CHAPTER II

LITERATURE REVIEW OF EMPIRICAL WORK ON THE IMPACT OF DIVIDEND POLICY ON SHAREHOLDERS’ WEALTH

The literature review shows the way for the researcher to have the better aptitude to discover the research methodology used by a variety of other researchers in the earlier period. It also directs him about the limitations of a range of available procedures and the facts and figures, well-expressed, revelation and understanding of the ambiguous results. It discovers the avenues for future research on the basis of the present research efforts related to the particular subject. The available works of the other researchers assist the researchers in case of the contradictory and surprising results.

As far as the impact of dividend policy on shareholders’ wealth is concerned, a number of researches have been carried out on its diverse facets by the researchers, economists, academicians in the subcontinent and overseas. Different researchers have accomplished research on the impact of dividend policy on shareholders’ wealth from different perspectives.
An attempt to incorporate literature review of empirical work on different aspects of the impact of dividend policy on shareholders’ wealth has been made in this section.

J E, Krishman\(^{xii}\) (1933) in his book said that Gordon’s model of dividend relevance is also describe as a bird- in- the- hand- argument. Logic is- what is available at present is preferable to what may be available in the future.

John Lintner\(^{xiii}\) (1956) in his study entitled “Distribution of incomes of corporate among dividends, retained earnings and taxes” revealed corporate dividend behaviour. His study of corporate dividend behaviour showed that firms set long-run target payout ratios, managers were concerned more about the change in the dividend than the absolute level, dividends had tendency to follow earnings, but smoother path than earnings and dividends were sticky in nature.

M H miller and F Modigliani\(^{xiv}\) (1961) in their study explained that the most comprehensive argument in support of the irrelevance of dividends is provided by the hypothesis.

Gordon\(^{xv}\) (1962) said that investors are not indifferent; rather they would prefer near dividend to distant dividend.
J E, Walter\textsuperscript{xvi} (1963) explained that the investment policy of a firm cannot be separated from its dividends policy and both are interlinked.

John A. Brittain\textsuperscript{xvii} (1966) conducted an extensive study of corporate dividend behaviour with the help of Lintner model by substituting cash flow for profit and dividing cash flow into profit and depreciation. His study revealed substantial support for the Lintner argument, particularly in the modified forms adopted by him.

Eugene Fama and H. Babik\textsuperscript{xviii} (1968) in their study entitled “Dividend Policy: An Empirical Analysis” made careful and thorough study of Lintner model. The study too bears out the Lintner model.

J Purnanandam\textsuperscript{xix} (1969) found that the linter model adequate in explaining corporate behaviour in India.

Soloman, E\textsuperscript{xx} (1969) in his book expressed that the crux of the argument supporting the irrelevance of dividends to valuation is that the dividend policy of a firm is a part of its financing decision. As a part of the financing decision the dividend policy of the firm is a residual decision and dividends are a passive residual.

Elton and Gruber\textsuperscript{xxi} (1970) have shown that investors in high income brackets have a preference for capital gains over dividends while those in low tax brackets favour dividends.
Brigham E F\textsuperscript{xxii} (1971) has said in his book that dividend policy of the firm affects both the shareholders’ wealth and the long term growth of the firm. The optimum dividend policy should strike the balance between current dividends and future growth which maximises the price of the firm’s shares.

R R. Pettit\textsuperscript{xxiii} (1972) has said that the informational content argument finds support in some empirical evidence. It is contended that changes in dividends convey more significant information than what earnings announcements do.

S.C. Kuchhal\textsuperscript{xxiv} (1979) has stated that dividend decision belong to critical area of financial management which brings in to open the conflicts of interest between management and the shareholders and also between one group of shareholders with another.

Farrelly, Gail E., H. Kent Baker and Richard B. Edelman\textsuperscript{xxv} (1986) in their study entitled “Corporate Dividends: Views of Policy Makers” surveyed 318 New York stock exchange firms and concluded that the major determinants of dividend payments are anticipated level of future earnings and pattern of past dividends.
Narayanan and Burthwal\textsuperscript{xxvi} (1990) have tried to examine the relationship between profitability and structure, using a sample of 38 pharmaceutical firms in India for the period 1970-1982 in their study entitled “Profitability and Structure: A Firm Level Study of Indian Pharmaceutical Industry”. With a view to finding out the determination of profitability, two measures of profitability i.e. net profit to total sales revenue ratio and net profit to total assets have been used by them to carry out the study. The outcome of the study was that the vertical integration was the most significant determinant of the profitability of the firms in the pharma industry under the condition of price controls. The analysis also demonstrated that size of the firm and advertising intensity were not found to be major determinants of profitability due to the inability of the firms to translate their market power into prices, because of controls. It was also demonstrated by the study that the coefficient of growth rate of sales were positive and significant because factors on the demand side of a firm had a greater impact on profitability than on the supply side.

Pruitt, S.W. and Gitman, L.W\textsuperscript{xxvii} (1991) in their study entitled “The interactions between the investment, financing, and dividend decisions of major US firms” asked financial managers of the 1000 largest U.S. and
reported that, current and past year profits are important factors influencing dividend payments.

D, Souza, J. (1999) in his study entitled “Agency cost, market risk, investment opportunities and dividend policy- an international perspective” found that dividend payout ratio has a positive but insignificant relationship in the case of growth and negative but insignificant relationship in case of market to book value.

Baker,H.Kent, and Garry E. Powell (2000) in their study entitled “Determinants of Corporate Dividend Policy: A Survey of NYSE firms” conclude from their survey of NYSE-listed firms that dividend determinants are industry specific and anticipated level of future earnings is the major determinant.

Ho, H. (2003) in his study entitled “Dividend Policies of Australian and Japan” shows that Australian firms’ found that dividend policies are positively affected by size but their counterparts in Japan have them positively affected by the liquidity, while risk has a negative effect. The dominant favourable tax effect of dividends in Australia, and the positive side effect suggest that transactions cost is a key determinant of distributing payments to shareholders in Australia but not in Japan, possibly because of its relatively small sized firms.
Omran, M. and Pointon, J. (2004) in their study entitled “Dividend Policy, Trading characteristics and Share Prices: Empirical Evidence from Egyptian Firms” found that for non-actively traded firms, the accounting book value is important determinant for dividend policy. But, for actively traded firms, gearing ratio and the market to book value are more important determinant of dividend policy.

Hu, Y and Liu S (2005) in their study entitled “Empirical Analysis of Cash Dividend Payment in Chinese Listed Companies” conclude that there is a positive relationship between the current earnings of a company and the cash dividend they pay, and a significant negative relationship between the debt to total assets and dividends.

Baker Kent H. and Dutta Gandhi, D (2007) in their study entitled “The Perception of Dividend by Canadian Managers: New Evidence” reported that Canadian dividend paying firms are significantly larger and more profitable, having greater cash flows, ownership structure and some growth opportunities.

M Y Khan and P K Jain (2007) stated that the dividend policy decision involves the choice between distributing the profits belonging to the shareholders and their retention by the firm. The selection would be influenced by the effect on the objective of maximising shareholders’ wealth.
Prasanna Chandra \( ^{xxxv} \) (2008) has said that the dividend payout ratio depends on factors such as funds requirement, liquidity, shareholders preferences, control and taxes.

I M Pandey \( ^{xxxvi} \) (2008) has summarised that wealth maximisation is superior to profit maximisation since wealth is precisely defined as net present value and its accounts for time value of money and risk.

D. Chandra Bose \( ^{xxxvii} \) (2010) has explained in his book that “As the shareholders are technically the owners of the company, their desire cannot be overlooked in spite of the directors’ liberty of the disposal of firm’s earnings.

From the above review of empirical works, it is clear that different authors have approached Dividend Payment Decision analysis in different ways in varying levels of analysis. These different approaches helped in the emergence of more and more literature on the subject over time. It gives an idea on extensive and diverse works on Dividend Payment Decision analysis. It has been noticed that the studies on Dividend Payment Decision analysis in various sectors provide divergent results relating to the study period overlap or coincide. The main reason for divergence in the results is use of different method for the measurement of Dividend Payment Decision analysis. All the studies aimed to analyse the Dividend Payment Decision analysis in Indian manufacturing sector.
with number of factors. It has been noticed that studies on the Dividend Payment Decision analysis in various industries used the variables like sellers’ concentration, advertising intensity, and economies of scale, absolute capital requirements, leverage, profit variability, firm growth and size. Very few studies appeared which used most of the tools viz. ratios analysis, Dividend trend analysis, determinants of shareholders’ wealth to measure the impact thereon.

The survey of the existing literature reveals that no specific work has been carried out to examine the Impact of Dividend Policy on Shareholders’ Wealth of Selected Major Pharmaceutical Units in India so far after liberalization and product patent regime, although performance of such study cannot be underestimated.

The present study is an attempt in this direction and therefore, aims to enrich the literature of the Impact of Dividend Policy on Shareholders’ Wealth of Selected Major Pharmaceutical Units in India relating to pharmaceutical industry in India. The present study is also an attempt to employ different sophisticated statistical and economic techniques before qualifying any aspect of the Impact of Dividend Policy on Shareholders’ Wealth of Selected Major Pharmaceutical units in India analysis for wider acceptability and appreciation. The present study is modest and unpretentious attempt in this regard.