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Impact of Profitability on Dividend Policy of Listed Agricultural Companies of India

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ABSTRACT

This study assesses the effect of profitability on the dividend policy of listed selected agricultural companies of India. The population of the study consists of eight(8) listed agricultural companies. Secondary data is collected from the sampled firms through their published audited financial statements for 15 years ranging from 2007-2023. The ex-post facto research design was adopted with descriptive analysis and regression analysis to determine the effect of explanatory variables. The results show that earnings per share, return on equity and return on assets have a positive correlation but insignificant effect on dividend policy. Based on the findings, the study concludes that the dividend policy has the probability of influencing the profitability of listed agricultural companies of India. The study also recommends that the companies should adopt policy and strategy on efficient use of their assets that would enable them to generate profits to meet up with dividends payment regularly to attract more investors. This is because investors assume that a firm which pays dividend regularly is an evidence that the company is healthy financially.

Keywords: Dividend Policy, Dividend Payout Ratio, Earnings Per Share, Return on Equity, Return of Assets, Listed Agricultural Companies

INTRODUCTION

Dividend policy is considered as one of the most important financial decisions that can affect a company's financial performance. Dividends are considered as an important element that enters into the self-financing process and company investment decisions, if those decisions depend on the available cash resulting from operational activities, as well as the effects these decisions may have on the investment opportunities available to companies.[2] Although it is still a matter of controversy between researchers and financial analysts, dividend policy is characterized by ambiguity and failure to understand all of its aspects. Selecting the suitable dividend policy is a vital decision for the company because the decision to pay or not to pay dividend may promote a company and may also crash the company. Also, the

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gateway to investing in future projects depends on the amount of dividend that they pay currently to their shareholders. Thus, dividend policy is the dependent variable and the payment of dividends depends on the profit generated by the company.[1]

AGRICULTURAL SECTOR

The agricultural sector is one of the backbones of Indian economy and the agricultural companies contribute immensely to gross domestic product (GDP) growth as it ensures food security as well as part of the major creator of employment opportunities.

The world's population is expected to grow to almost 10 billion by 2050, boosting agricultural demand. In a scenario of modest economic growth by some 50 percent compared to 2013. Income growth in low and middle income countries would hasten a dietary transition towards higher consumption of meat, fruits and vegetables, relative to that of cereals, requiring commensurate shifts in output and adding pressure on natural resources.

The decline in the share of agriculture in total production and employment is taking place at different speeds and poses different challenges across regions. Although agricultural investments and technological innovations are boosting productivity, growth of yields has slowed to rates that are too low for comfort. Food losses and waste claim a significant proportion of agricultural output, and reducing them would lessen the need for production increases. However, the needed acceleration in productivity growth is hampered by the degradation of natural resources, the loss of biodiversity, and the spread of transboundary pests and diseases of plants and animals, some of which are becoming resistant to antimicrobials.

Satisfying increased demands on agriculture with existing farming practices is likely to lead to more intense competition for natural resources, increased greenhouse gas emissions, and further deforestation and land degradation.

DIVIDEND AND DIVIDEND POLICY

A dividend is the share of profits that is distributed to shareholders in the company and the return that shareholders receive for their investment in the company. The company's management must use the profits to satisfy its various stakeholders, but equity shareholders are given first preference as they face the highest amount of risk in the company. A few examples of dividends include:

1. Cash Dividend

A dividend that is paid out in cash and will reduce the cash reserves of a company.

2. Bonus Shares

Bonus shares refer to shares in the company are distributed to shareholders at no cost. It is usually done in addition to a cash dividend, not in place of it.

Examples of Dividend Policies

The dividend policy used by a company can affect the value of the enterprise. The policy chosen must align with the company's goals and maximize its value for its shareholders. While the shareholders are the owners of the company, it is the board of directors who make the call on whether profits will be distributed or retained.

The directors need to take a lot of factors into consideration when making this decision, such as the growth prospects of the company and future projects. There are various dividend policies a company can follow such as:

1. Regular Dividend Policy

Under the regular dividend policy, the company pays out dividends to its shareholders every year. If the company makes abnormal profits (very high profits), the excess profits will not be distributed to the shareholders but are withheld by the company as retained earnings. If the company makes a loss, the shareholders will still be paid a dividend under the policy.[3]

The regular dividend policy is used by companies with a steady cash flow and stable earnings. Companies that pay out dividends this way are considered low-risk investments because while the dividend payments are regular, they may not be very high.

2. Stable Dividend Policy

Under the stable dividend policy, the percentage of profits paid out as dividends is fixed. For example, if a company sets the payout rate at 6%, it is the percentage of profits that will be paid out regardless of the amount of profits earned for the financial year.

Whether a company makes $1 million or $100,000, a fixed dividend will be paid out. Investing in a company that follows such a policy is risky for investors as the amount of dividends fluctuates with the level of profits. Shareholders face a lot of uncertainty as they are not sure of the exact dividend they will receive.[3]

The stable dividend policy is further divided into per share constant dividend, pay-out ratio constant, stable dividend plus extra dividend.

3. Irregular Dividend Policy

Under the irregular dividend policy, the company is under no obligation to pay its shareholders and the board of directors can decide what to do with the profits. If they a make an abnormal profit in a certain year, they can decide to distribute it to the shareholders or not pay out any dividends at all and instead keep the profits for business expansion and future projects.

The irregular dividend policy is used by companies that do not enjoy a steady cash flow or lack liquidity. Investors who invest in a company that follows the policy face very high risks as there is a possibility of not receiving any dividends during the financial year.[3]

4. No Dividend Policy

Under the no dividend policy, the company doesn't distribute dividends to shareholders. It is because any profits earned is retained and reinvested into the business for future growth. Companies that don't give out dividends are constantly growing and expanding, and shareholders invest in them because the value of the company stock appreciates. For the investor, the share price appreciation is more valuable than a dividend payout.[3]

Final Word

The dividends and dividend policy of a company are important factors that many investors consider when deciding what stocks to invest in. Dividends can help investors earn a high return on their investment, and a company's dividend payment policy is a reflection of its financial performance.

DIVIDEND PAYOUT RATIO - DPR

The Dividend Payout Ratio (DPR) is the amount of dividends paid to shareholders in relation to the total amount of net income the company generates. In other words, the dividend payout ratio measures the percentage of net income that is distributed to shareholders in the form of dividends.[3]

A 40% payout ratio would be favorable for an investor because a payout ratio below 50% gives a company

enough flexibility to reward shareholders while reinvesting in new projects.

The dividend payout ratio can be calculated by taking the yearly dividend per share and dividing it by the earnings per share or you can use the dividends divided by net income.

PROFITABILITY AND IT'S IMPORTANT RATIOS

Profitability is the cornerstone or livewire of every business, being it small, medium or large. The ability of any company to operate effectively depends upon the profit which it generates. When a company's profitability turns low, no amount of miracles or magic that can make the company perform better. The low profit would have a significant impact on dividend payout decisions. However, when a company earns higher profit, it will decide to give higher back to the shareholders who are the owners of the company (Sartaw, 2008). Hence, the study has taken profitability as an independent variable measured by return on assets (ROA), return on equity (ROE) and earnings per share (EPS).[12]

RETURN ON ASSETS - ROA

Return on assets is a profitability ratio that provides how much profit a company can generate from its assets. In other words, return on assets (ROA) measures how efficient a company's management is in earning a profit from their economic resources or assets on their balance sheet.[10]

A ROA of over 5% is generally considered good and over 20% excellent. However, ROAs should always be compared amongst firms in the same sector. For instance, a software maker has far fewer assets on the balance sheet than a car maker.

An ROA that rises over time indicates the company is doing a good job of increasing its profits with each investment dollar it spends. A falling ROA indicates the company might have over-invested in assets that have failed to produce revenue growth, a sign the company may be trouble.

RETURN ON EQUITY - ROE

Return on equity (ROE) is the measure of a company's net income divided by its shareholders' equity. ROE is a gauge of a corporation's profitability and how efficiently it generates those profits. The higher the ROE, the better a company is at converting its equity financing into profits.[9]

While average ratios, as well as those considered "good" and "bad", can vary substantially from sector to sector, a return on equity ratio of 15% to 20% is usually considered good. At 5%, the ratio would be considered low.

ROE is a useful metric for evaluating investment returns of a company within a particular industry. A higher ROE signals that a company efficiently uses its shareholder's equity to generate income. Low ROE means that the company earns relatively little compared to its shareholder's equity.

EARNINGS PER SHARE - EPS

Earnings per share or EPS is a common metric used to carry out corporate value. It can be defined as the value of earnings per outstanding share of common stock of the company. EPS indicates the company's profitability by showing how much money a business makes for each share of its stock.[10]

EPS equals the difference between net income and preferred dividends, divided by the average number of outstanding common shares. EPS is sometimes known as the bottom line of a firm's worth.

As a general rule, the higher a company's EPS, the more profitable it's likely to be, though a higher EPS isn't a guarantee of future performance. It's important to remember that the quality and reliability of a

company's EPS ratio can be influenced by how the company reports earnings and expenses.

This study recommends that firms, especially those operating in infant industries like agriculture, should ensure that they have good and robust dividend policies in place. This will enhance their profitability and attract investments to the sector.

LITERATURE REVIEW

According to Welsch[14] (1992), through the approval of the board of directors are usually distributed cash dividends to shareholders. It can also include the dividend in shares or other form of payment. Stock dividend is a distribution of additional shares to holders of ordinary shares[5] (Higgins, 1998: 217).

On the other hand, Ross (2002: 66) the profit is divided into two parts; either retained earnings or paid as dividends.[11] While Wild et al. (2005: 96)[15] and Kieso (2004: 132-141) suggests that retained earnings are the main source of the distribution of dividends to shareholders. Regular cash dividend payments made by companies to shareholders. He also mentioned that dividend decided by the board of directors and can range from zero to nearly every company can afford to pay.[9]

Choosing the appropriate dividend policy is one of the important factors for assessing corporate performance. The behaviour of the dividend policy is one of the most debatable issues in financial literature and still maintains a noticeable place in emerging markets (Hafeez et al., 2018).[16]
Hafeez, M. M., Shahbaz, S., Iftikhar, I., & Butt, H. A. (2018).
Impact of Dividend Policy on Firm Performance.
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Few studies have investigated the effect of dividend policy on financial performance, especially in emerging countries. Enekwe et al., (2015)[17] tested the impact of dividend pay-out on the performance of cement companies in Nigeria over 12 years,using three variables to measure company performance: return on capital employed (ROCE); return on assets (ROA) and return on equity (ROE) as dependent variables and dividend pay-out ratio (DPR) as the independent variable to measure dividend policy. The result detected a strong relation between dividend pay-out ratio (DPR) with all of the dependent variables (ROCE, ROA and ROE).

Chelimo and Kiprop (2017) also aimed to study how dividend policy effects shares prices for insurance companies. Dynamic regression analysis was used to establish the relationship between dividend policy and share price.[3] The result revealed that dividend distribution, dividend yield, earnings per share and inflation have a common importance in predicting the value of the share price. The same result was achieved by Nishat and Irfan (2004) who detected that dividend policy measured through dividend yield and pay-out ratio both had important effects on share price volatility.[18]

OBJECTIVES OF THE STUDY

This paper focuses on the analyses of the impact of dividend policy on company financial performance. The objective of the study is to examine the effect of dividend policy on the profitability of listed agricultural companies of India. These are

1. To study the effect of return on assets (ROA) on dividend policy;

2. To study the effect of return on equity (ROE) on dividend policy;
3. To study the effect of earnings per share (EPS) on dividend policy.

HYPOTHESIS

H_{01}: Return on assets (ROA) has no significant effect on dividend policy of listed agricultural companiesofIndia.
H_{02}: Return on equity (ROE) has no significant effect on dividend policy of listed agricultural companies of India.

H_{03}: Earnings per share (EPS) has no significant effect on dividend policy of listed agricultural companies of India.

RESEARCH METHODOLOGY

The study adopts the panel data approach to examine the association between dividend payout ratio, return on assets, return on equity and earnings per share. A sample of 8 listed agricultural companies of India is used for the period of 15 years from 2007- 2021. Dividend policy was taken as dependent variable measured by dividend payout ratio, while profitability as independent variable proxies by returnon assets, return on equity and earnings per share. Following table shows the independent and dependent variables of Dividend Policy of our study:

Dividend Policy and Profitability		
Sr. No.	**Profitability (Independent Variables)**	**Dividend Policy (Dependent Variable)**
1	Earnings Per Share (EPS)	Dividend Payout Ratio
2	Return on Equity (ROE)	
3	Return on Assets (ROA)	

Table 1 : Dependent and Independent Variables of the study

Multiple regression model was utilized to determine the effect of these different variables on dividend policy. The model used in this study is as follows:

$$DPR = \beta_0 + \beta_1. EPS$$
$$DPR = \beta_2 + \beta_3. ROE$$
$$DPR = \beta_4 + \beta_5. ROA$$
$$DPR = \beta_6 + \beta_7. EPS+ \beta_8. ROE+ \beta_9. ROA$$

Where
DPR = Dividend Payout Ratio
EPS = Earnings Per Share
ROE = Return on Equity
ROA = Return on Assets

	EPS	ROE	ROA	DPR
Mean	22.83	11.11	5.95	12.28
S.D.	9.80	1.58	0.56	4.03
Min Value	3.04	2.48	2.94	0
Max Value	158.17	21.71	10.10	41.62

Table 2 : Descriptive Statistics calculated using MS Excel

Above table shows the depths of the descriptive statistic of the variables utilized in the study.Dividend policy was taken as the dependent variable measured by dividend payout ratio. The dividend payout ranges from -22.85 to 41.62 with a standarddeviation of 4.03 and a mean value of 12.28. While profitability was used as independent variable proxies by return on assets, return on equityand earnings per share. The return on assets ranges from 2.94 to 10.10 with a standard deviation of0.56 and mean value of 5.95. The return on equity ranges from 2.48 to 21.71 with a standarddeviation of 1.58 and a mean value of 11.11. The earnings per share range from 3.04 to 158.17 with a standard deviation of 9.8 and a mean value of 22.83.

Correlation and Regression analysis is conducted to test the significant relationship between DPR, EPS, ROE and ROA; using MS Excel.

	DPR		
	r	R^2	F Value
EPS	r = 0.0231	$R^2 = 0.0005$	0.93
ROE	r = 0.3170	$R^2 = 0.1005$	0.25
ROA	r = 0.2013	$R^2 = 0.0405$	0.47

Table 3 : Correlation and Regression Analysis

Above table shows that there is a positive correlation between Earnings per share and Dividend Payout Ratio but from the F value it is concluded that the relationship between them is not significant. Similarly, there is a positive correlation between Return on Equity and Dividend Payout Ratio but from the F value it is concluded that the relationship between them is not significant. In the same way, there is a positive correlation between Return on Assets and Dividend Payout Ratio but from the F value it is concluded that the relationship between them is not significant. The data is analyzed at 5% level of significance.

RESULTS AND RECOMMENDATIONS

1. Return on assets (ROA) has no significant effect on dividend policy of listed agricultural companies of India.
2. Return on equity (ROE) has no significant effect on dividend policy of listed agricultural companies of India.
3. Earnings per share (EPS) has no significant effect on dividend policy of listed agricultural companies of India.

Since the relationships between the variables are not significant further functional relationship between the variables cannot be obtained. It may happen that the company is not declaring the dividends even if they are making profits. The study recommends that the companies should adopt policy and strategy on efficient use of their assets that would enable them to generate profits to meet up with dividends payment regularly to attract more investors. This is because investors assume that a firm which pays dividend regularly is an evidence that the company is healthy financially.

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