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Corporate Governance and Dividend Policy in India

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Abstract: ***This paper examines the impact of corporate governance on dividend policy decision of BSE-30 companies. Secondary have been collected and source of data was capitaline database and annual reports of respective companies. The time period was 5 years from 2008 to 2014. Researcher has examined the correlation between DIP and corporate governance variables. The correlation found significant. Researcher has also developed regression model to examine casual relationship which is also found significant. It is concluded that corporate governance plays significant role in devising dividend policy decision.***

Keywords: Corporate Governance, dividend policy, BSE-30, Secondary, DIP.

I. CORPORATE GOVERNANCE

In recent times high quantities of domestic and international capital are being availed by business, a prime benefit of Corporate Government is the improvement in the prospects for attracting long –term capital. The investors are afforded a wide range of choices by the world-wide development of corporate finance and control systems. Providers of finance today emphasize on good governance and credibility aspects of the corporation. Good practices in Corporate Governance must be evolved in order to attract international investors and encourage domestic investors. The management--- which is represented by working directors is very distinct and separate from providers of capital and managers---representing the executive group from the line are responsible for the efficient use of assets in pursuit of the firms' objective. Besides the judicious functioning of the management and the managers the firm has to perform. It must achieve or strive to achieve heightened economic performance in order to survive and sustain its long-term goals. For this the firm has to garner support, generate stable, long-term and low cost capital.

The Corporate Board is comprised of a board director who is at the helm of affairs organization. They must hold the managers down the line responsible for proper utilization of the shareholders' funds/ assets. Secondly they must corporate the concept of Corporate Governance. This is essential in that, that it affects a firm's economic performance and its ability to attract quality investors. The help, improve the above function, corporate governance guidelines and code of practice are so designed.

II. DIVIDEND POLICY

Dividend policy is a flexible and comprehensive term. In narrow sense, dividend policy means the policy followed by the board of directors concerning quantum of profits to be distributed as dividend. In broader sense, dividend policy refers the determination of the principal's rules and procedure for the planning of distribution dividend after deciding the rate of dividend. The oxford Dictionary defines a policy as "the plan of action accepted by a person or organization." A company's dividend policy can be defined as the plan of action adopted by its directors whenever the dividend decision is to be made."

Thus deciding a dividing policy is the most significant decision among three important decisions (investment, financing and dividend) of the financial management as the dividend policy determines the division of earnings, generally remains in business, are of much use for financing the replacement of assets and expansion programmes of the company. On the one hand, dividend entails cash outflow and consequently reduction in current assets. Distribution of dividend at high rate results in reduction in current assets. Distribution of dividend at high rate results in reduction of ploughing back of profits and slackness in the rate of development. On the other hand merge distribution of dividend causes dissatisfaction among the shareholders. Therefore it is imperative for the directors to follow an unambiguous and balanced dividend policy.

III. ABOUT BOMBAY STOCK EXCHANGE

BSE SENSEX (Bombay Stock Exchange Sensitive Index), also-called the BSE 30 or simply the SENSEX, is a free-float market-weighted stock market index of 30 well-established and financially sound companies listed on Bombay Stock Exchange. The 30 component companies which are some of the largest and most actively traded stocks are representative of various industrial sectors of the Indian economy. Published since 1 January 1986, the BSE SENSEX is regarded as the pulse of the domestic stock markets in India. The base value of the S&P BSE SENSEX is taken as 100 on 1 April 1979, and its base year as1978–79. On 25 July 2001 BSE launched DOLLEX-30, a dollar-linked version of S&P BSE SENSEX. As of 21 April 2011, the market capitalization of S&P BSE SENSEX was about ₹29733 billion (US$482 billion) (47.68% of market capitalization of BSE), while its free-float market capitalization was ₹15690 billion (US$254 billion). During 2008-12, Sensex 30 Index share of BSE market capitalization fell from 49% to 25% due to the rise of sectorial indices like BSE PSU, Bankex, BSE-Teck, etc.

IV. REVIEW OF LITERATURE

Plenty of literate available on this topic. But researcher has presented some significant reviews of studies here.

1. **Husam-Aldin Nizar Al-Malkawi (2008)** worked on ***Factors Influencing Corporate Dividend Decision: Evidence from Jordanian Panel Data"*** in his research he examined the determinants of corporate dividend decisions of publicly quoted companies in Jordan as a case study of an emerging market. The analysis is based on 15-year unbalanced panel data with 1137 firm-year observations covering the period between 1989 and 2003. The study develops five research hypotheses and used the general-to-specific modeling approach to choose between the competing hypotheses. We estimate the determinants for a given firm to pay dividends to its shareholders through Probity specifications. The factors that affect dividend policy in developed stock markets seem to apply for this emerging market. For example, factors such as size, profitability, and age increase the likelihood to pay dividends. Financial leverage decreases the probability to pay dividends. Taken together, the findings provide support for the agency costs hypothesis and are broadly consistent with the pecking order hypothesis.

2. **Oskar Kowalewski, Ivan Stetsyuk and Oleksandr Talavera (2007)** ***Does Corporate Governance Affect Dividend Policy? Evidence from Poland"*** worked on the determinants of the dividend policy in Poland. Second, we test whether corporate governance practices determine the dividend policy in the non-financial companies listed on Warsaw Stock Exchange. We compose, for the first time, quantitative measures on the quality of the corporate governance for 110 non-financial listed companies. Our results suggest that large and more profitable companies have a higher dividend payout ratio. Conversely, concentrated share ownership as well as the deviation from the one-share one-vote principle leads to a reduction of the payout dividend ratio. This result suggests that dividends may signal the severity of conflicts between controlling owners and minority shareholders. While, we find support for the fee cash flow hypothesis we document that dividends in Poland have less of a signaling role than in the developed capital markets. We present also that riskier and more indebted firms prefer to pay lower dividends. The findings are based on the period 1998-2004. Finally, our results demonstrate that an increase in the TDI or its subindices that represent corporate governance practices brings about a statistically significant increase in the dividend payout ratio. Moreover, the estimates prove to be significant after the inclusion of performance and control variables.

3. **Black (1976)** finds no convincing explanation of why companies pay cash dividends to their shareholders. Since that introduction of the "dividend puzzle," a voluminous amount of research offers alternative and appealing approaches to solve it. Most of them are rooted in information asymmetries between firm insiders and outsiders, ownership and controlling structures and suggest that firms may indicate their future profitability by paying dividends.

4. **Morad Abdel-Halim & Adel Bino (2008)** Corporate governance and dividend policy: An empirical investigation of Jordanian non financial corporations study aims at investigating the relationship between dividend policy and the corporate governance mechanism, measured by firm's ownership structure, of non-financial corporations listed on Amman Stock Exchange. Based on a sample of 110 corporations over the period 2004-2008 and using several econometric models with different specification that account for firm-specific unobservable variables and controls for the impact of other confounding factors, the results show a significant negative relationship between firm's dividend payout ratio and its capitals owned by block holders. This may indicate that large shareholders may be expropriating the rights of minority shareholders and benefiting from the firm through other means other than the payment of dividends. Also, the results show that there is a negative relationship between dividend payout ratio and sales growth.

5. **Klaus Gugler, B. Burcin Yurtoglu (2002)** wrote on "Corporate governance and dividend pay-out policy in Germany" A new explanation of why dividends may be informative is put forward in this paper. We evidence that dividends signal the severity of the con1ict between the large, controlling owner and small, outside shareholders. Accordingly, dividend change announcements provide new information about this con1ict. To test the rent extraction hypothesis and discriminate it from the cash 1ow signaling explanation, we utilize information on the ownership and control structure of the firm. We analyze 736 dividend change announcements in Germany over the period 1992– 1998 and significantly larger negative wealth effects in the order of two percentage points for companies where the ownership and control structure makes the expropriation of minority shareholders more likely than for other 0rms. The rent extraction hypothesis also has implications for the levels of dividends paid. We and larger holdings of the largest owner to reduce, while larger holdings of the second largest shareholder to increase the dividend pay-out ratio. Deviations from the one-share-one-vote rule due to pyramidal and cross-ownership structures are also associated with larger negative wealth and lower pay-out ratios

6. **Lintner's (American Economic Review 46 (2) (1956) 97–113)** model of dividend determination us and are corroborating results. The presence of a second largest shareholder with a considerable equity stake makes a crucial difference in the

governance of the 0rm. Our results call for better minority shareholder rights protection and increased transparency in the course of European Capital Market Reform.

7. **Grossman and Hart (1980)** point out that the dividend payouts mitigate agency conflicts by reducing the amount of free cash flow available to managers, who do not necessarily act in the best interests of shareholders. In line with that,
8. **Jensen (1986)** argues that a company with substantial free cash flows is inclined to adopt investment projects with negative net present values. If managers increase the amount of dividend, all else being equal, it reduces the amount of free cash flows, thereby mitigating the free cash flow problem. Thus, dividend payouts may help control agency problems by getting rid of the excess cash that otherwise could result in unprofitable projects. Furthermore,

9. **Easterbrook** (1984) argues that dividends help alleviate agency conflicts by exposing firms to more frequent monitoring by the primary capital markets because paying dividends increases the probability that new common stock has to be issued more often. This, in turn, leads to an investigation of management by investment banks, security exchanges, and capital suppliers. The importance of monitoring by investment banks has been recognized in literature.

10. **Shleifer and Vishny (1986) and Allen, Bernardo, and Welch (2000)** note that institutional investors prefer to own shares of firms making regular dividend payments, and argue that large institutional investors are more willing and able to monitor corporate management than are smaller and diffuse owners. As a result, corporate dividend policies can be tailored to attract institutional investors, who in turn may introduce corporate governance practices.

V. OBJECTIVES

Following objectives have been framed for this study.

1. To study the concept of corporate governance and dividend policy decision.
2. To examine the impact of corporate governance on dividend policy of BSE-30 Firms.
3. To establish correlationship between the parameters of corporate governance and dividend policy.
4. To check the effect of the independent variables of corporate governance on the dividend policy variable like dividend per share.
5. To give suggestion to policy makers.

VI. RESEARCH METHODOLOGY

The title of the paper is “Corporate Governance and Dividend Payout: Evidence from Indian firms.” Secondary data have been used for this study. The sources of data are capitaline data base and annual reports of respective companies. The period of the study was from 2008 to 2012. The scope of study has been BSE-30 companies.

VII. DATA ANALYSIS

A. DESCRIPTIVE ANALYSIS

Table-1
Descriptive statistic

Sr. No.	Variables	Mean	Standard Deviation	Kurtosis	Skewness	Range	Minimum	Maximum	Count
1	P/E ratio	21.12	6.66	-0.60	0.03	26.40	8.37	34.77	30.00
2	Return on assets	22.87	28.50	10.75	3.18	136.87	1.57	138.44	30.00
3	Return on net worth	26.24	17.42	6.91	2.33	84.41	8.95	93.36	30.00
4	Tobin’s Q	25.83	64.70	20.27	4.27	338.71	0.99	339.70	30
5	BOARDSIZE	12.60	2.67	-1.11	-0.18	9.00	7.60	16.60	30.00
6	Outside Director	7	2	-1	0	6	4	10	30
7	Ownership concentration	35.66	24.11	-0.30	0.90	82.47	7.53	90.00	30.00
8	Leverage	0.32	0.30	0.26	1.19	0.94	0.00	0.94	30.00
9	Firm Size	30221.684	37876.297	18.018	3.907	208868.540	391.460	209260.000	30.000
10	CEOSTATUS	0.95	0.19	21.72	-4.57	1.00	0.00	1.00	30.00
11	Foreign CEO	1	0	12	-4	1	0	1	30
12	Age	44	27	0	1	88	15	103	30
13	DPR	30.9	17.3	0.1	0.9	67.5	5.1	72.6	30.0

Average PE ratios of BSE-30 firms were 21.21 with standard deviation of 6.66%. The range of PE ratio was 34.77% and 8.37% during the study period. The average of return on assets was 22.87 and standard deviation was 28% percent. The Skewness was

3.18 with range of 138.44% and 30%. Return on Net worth ranged between 96.36% and 8.95% with mean of 26.24%. The Tobin's Q was 25.83 percent with Kurtosis of 20.27%. The range of Tobin's Q was between 0.99 and 339.70. Mean of Board size was 12.60 with standard deviation of 2.67%. The range was 9 with skewness of -0.18. The outside director's mean was 7 with maximum of 10 and minimum of 4 directors. Ownership concentration has the average of 35.66% with standard deviation of 24.11%. The range was 82.47. Average of leverage was 0.32 with standard deviation of 0.30%. Firm size in term of net sales was 30221.684 crores with kurtosis of 18.018%. The average age of BSE-30 firms has been 44 years with the range of 103 years and 15 years. DPR was 30.9% with standard deviation of 17.30% which showed stability in Dividend pat out ratio.

B. Pearson Correlation

Table-2
Pearson Correlation

Correlations													
	DPR	PR	ROA	ROWN	Tobin's Q	Dirshare	Board size	Outside	Concent	Debt-Leverage	Firm size	CEO Status	Foreign CEO
DPR	1												
PR	.471**	1											
ROA	0.123	0.04	1										
ROWN	.565**	0.124	0.246	1									
Tobin's Q	-0.004	0.115	-0.052	-0.118	1								
Dirshare	-0.103	-0.173	-0.065	0.022	-0.335	1							
Board size	0.226	0.029	0.05	-0.034	0.034	-0.015	1						
Outside	0.064	-0.003	0.205	-0.081	0.32	-0.159	.686**	1					
Concent	0.212	-0.182	-0.191	0.094	-0.2	.392*	0.261	-0.29	1				
Debt-Leverage	-0.174	-0.077	-0.323	-0.361	.622**	-0.186	0.039	0.211	-0.168	1			
Firm size	-0.22	-0.246	-0.121	-0.189	-0.071	0.247	0.13	0.059	-0.009	0.12	1		
CEOStatus	0.058	0.002	-.526**	-0.001	0.028	-0.277	0.185	-0.029	0.107	0.053	0.031	1	-
ForeignCEO	0.038	-0.068	0.016	-.379*	0.114	-0.181	0.038	0.27	-0.127	0.197	0.027	-0.062	1
**. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).													

Table No-2 showed the correlation coefficient between the different components of corporate governance and dividend payout ratio. The correlationship between DPR and P/E ratio is 0.471 which is significant at 1% level of significant. The correlation between DPR and ROA is 0.123 which is insignificant at both level of significant. The correlation between DPR and RONW is 0.565 which is significant at 5% level of significant. The correlationship between DPR and Tobin's Q is minus 0.004 which insignificant at both level of significant. The DPR has negative correlation with director's shareholding, debt equity ratio, and firm's size which is insignificant at both levels of significance. The DPR has positive correaltionship with board size, outside directors, ownership concentration, CEO status and foreign CEO which is insignificant at 1% and 5% level of significant/E ratio has positive relationship with ROA, ROWN, Board size, CEO status and Tobin's Q but it is significant with DPR only. Whereas P/E ratio has negative relationship with director shareholding, outside directors, ownership concentration, Debt-equity ratio, firms size and foreign CEO.ROA has positive correlationship between ROWN, Board size, outside director and Foreign CEO status. However ROA has been negatively correlation with Tobin's Q, Director Shareholding, Ownership Concentration, and outside director. However it has significant correlation with foreign CEO. Outside director and ownership concentration has negative correlation and the difference is insignificant. The correlation between outside director and debt-equity ratio, firm size and foreign CEO is positive but the difference is insignificance. The outside director has negative correlation with CEO status. Ownership concentration has also negative relation with debt-equity ratio, firm size, and foreign CEO. But it has positive relation with CEO status. Debt equity ratio has significant relationship with Tobin's Q. and it has insignificant relationship with all other variables like DPR, PE ratio, ROA, RONW, Director Shareholding, Board size, outside director, and ownership concentration. In the last CEO status and foreign CEO has correlation with all the components but the difference is insignificant.

C. Regression Analysis

Table No.3 showed the coefficient of independence variable like PE ratio, ROA, RONW, Tobin's Q, Director Shareholding, Board size, outside director holding, ownership concentration, Debt-equity ratio, CEO status, Foreign CEO, and firm size. This showed the impact of independence variable on the dependence. P/E ratio has positive impact on DPR and t test is also significant.

ROA has negative impact with significant of t test. ROWN, Board size, ownership concentration, debt equity ratio, and foreign CEO and Firma size have positive and significant effect on DPR. Whereas independence variables like Tobin's Q, director shareholding; outside director and CEO status have negative effect DPR. Overall DPR has been negative regression effect.

Table-3
Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-52.882	36.659		-1.443	.167
	PR	1.240	.426	.477	2.911	.010
	ROA	-.002	.123	-.003	-.013	.990
	ROWN	.631	.165	.635	3.813	.001
	Tobin's	-.011	.057	-.039	-.186	.855
	Dirshare	-.111	.175	-.146	-.636	.533
	Boardsize	.999	2.026	.155	.493	.628
	Outside	-.378	3.220	-.038	-.117	.908
	Concent	.212	.178	.295	1.189	.251
	Debt-Leverage	3.417	12.848	.058	.266	.793
	CEOStatus	-2.218	18.667	-.023	-.119	.907
	ForeignCEO	18.565	9.608	.328	1.932	.070
	firmsize	1.342	3.231	.088	.415	.683
a. Dependent Variable: DPR						

Table-4
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.821a	.675	.445	12.87841
a. Predictors: (Constant), firm size, Tobin's, CEO Status, ROWN, Concent, Board size, Foreign CEO, PR, ROA, Debt-Leverage, Dirshare, Outside				

Table No. 4 showed multiple regression summaries. Model has giver three important value R (0.821), R square (0.675), and Adjusted R square (0.445). The value is 0.146 or 14.60% more than the value of adjusted (r2). This implies that adjusted (r2) has been reducing the overall proportion of the explained variation of the dependent variable attributed to independence variable by 14.60%. If more insignificance variables are added in the regression model, the gap between (r2) and adjusted (r2) tends to widen.

VIII. SUGGESTIONS

After analyzing the subject of corporate governance and dividend policy appropriately, Researcher has come on the following suggestions

1. As the key to good corporate governance lies with the with the well functioning of the board of director, the full board which should be signed tried, should meet a least six times a year with a gap of 2 month.
2. The non executive director should comprise 30 percent of the board one of them being the chairman.
3. The non executive director should compromise at least 50% of the board if the chairman and the managing director is the same person.
4. No individual should be a director on the board.
5. Non executive director should be paid commission and offered with stock option for their professional inputs besides their settings fees.
6. non executive director must be active, have defined responsibilities and be conversant with profit and loss account, balance sheet, cash flow statement, financial ratios and have some knowledge of company laws
7. The board should be informed of the operating plans and budget, long term plans, quarterly divisional results and internal audit reports.
8. Directors who have not been present for at least 50% of the board meetings should not be re-appointed.
9. Details of defaults, payments for intangible and foreign exchange exposures should be reported of the board.
10. In audit committee comprising at least three non executive directors should be set up and given access to all financial information.
11. For appointment of new director, shareholders must be provided with a brief resume of the candidates, nature of his expertise and his other directorship.
12. Board committees under the chairmanship of a non executive director should be formed to specifically look in to shareholders' complaints.
13. The power of share transfer should be delegated to an officer or committees or to the registers and transfer agents.
14. This recommendation may be implemented through the listing agreements.

15. The company should arrange to obtain certificates from his auditors regarding compliances of the corporate governance provisions.

IX. CONCLUSION

This paper examines the impact of corporate governance on dividend policy decision of BSE-30 companies. Secondary have been collected and source of data was capitaline database and annual reports of respective companies. The time period was 5 years from 2008 to 2014. Researcher has examined the correlation between DIP and corporate governance variables. The correlation found significant. Researcher has also developed regression model to examine casual relationship which is also found significant. It is concluded that corporate governance plays significant role in devising dividend policy decision.

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