Impact of Consistent and Stable Dividend on Share Values: Insights from Indian Corporate Firms

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Abstract: *The study undertakes to determine the impact of Dividend Decisions on the value of shares. For this purpose, the study attempts to know whether firms follow consistency in their dividend payments and if that consistency brings an effect on the value of the firm measured by share prices. The firms listed on NSE 100 index has been taken as the sample and the firms are divided into three categories of Consistent Dividend Payers, Irregular Dividend Payers and Consistent as well as Stable Dividend Payers. Test results supported the use of Fixed Effects Method and Driscoll Kraay Robust Standard Errors are employed along to address the issues of multicollinearity, heteroscedasticity and autocorrelation. The results under all the firms, Consistent Dividend Payers, consistent as well as Stable Payers are almost the same which showed that Dividend payout is not an influencing factor of share value aligning with the MM theory of Dividend. But in case of Irregular Payers, Dividend payout appeared to be statistically significant indicating that payment of Dividend signals positive information to the market thereby increasing the value of shares. The results are mixed supporting both the Relevancy and Irrelevancy theory of Dividends.*

Keywords: Consistent Dividend, Dividend Payout, Irregular Dividend Payers, Share Value, Stable Dividend

INTRODUCTION

Dividend Policy has always been a matter of debate in Corporate Finance. Shareholders invest money in firms with the expectation of earning a return. This return is received by them in two forms: (i) Capital Gains and (ii) dividends. The tax deduction on dividend income is higher than that on capital gains if the shareholders fall in the high tax slab. This is one of the reasons why investors prefer capital gains (Brennan,1970). This raises the question of why corporations pay dividends even if it is not mandatory. There may be different reasons for dividend distribution by a company, but it cannot be said with certainty that the reason for distribution is to have an impact on the value of a firm. This brought into picture two schools of thought: dividend relevancy and dividend irrelevancy. Supporters of Dividend Relevancy state that dividend payment impacts a firm's value, while the other school opposes this by saying that it has no impact on a firm's value. Instead of many studies, a proper consensus has never been reached. Almost all previous research has studied the impact of dividend payments, but few studies have focused on the consistency of dividend payments. So the current study is undertaken to determine the changes in the share values by categorizing the firms on the basis of their consistency in Dividend Payments. This classification is novel in its approach as a few studies have studied this kind of consistency and variability in dividends. This classification helps determine whether firms consistent in paying dividends have a greater impact on shareholders' value or whether firms with less consistency show a greater impact. This helps firms decide on their dividend payouts and investors make dividend-related decisions.

REVIEW OF LITERATURE

Dividend decisions were considered relevant while determining the value of the firms (William J 1938; Walter 1956; Gordon 1959). However, with the proposition of the Dividend Irrelevancy theory by Modigliani and Miller (1961), the thoughts on dividends changed. Later, Brown (1977) supported the theory of irrelevancy by finding that dividend announcements have no evidence of affecting firm value. Research on why corporations pay dividends if they are not relevant in valuing firms has begun. Black (1976) developed a paper titled The Dividend Puzzle," with Black supporting the notion that dividend decisions are one of the top ten most difficult problems in Financial Economics. Bhattacharya (1979) laid the foundation of the signaling theory of dividends, which posits that dividend

announcements convey good signals to the market, supporting the relevance theory of dividends. Beyond these, other theories have also examined the reasons for paying dividends with the clientele effect of dividends, stating that the preference for dividends is based on the type of investors a firm has, with retirees preferring dividends as current income, whereas adventurous investors prefer capital gains (Elton & Gruber, 1970). The tax preference theory states that high taxes on dividend income led investors to prefer capital gains (Litzenberger & Ramaswamy, 1982). Agency theory argues that paying dividends can help minimize conflict between managers and shareholders, thus supporting the relevance theory of dividends (Jensen & Meckling, 1976). A firm in its growth stage may pay low dividends to save funds for the future, while a firm in its maturity stage pays a good number of dividends as the growth of the firm becomes stagnant (Deangelo et al,2006) and funds may be used for distribution.

Firms are stable in paying dividends and adjust dividends according to their target payout ratios (Lintner, 1956). Building on this theory, Brittain (1968) also found that dividend payers are profitable, whereas non-dividend payers retain profits for the future. Denis and Osobov (2008) found that dividend payers are larger, more profitable, and more mature, whereas non-payers are smaller and have high growth opportunities. The percentage of dividend-paying firms increased even if dividends are considered irrelevant, showing that dividend-paying firms are profitable, whereas the number of non-dividend payers decreased, showing that dividends are relevant (Sharma & Wadhwa, 2017). Many studies have classified firms into payers and non-payers, but only a few have identified consistent and inconsistent patterns of dividends and their impact on share value. This classification helps in knowing whether consistency and less variability in dividend payments have a different impact than those firms that are not consistent in paying dividends. This classification helps determine whether dividend payments affect firm value.

METHODOLOGY

The current research is analytical in nature, as it aims to gather, analyze, and interpret information to reach conclusions. The study is empirical as it aims to analyze the impact of independent variables on the dependent ones. To achieve the objective, this study uses firms listed on the NSE 100 index as of April 1, 2014. The NSE 100 is taken as the sample as it covers the largest and most traded companies in India. The data for the study were drawn from the Center for Monitoring Indian Economy (CMIE) Prowess database, which is a well-regarded source of corporate information in India. The study covers a period of 10 years from April 1,2014 to March 31,2024 to ensure a robust dataset. All tests were conducted using R software.

Data involving repeated entities over different time periods are called panel data. Regression analysis is best suited for this study as it helps to understand the effects of one variable over the other. The regression equation under this analysis can be studied using three methods: Pooled Ordinary Least Squares (OLS), Fixed Effect Model (FEM), and Random Effect Model (REM). The choice between them is determined using a systematic approach involving the Breusch Pagan (BP) and Hausman tests. Panel data regression analysis necessitates that the data be free from multicollinearity, heteroskedasticity, cross-sectional dependence, and autocorrelation. If the data are not free from all of these, Driscoll Kraay Robust Standard Errors can be applied to handle these issues (Kraay & Driscoll, 1998).

The firms in the sample are divided into four categories.

1.All firms: All firms in the sample without any categorization.

2.Consistent Dividend Payers: Those Firms with a dividend history of seven years or more.

3.Irregular Dividend Payers: Those Firms with a dividend history of less than seven years.

4.Consistent and Stable Dividend Payers: The top 10 consistent firms that showed the lowest variability in their dividend payments.

The analysis is thus conducted over four types of categories to determine whether dividend payments have differing impacts on different categories.

To determine the effect of dividend payments on share value, the following Regression Equation is formed:

$$\textbf{ShareValue}=\beta_0+\beta_1 MCap_{it}+\beta_2 EPS_{it}+\beta_3 P/E_{it}+\beta_4 NCFO_i t+\beta_5 CashEq_{it}+\beta_6 OPM_{it}+\beta_7 NPM_{it}+\beta_8 ROE_{it}+\beta_9 \text{Current Ratio}_{it}+\beta_{10} DebtEquity_{it}+\beta_{11} DPR+u_{it}$$

Where

i represents the firm, and t represents the year.

β_0 is the model's intercept.

$\beta_1 \ldots, \beta_{11}$ are the coefficients corresponding to the control variables: market capitalization (MCap), Earnings Per Share (EPS), price-to-earnings ratio (P/E ratio), Net Cash Flow from Operating Activities (NCFO), Cash and Cash Equivalents at Year-End(CashEq), Operating Profit Margin (OPM), Net Profit Margin (NPM), Return on Equity (ROE), Current Ratio and Debt-to-Equity Ratio (D/E ratio); while $\hat{a}_{11}$ is the coefficient of the independent variable: Dividend Payout Ratio(DPR) and u_{it} is the error term capturing unobserved effects.

The Share value is estimated by taking the average of the daily closing market price of the firm's shares during each financial year.

RESULTS

Treatment of Outliers and Missing data: Outliers were detected but retained as they were. Because extreme values represent real financial behavior, no outliers were dealt with in the sample to capture the effects of real data points. There were 100 firms in the sample containing data for ten years, leading to 1000 firm year observations. First, all missing values were removed from the sample. Then, all financial firms, such as banks and insurance companies, were removed as the workings and compliance of these enterprises differ from those of non-financial firms. The sample is then left with 69 firms, leading to 690 firm-year observations.

Selection of Appropriate Panel

To determine the best estimation method for the panel data, the Breusch–Pagan Lagrange Multiplier (LM test) and Hausman tests were performed, and the results supported the use of the Fixed Effects Model.

Checking for Assumptions: When the assumptions were checked, the data were not found to be free from the issues of multicollinearity, autocorrelation, and heteroscedasticity in each of the categories. Therefore, Driscoll Kraay Robust Standard Errors were applied, and the results were analyzed under each category.

Regression Results: The regression results for each category are presented below with their estimates and standard errors:

Table 1: Regression Results

Variables	69 Firms (All firms)	39 Firms (Consistent Dividend Payers)	15 Firms (Irregular Payers)	10 Firms (Consistent as well as Stable Payers)
Dividend Payout	0.04 (0.10)	0.67 (1.39)	0.18*** (0.07)	-0.94 (1.29)
Earnings Per Share	15.56*** (3.65)	23.06*** (2.53)	33.32*** (8.57)	27.38*** (4.37)
Market Capitalisation	0.0017*** (0.0005)	0.0019*** (0.0005)	0.0031*** (0.0003)	0.00077* (0.0004)
Price to Earnings Ratio	0.68** (0.28)	3.24*** (0.94)	0.40 (0.34)	12.30*** (2.41)
Net Cash Flow from Operations	-0.02** (0.01)	-0.03** (0.02)	-0.03*** (0.01)	-0.01*** (0.00)
Cash & Cash Equivalents	-0.005 (0.01)	-0.0003	-0.04 (0.03)	0.02 (0.02)
Operating Profit Margin	-1.28 (1.16)	0.04 (2.01)	-5.65 (4.09)	-0.83** (0.33)
Net Profit Margin	2.00 (5.67)	-3.05 (4.30)	9.60 (8.43)	-26.78*** (7.47)
Return on Equity	-3.94 (2.73)	-5.12 (3.63)	-75.594	-4.58*** (1.32)
Current Ratio	51.91*** (17.5)	-73.76** (37.01)	-31.61 (51.56)	-5.42 (18.36)
Debt/Equity	39.58 (148.34)	-18.74 (137.90)	348.39*** (94.26)	-5.74 (126.99)

Numbers = Estimate (Standard Error), ***p<0.01, **p<0.05, *p<0.1

The results in Table 1 show that the effect of dividend payments is not uniform across all types of firms. For all 69 firms, dividend payout has a small and statistically insignificant impact on share value. For the 39 consistent dividend payers, the value is positive but statistically insignificant, and for the 10 firms that show the lowest variability in dividends, the value is negative and insignificant. This shows that firms that continuously pay dividends do not carry any new signals to the market, as investors are sure about receiving dividends. Interestingly, for the 15 firms that are irregular payers, dividend payout turns out to be positive and statistically significant, indicating that as these firms pay dividends less frequently, payment of dividends sometimes carries a positive signal to the market, thereby influencing shareholders' value. Across all categories of firms, EPS and market capitalization are important drivers of share value. The remaining variables exhibited mixed effects across the various categories.

The results align with classic dividend theories, the signaling theory for irregular payers, and dividend payments that provide a positive signal to the market. Conversely, Modigliani and Miller suggest that under perfect market dividends do not have any influence on shareholders' value, which aligns with the negligible and negative impact found in consistently dividend-paying firms. However, these results disagree with those of studies conducted by (Qi Qin, et.al.,2022; Kapon et al. (2023), who found that stability and consistency in dividends lead to an increase in the value of a firm. The results support both schools of thought, Dividend Relevancy and irrelevancy, suggesting that Dividend Relevance is conditional upon dividend predictability and investor perception.

DISCUSSION

The division of firms into different categories helped us understand the differing impacts of Dividend Payout. When all the firms in the sample were analyzed, dividend payout appeared to be statistically insignificant, aligning with the results of Modigliani and Miller that Dividend decisions do not influence the value of shares. For those 39 Consistent Dividend Payers, the value, however, became slightly positive but remained insignificant, again supporting the Irrelevancy School of Dividend. When from those 39 firms the top 10 firms with the lowest variability in their dividend payments were analyzed, the value became even more negative and statistically insignificant, indicating that only stability in payouts does not ensure a firm's value until the investors consider those firms good enough in other metrics. However, surprisingly, for the 15 firms that were not regular in paying dividends, the value of the estimate was positive and statistically significant, which shows that dividends carry important information for those firms in the market and act as a positive signal, aligning with the Signaling Theory of Dividends. The results thus show mixed evidence and lead to the conclusion that dividends may not be a uniform driver of share value, but their relevance is context-dependent. They matter for firms that follow investor-oriented payout strategies.

However, the categorization of firms into small subsamples may lead to biased estimates, as smaller samples generally lead to larger standard errors.

CONCLUSION

To know the impact of Dividend Decisions on the Share Value, this study considers the firms listed on the NSE 100 index and studies the firms over a period of 10 years. To determine the effect, the firms in the sample were first analyzed as a whole and then divided on the basis of their consistency in Dividend Payments, leading to three categories: 1) Consistent Dividend Payers, 2) Irregular Dividend Payers, and 3) consistent as well as Stable Dividend Payers. Regression analysis was conducted for each category, and the results were obtained. The results of all firms in the sample, consistent payers, and consistent as well as stable payers did not find dividend payments to be a significant factor in affecting market prices. However, in the case of irregular payers, dividend payout significantly affects the value of shares. This shows that consistency in Dividend Payments has nothing to do with shareholders' Value. Earnings Per Share (EPS) as well as Market Capitalization(MCap) appeared to be significant variables under all categories, which means that firms with higher EPS and higher MCap have higher share values. Thus, Dividend Payout may not be a uniform driver of the firm's value, but earnings per share and market capitalization are major components.

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