also a positive association was found between the decision and the dividend payout. But it is also important that no significant association was found between the dividend policy and the composition of the board of directors of the company (Abdelsalam, and Al MasrySegrini, 2008). The dividends are not exclusively associated with a profit, but with the last dividend paid, in fact the strongest determinant of the dividend payout ratio is his past relationships. There is no significant association of the ratio of dividend payout with the past, present or future net earnings and also the correlation between the ratio of distribution of profits and future earnings growth is negative and insignificant. Also note that the level of leverage of the company has a negative relationship with dividend payout ratio (Twaijry, 2007). Dividend policy is like a puzzle that is still unresolved and seeks an explanation for this still continues. There is an inverse relationship between the pattern of dividend signaling and managerial, that is, a manager with lower productivity declare higher dividends and the one with lower productivity declare higher dividends, showing that the difference in terms of productivity and integration of efforts costly modification results .

Whereas the application of the empirical model suggests that the value of the dividend is the highest indication of the type of agent should translate into lower and lower efficiency and also lower the value of the firm. Both approaches mentioned above are a contradiction to the dividend signaling theory that the higher value of the firm is reported to have higher dividends arguments in support of the declaration of dividends left managers with less cash flow to waste in present-value projects net negative or searched in most of the managers (N. Bhattacharyya, 2007). There have been conflicting results on whether there is a relationship between dividends or profits of a company for the long-term financial performance or profitability of the company. In most cases, the ratio of dividends or profits not has to do anything with the long-term viability of the company. There were also some cases in which the companies that reported lower earnings and cut dividends revealed larger excess returns over the next five years (Gunasekara and Power, 2006)

The profitability of the company is not the only factor that ensures the free flow of dividends to the holder of the share. Dividends are distributed from net income, but dividends are not the only option, there can be conflicts between the managers that profit can be used to either pay dividends, keep retained earnings or invest in existing projects net marginal and consumption of the Director of perquisite as dividend payments and interest payments of the debt decrease the availability of free cash flow manager (Amidu and Abor, 2006). It is absolutely obvious that the company does not give dividends is not a profit, and some predictions about its performance cannot be expected of its owner share in the coming years. Many companies, despite going in profits does not declare profits because they have a lot of projects net present values of positive and do not like them, other states because it does not have enough cash flow to accommodate their shareholders. In many cases, the termination of the dividends is an indication of the company's financial difficulties, but it can also cause an increase in the share price in the following years due to the investments made by the company in particular any projects with positive net present value (McManus et al, 2006). There is no single factor or theory about the explanation of dividends in corporate finance. There are various roles whose influence in many cases has a combined effect on the dividend policy for reporting such models, models agency, models of support pole and management models. There is not a single reason to believe that the dividend policy of any business entity is guided by that particular single factor. The discussion would be important to investigate this factor that has the greatest contribution in influencing the dividend policy, for example, the signaling model is known as the factor that drives the dividend policy, but in a search that was established that the its impact has been present, but very little extent. (Eagan et al, 1999)

Dividend policy declared by the management of any company is irrelevant in the share price in the case of perfect markets are efficient too and so in this configuration investors are not very concerned about the choice between capital gains and dividends with the arbitrage ensures that the dividend policy is irrelevant under the efficient markets (Modigliani and Miller, 1961). There is a theory that relaxes the assumption of efficient capital markets and the theory of arbitrage. The main parts are that there are some investors who are uninformed, time-varying demands for dividends and sometimes arbitrage cannot avoid this request of investors who runs the prices of securities that pay and do not pay dividends, and finally manager disturbing about the demand of investors, if they put higher prices on the actions of taxpayers and put the lowest prices for non-taxpayers (Baker and Wurgle, 2002). Profitability is undoubtedly an important factor in determining uniform policy for the win, but the strong block holders also play as a barrier between the two variables above. This bracketlock believes that the high payout to shareholders may make the company to be in a strong liquidity position resulting investment policy is not optimal. In this way, the impact of such shareholder coalitions always has a negative magnitude to payments (Renneboog and Trojanowski, 2007).

The decision to maintain or not retention is chosen by managers, if you make the decision to withhold part of the leaders, then the decision to determine the net present value is made up of managers and if the additional distribution to shareholders decision is taken by the manager ,then the NPV is determined by the expectations of new shareholders. So, concluding that shareholder wealth is controlled only by the operators if the decision is made by the managers of retention, despite the fact that the managers are very interested in retained earnings because this gives them a lot of control on the shareholders and also gives them the opportunity to invest in projects that have a negative NPV is sometimes (Magni, 2006). The announcement on dividends has an effect on the prices of shares on the market and there have been many investigations on the behavior of price fluctuations in the market price of the shares in respect of news regarding the provision of favorable, unfavorable or non-existent (McCluskey et al , 2007).

III. Methodology

In this paper researcher analyzed 90 companies, and the data were collected mainly from the website of the Lahore stock exchange website. All data refer to secondary sources. Researcher calculated the ratios of the factors that are fundamentally embedded in the dividend policy of the company and any of the data is for the past five years. The company includes the major sectors such as the textile sector, Telecom sector, banking sector and a vast collection of the main areas that are basically playing a strong role for the country's economy. The reports were calculated and statistical tests were applied to observe the correlation between these determinants of dividend policy. Researcher has included five reports that mainly determine the dividend policy of the company and that researcher have included. These reports are dividend payout ratio, firm size, return on assets ratio, and return on equity and, ultimately, market to book value of the company.

Data and Analysis

		Dpo	Size	Roa	Roe	Bm
dpo	Pearson Correlation	1	.047	.096(*)	.322(**)	-.019
	Sig. (2-tailed)		.304	.036	.000	.681
	N	400	400	400	400	400
size	Pearson Correlation	.047	1	.331(**)	-.059	.129(**)
	Sig. (2-tailed)	.304		.000	.202	.005
	N	400	400	400	400	400
roa	Pearson Correlation	.096(*)	.331(**)	1	.038	.619(**)
	Sig. (2-tailed)	.036	.000		.407	.000
	N	400	400	400	400	400
roe	Pearson Correlation	.322(**)	-.059	.038	1	-.014
	Sig. (2-tailed)	.000	.202	.407		.763
	N	400	400	400	400	400
bm	Pearson Correlation	-.019	.129(**)	.619(**)	-.014	1
	Sig. (2-tailed)	.681	.005	.000	.763	
	N	400	400	400	400	400

*Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

Analyzing the table it is evident that the dividend payout ratio has a significant relationship with the return on the share of capital that the firm size has no significant correlation with the return on assets ratio. Return on factor activity that has a significant relationship with the distribution of dividends, the size and the ratio of market value. Return on equity also has a significant correlation with the ratio of dividend distribution. The latest report is that the book to market value has a significant correlation with the size of the company and also with the return on assets ratio. Therefore, analyzing the above statistics it is evident that all four reports that are mostly embedded in the dividend policy of the companies have a significant correlation between them and consider all the factors mentioned above which are mainly included in the dividend policy of the company, the return on assets has a significant correlation with three of the four factors that determine the dividend policy of the company. The equations that formulated for the relationship between these determinants of dividend policy areas below.

$$DPO_{it} = \beta_{0it} + \beta_1 ROA_{it} + \beta_2 ROE_{it} + \beta_3 BM_{it} + \beta_4 S_{it+} \varepsilon_{it}$$

In the analysis of the above equations, the second equation does not have a significant correlation with most of the reports as indicated in the previous paragraph, so for our newspaper and given that I've included, this equation essentially describes the factors that are included in dividend policy that have a significant impact on business performance.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
DPO	400	-.07	2.36	.0855	.16594
SIZE	400	3.52	22.93	10.4891	4.41683
ROA	400	-11.98	86.69	3.0186	6.29309
ROE	400	-2.10	3.87	.1672	.31717
BM	400	-1.10	676.90	1.6816	31.05148
VALID N(LISTWISE)	400				

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.345(a)	.119	.111	.15643

a Predictors: (Constant), bm, roe, size, roa

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.034	.019		1.783	.075
	size	.001	.002	.034	.732	.464
	roa	.004	.002	.137	2.351	.019
	roe	.166	.023	.317	7.284	.000
	bm	-.001	.000	-.104	-1.871	.062

a. Dependent Variable: dpo

Limitation of the study

Limitation of the study is that there are many other variables that can be included as the determinants of dividend policy other than what I've included in our study. The variables that I have supplied reports and there may be many other reports that may be included as the determinants of dividend policy. Even the same variables that I included in our study as factors touching the performance of enterprises. There may be many other factors included that measure the performance of companies, such as net income, sales, etc. relating to the operating profitability of the company.

IV. Conclusion

Analyzing the above data and the statistical tests that have been applied, the determining factors were tested to see the correlation between these are the main factors that determine the dividend policy of substantially all businesses that have an impact on the overall performance of 'company. There are five main factors that have been set as the determinants of dividend policy and analyzed their significance level with each other. The return on assets has a significant correlation with three of the four factors that determine the dividend policy of the company. Thus, in our tests this particular variable has a more significant impact among all the variables in our tests, and then the equation that I made including the return on the factor of assets will not show the most significant results. The impact on the performance of the activity report is largely determined by three factors that are dividend payout ratio, return on equity ratio and, finally, the book to the ratio of market value. The return on assets has a significant correlation with these entire factors do not show a linear relationship with all the above factors. Thus, the return on assets when considered in dividend policy is strongly influenced by these three reports that were included in the ration principle of our study. In addition, this report, the other three equations that formulated also do not show a significant linear relationship between the ratios, return on asset, but has the most significant relationship between all these factors and, therefore, will have a major role in formulating the overall dividend policy of society.

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