

## Does Dividend Policy Influence Financial Performance? Evidence from Selected IT Companies in India

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### Abstract

The purpose of the study is to examine the impact of Dividend Policy on firm's financial performance; especially on selected Indian IT Companies. The data have been collected from the annual reports, journals and money control website. Panel data regression model has been applied to examine the impact of dividend policy on financial performance of Selected Indian IT Companies for the study period ranging from 2011 to 2020. For the purpose of the study, we have considered 10 Indian IT sector companies on the basis of their Revenue and Market Capitalisation. Findings of the study reveal that Net Profit, Firm size and Dividend pay out Ratio have statistically significant effects on financial performance.

**Keywords:** Financial performance; ROA; ROCE; Dividend Payout; Firm Size; Net Profit.

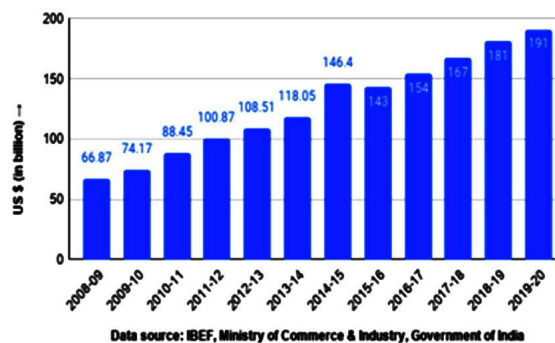
## INTRODUCTION

The Information Technology (IT) industry is a vital part of the technology driven knowledge economy of the twenty first century. Because of its impressive IT industry, India has been dubbed a knowledge economy around the world. The IT industry includes IT services, IT enabled services (ITES), Software and Hardware goods and e-commerce (online business). This industry has a significant impact on increasing the productivity in practically every other sector of the economy, it also has enormous potential for further rapid growth and development. Information technology

has not only aided the country's economic progress but it has also improved governance efficiency and responsiveness. In the world's economies, India's IT industry has risen at an unprecedented rate. In the previous two decades, all sub-sectors of this industry (hardware items have seen less success) have increased revenue and fuelled the rise of the Indian economy.

Indian IT industry is still showing positive signs and has the resilience to overcome the unprecedented

Graph 1: Market Size of India's IT Industry



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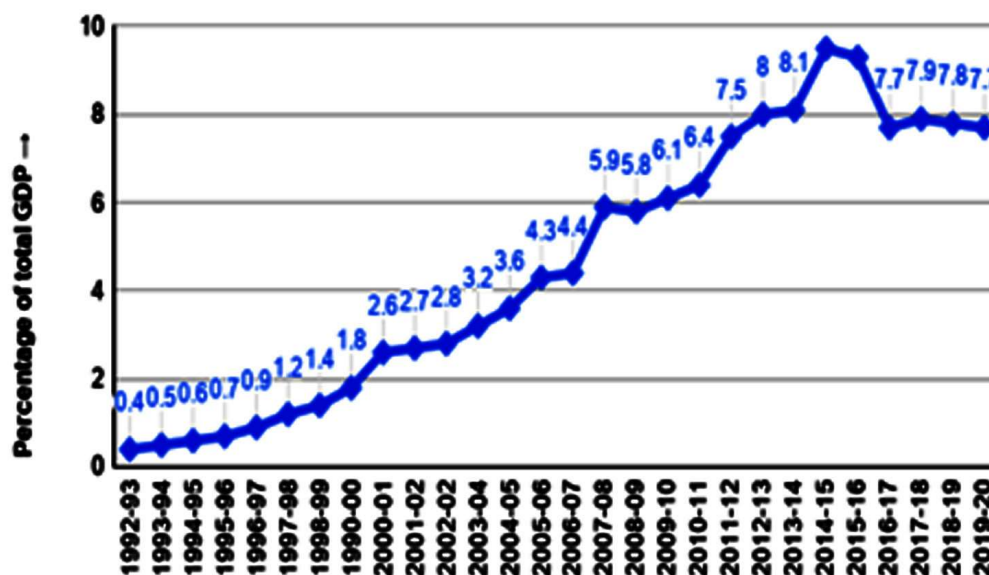
tragedy of Covid-19. It has emerged as a global economic force and a major contributor to the Indian economy in particular and the world in general.

After the 1991-92 economic reform, the Indian IT industry grew at a breakneck pace, with an exponential growth rate. Thousands of centres have been established by Indian IT companies in India and about 80 locations across the world. India, which accounts for about 55 percent of the global service sourcing industry (US \$200-250 billion) in 2019-20, is where the majority of global firms source IT-ITES. The IT industry's market size (particularly export) has increased dramatically from approximately 67 billion dollars in 2008-09 to 191 billion dollars in 2019-20 (Graph 1). Revenue is predicted to expand at a faster rate in the following years, reaching 350 billion US dollars by 2025. The unique aspect of India's IT industry is that, while it grows in terms of market size, it is also incrementally adding a major share of India's gross

domestic product (GDP), so helping the country's growth and development. The IT industry generated roughly 8% of India's overall GDP in 2017-18, up from a meagre 0.4 percent in 1991-92. (Graph 2). By 2025, this percentage is predicted to rise to 10%. In this situation, it is the time to consider the financial performance of Indian IT companies. Financial Performance can be viewed from various perspectives and there are different indicators for measuring a firm's performance. Financial Performance means how well a firm is doing effectively and efficiently its policies and operation in the Industry in monetary terms. These results are manifested in the firm's Return on Assets, Return on Investment and Dividend Policy, etc. By financial analysis we may say current and future performance and position of a firm on the basis of historical data collected from the annual reports.

Dividend policy of a organisation are sets in such a way that provides the management with

Graph 2: IT Industry's share in GDP (in%)



guidelines and rules to determine the how much of firm's return to be retained and how much to be distributed to the shareholder as cash dividend respectively. However, the dividend decisions of the organisation are mostly depended on financial performance. The study has tried to examine the impact of dividend policy on financial performance of selected Indian IT companies.

For the purpose of the study, we have organized the whole paper into five chapters. Chapter 1 includes Introduction. The rest of this paper is organized as follows: Chapter 2 contains an overview of the existing literature, research gap,

objectives and hypotheses. Chapter 3 describes the variables, research framework, basic models and methodology used for this study. Chapter 4 presents and discusses the analysis and findings of the study and Chapter 5 provides a conclusion.

## REVIEW OF LITERATURE

For the purpose of the study, we have reviewed some literatures. A few of them are mentioned below.

*Usha, S. (2008)*<sup>1</sup> conducted a study for measuring financial Performance of 65 Software companies

in India, and the result of the analysis shows that some of the selected ratio have shown inconsistent performance (Debt Equity ratio, Interest coverage ratio, Price Earnings ratio, Return on Shareholder's Fund, Return on Total Assets, EBIT/Net Sales, Net profit After tax/Net Sales, Dividend Payout ratio And return on Investment). From multiple regression analysis of the selected company, it is observed that Net Sales, Long Term Debt, Operating Expenses, Net Worth, Networking Capital & Retained Earning influencing Operation Profit but Current Liability and Fixed Assets do not have significance influence on the Operating Profit.

*Sharma, N. (2011)*<sup>2</sup> in her study on financial performance of passenger and commercial vehicle segment of the automobile industry used four financial parameters namely, liquidity, profitability, leverage and managerial efficiency analysis for the period from 2001-02 to 2010-11. She found that profitability and managerial efficiency of Tata motors as well as Mahindra & Mahindra Ltd are satisfactory but their liquidity position is not satisfactory. The liquidity position of commercial vehicle is much better than passenger vehicle segment. *Daniel, A.M.J., (2013)*<sup>3</sup> has made a study to analyze the effect of the financial strength and weakness of the Tata motors Ltd. using past 5 years financial statements on the basis of Trend analysis & ratio analysis used to comment of financial status of company. The Study conclude that financial performance of the company is satisfactory and also suggested to increase the loan levels of company for the better performance. *Meften, H.S., Tirkey, M.R. (2014)*<sup>4</sup> have made a study to analyze the financial analysis of Hindustan petroleum corporation Ltd. by using secondary data. They found that the company has got excellent gross profit ratio and rising trend during the study period. The net profit for the year 2010-11 is excellent & it is 8 times over the past year indicating reduction in operating expenses and large proportion of net sales available to the shareholders of the company *Ganga, M., Kalaiselvan, P., Surya, R. (2015)*<sup>5</sup> in their study conclude that the financial performance of Equitas Micro Financial Private Limited on the basis of Current Ratio are satisfactory, but Liquid Ratio are much more than ideal ratio (1:1); but on the basis of correlation & regression analysis the companies' income and expenses are deviate but as per trend analysis the company's position is increasing. *Ravichandran, M., Subramaniam, V. (2016)*<sup>6</sup> has made a study to analyse financial performance of Force Motor Limited for 5 years (2011-15) to show their viability, stability and profitability using various financial tools such as gross profit ratio,

operating profit ratio, net profit ratio, return on capital employed, return on net worth, current ratio, quick ratio, debt equity ratio. They found that company has got enough fund to meet its debts and liability because liquid and solvency ratio are very strong. And company can further improve financial performance by reducing the administrative, selling and operating expenses. *Kumar, A. (2018)*<sup>7</sup> in their study conclude that the financial performance of 4 IT companies on the basis of Gross profit ratio, Net Profit ratio, Current Ratio and return on capital ratio all the 4 companies statistically significant but TCS performance better among the other three companies (Infosys, Wipro, HCL) but on the basis of Return of Equity all the companies are statistically significant but HCL ranked top among the other three company. *Kanagavalli, G., Devi, R.S. (2018)*<sup>8</sup> in their study analyse the financial performance of 3 Automobile Companies for periods 5 years (2013-17). The study found that there is the positive strong relationship of liquidity ratio because of efficient inventory management and less conversion period. But solvency ratio little risk to meet their long term Obligation. Among the three companies, the Hero Motocorp company's efficiency and turnover and Profitability ratio are high rank because of good assets and recourse management. But Bajaj Auto & TVS Motor are also satisfactory for their performance. *Narayanan, R., Sharma, S. (2019)*<sup>9</sup> has made a study for analysing financial performance of maruti Suzuki India Limited of 5 Years (2013-2018). The result of the analysis shows that some of the selected ratios have shown good performance of the company like EPS & DPS' and it also growing than it earlier. The Liquidity & Debt Equity Ratio shows the company's ability to meet its immediate obligation promptly. *Husain, T., S., Sunardi, N. & L. (2020)*<sup>10</sup> conducted a study of 11 firms under the automotive and components subsector using profitability (ROA) as an independent variable and firm Value (Price to Book value) as a dependent variable and dividend policy as a mediating variable and on the basis of path analysis we may conclude that profitability ratio has no significant effect on dividend policy, while dividend policy has no significant effect on firm value too. However, the dividend policy does not mediate the effect on profitability ratio on the firm value. *Murekefu, T.M., Ouma, O.P. (2010)*<sup>11</sup> has analysed the relation between dividend payout and firm performance on the basis of regression analysis and taking dividend paid, total assets and revenue as an independent variable and profit margin as a dependent variable, he found that all the independent variable are positively significant

to measure the firm performance. *Chashmi, N., Fadaee, M. (2016)*<sup>12</sup> has been investigated the impact of financial performance and growth opportunity of success and failure of listed company on the basis of Earning per share, Return on equity, Return on Assets and Growth Opportunity as a Dependent variable and firm size as control variable and success and failure as a independent variable, they found that Return on equity and growth Opportunity are not statistically significant as a measure of financial performance and success or failure but in case of Return on assets and Earning per share are statistically significant as a measure of financial performance and success or failure. *Farrukh, K., Irshad, S., Khakwani, M.S., Ishaque, S., Ansari, N.Y. (2017)*<sup>13</sup> has analysed the impact of dividend policy on shareholders wealth and firm performance on the basis of EPS, Share Price and Return on equity as a dependent variable and Dividend Policy (Dividend per share and Dividend Yield) independent variable, they found that the dividend policy are positively related in EPS, share price & RO. *Kimunduu, G.M., Mwangi, M., Kaijage, E., Ochieng, D.E., (2017)*<sup>14</sup> has analysed the financial performance and dividend policy on the basis of return on equity, operating cash flow and price earning jointly as a indigent variable and dividend as a dependent variable the found that the firm performance and dividend policy are significant. *Kolawole, E., Sadiq, M.S., Lucky, O., (2018)*<sup>15</sup> conducted a study on the effect on the dividend policy on the performance of listed oil and gas firms on the basis of secondary data. The findings indicate that dividend payout ratio and earning per share have significant and positive affect on the EPS of listed Oil and gas firms in Nigeria while Dividend yield had significant but negatively affect the earning per share. *Sondakh, R. (2019)*<sup>16</sup> for their study analysis the effect of dividend policy, liquidity Ratio, Profitability Ratio and Firm Size to measure the firm value using multiple linear Regression model (One Sample Kolmogorov-Smirnov test); found that dividend policy has a negative and significant effect on the firm value Liquidity and Firm Size partially influence positively and significantly on firm value while profitability ratio is not significant to measure the firm value. *Kanakriyah, R. (2020)*<sup>17</sup> has conducted a study dividend policy and firm financial performance of 92 industrial and service sector company on the basis of Return on assets

(ROA) and Return on equity (ROE) as a dependent variables and dividend as an independent variable and some control variables like, firm size, leverage ratio and liquid ratio have been used. He found that two dependent variable like ROA and ROE are statistically significant to measure the firm financial performance.

## RESEARCH GAP

Based on there view of literature, it is found that most of the studies related to the measures of financial Performance; which were conducted in foreign countries. There are a few studies that have been made on Dividend Policy conducted in India. Therefore, we have undertaken the study to analyse the financial performance on the basis of Liquidity, Profitability and Dividend Policy of selected Indian IT companies.

## OBJECTIVE OF THE STUDY

- To study the impact of Dividend policy on financial performance of IT Sector Companies in India.
- To study the impact of Firm Size on financial performance of IT Sector Companies in India.
- To study the impact of Net Profit on financial performance of IT Sector Companies in India.

## HYPOTHESIS OF THE STUDY

*The Following hypotheses have been considered in the present study:*

- H<sub>0</sub>1: Dividend payout ratio has no significant effect on Financial Performance of Selected IT sector Company in India.
- H<sub>0</sub>2: Firm Size has no significant effect on Financial Performance of Selected IT sector Company in India.
- H<sub>0</sub>3: Net Profit has no significant effect on Financial Performance of Selected IT sector Company in India.

We have considered the following variables so as to fulfil the objectives of the study

In this study, five variables have been considered, viz. ROA, ROCE, D/P Ratio, Firm size and Net Profit Ratio among which the first two are the

dependent variables, while the last three are the independent variable.

## RESEARCH FRAMEWORK

A schematic figure of the current research framework is provided below

## BASIC MODELS & RESEARCH

## METHODOLOGY

For the purpose of the study, Return on Assets and Return on Capital Employed are used as proxies of the financial performance and dividend pay-out ratio is used as proxy of the dividend policy. Firm size and net profit ratio are used as control variables.

### Variables Used

| S. No. | Variable                   | Abbreviation | Measurement                                |
|--------|----------------------------|--------------|--------------------------------------------|
| 1      | Return on Assets           | ROA          | (Net Income/ Total Assets) *100            |
| 2      | Return on Capital Employed | ROCE         | (EBIT/ Capital Employed) *100              |
| 3      | Dividend pay-out Ratio     | D/P ratio    | Average Dividend/ Average Profit after Tax |
| 4      | Firm size                  | Ln_Firm size | Total Assets of the Firm.                  |
| 5      | Net Profit Ratio           | NP           | (Net Profit/Sales) *100                    |

Source: Own calculation

### Independent Variables

**Firm Size**  
(Total Assets of the Firm.)

**Dividend Payout**  
(Total Div./Net Income.)

**Net Profit**  
(NP/Sales)

### Dependent Variables

- Return on Assets (ROA)**
- Return on Capital Employed (ROCE)**

Fig. 1: Current research framework.

### Basic model of the Study:

$$ROA = f(\text{Ln\_size}, \text{NP}, \text{Dividend Pay-out}) \dots \dots \dots (i)$$

$$ROCE = f(\text{Ln\_size}, \text{NP}, \text{Dividend Pay-out}) \dots \dots \dots (ii)$$

### The equation for the fixed effects model:

$$Y_{1it} = \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \alpha_i + \text{uit} \dots \dots \dots (i)$$

$$Y_{2it} = \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \alpha_i + \text{uit} \dots \dots \dots (ii)$$

Where,  $Y_{1it}$  = the return on asset (ROA)

$Y_{2it}$  = the return on asset (ROCE)

$X_{1it}$  = Total Assets of the firm.

$X_{2it}$  = Dividend Payment per year.

$X_{3it}$  = Net Profit During the year.

$\beta_1, \beta_2$  and  $\beta_3$  are the coefficient

$\alpha$  (i=1....n) is the intercept for each entity uit is the error term

i=different IT Company

t=time

The equation for the random effects model:

$$Y_{1it} = \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \alpha_i + \text{uit} + \text{eit} \dots \dots \dots (i)$$

$$Y_{2it} = \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \alpha_i + \text{uit} + \text{eit} \dots \dots \dots (ii)$$

Where, uit= between entity error

eit = Within entity error

**Sources of Data:** The present study is based on secondary data and data is collected from the official website of the Company, Annual reports, journals, Money control website etc. Ten Companies from Indian IT sector were selected on the basis of Revenue and Market Capitalisation.

**Sample Size:** The sample consist the 10 Indian IT sector companies which have been selected for the study on the basis of their Revenue and Market Capitalisation.

**Period of the Study:** The study period has been considered for Ten years, i.e., 2011-2020 to examine the Financial Performance for selected Indian IT sector Companies.

**Tools used for Analysis:** For analysis of the nature of the variables we have used Descriptive Study. We have also conducted Panel Data Analysis both fixed and random effects to examine the performance of selected Indian IT sector Companies.

Table 1 shows that mean value of ROA is 17.3633 and the standard deviation is 5.9775. ROCE ranges from 5.39 to 56.48 with mean value 25.5919 and it has standard deviation of 9.1843. The mean value of Ln\_Firm Size is 9.7536 and its standard deviation is 1.6409. NP extends from 5.13 to 34.18 and its standard deviation is 5.6704. DP ranges from 5.62 to 116.38 with mean value 37.1818 and it has standard deviation of 21.1730.

## ANALYSIS AND FINDINGS

**Table 1:** Descriptive Statistics

| Variables    | Observations | Mean    | Std. Deviation | Min. | Max.   |
|--------------|--------------|---------|----------------|------|--------|
| ROA          | 100          | 17.3633 | 5.9775         | 4.33 | 36.04  |
| ROCE         | 100          | 25.5919 | 9.1843         | 5.39 | 56.48  |
| Ln_Firm Size | 100          | 9.7536  | 1.6409         | 6.92 | 12.64  |
| NP           | 100          | 16.9084 | 5.6704         | 5.13 | 34.18  |
| DP           | 100          | 37.1818 | 21.1730        | 5.62 | 116.38 |

Source: Authors' own calculation

It is seen from Table 2 that ROA, ROCE have significant Positive relation with Firm Size, Dividend pay-out and Net Profit ratio.

## PANEL REGRESSION MODEL

The Regression Model helps in establishing fact that how the particular value of dependent variable will change with any change in one of the independent

**Table 2:** Correlation Matrix

| -            | ROA     | ROCE    | NP      | Ln_Firm Size | DP     |
|--------------|---------|---------|---------|--------------|--------|
| ROA          | 1.0000  | -       | -       | -            | -      |
| ROCE         | 0.9227* | 1.0000  | -       | -            | -      |
|              | 0.0000  | -       | -       | -            | -      |
| NP           | 0.6397* | 0.5177* | 1.0000  | -            | -      |
|              | 0.0000  | 0.0000  | -       | -            | -      |
| Ln_Firm Size | 0.4008* | 0.5123* | 0.1740* | 1.0000       | -      |
|              | 0.0000  | 0.0000  | 0.0000  | -            | -      |
| DP           | 0.3197* | 0.3331* | 0.3873* | 0.0220*      | 1.0000 |
|              | 0.0000  | 0.0000  | 0.0000  | 0.0000       | -      |

Source: Authors' own calculation

variables; while keeping other independent variables fixed. For panel regression analysis, we have to consider which model (Fixed effect model or Random effect model) is best suited for analysis. The Hausman test is used for selecting the effective model for analysis.

Table 3 exhibits the result of Panel Data Analysis under both Fixed and Random effects models. The Hausman Test accepts the Random Effects Model as the expected model for panel data analysis. The p-value (0.000) of the  $\chi^2$  (99.08) of the random effects model shows that the model is a good fit for the study. The value of  $R^2$  indicates that the

**Table 3:** Regression Analysis (Dependent Variable: ROA)

| Model / Independent Variable | Fixed Effect Model Coefficients (p-value) | Random Effect Model Coefficients (p-value) | Hausman Test Chi <sup>2</sup> (p-value) | Preferred Model                                                       |
|------------------------------|-------------------------------------------|--------------------------------------------|-----------------------------------------|-----------------------------------------------------------------------|
| Constant                     | -3.00<br>(0.611)                          | -4.08<br>(0.412)                           | 1.77<br>(0.621)                         | Random Effect Model<br><br>(As the p-value of Chi <sup>2</sup> >0.05) |
| NP                           | 0.96<br>(0.000)                           | 0.91<br>(0.000)                            |                                         |                                                                       |
| Ln_Firm Size                 | 0.34<br>(0.565)                           | 0.56<br>(0.242)                            |                                         |                                                                       |
| DP                           | 0.02<br>(0.611)                           | 0.02<br>(0.223)                            |                                         |                                                                       |
| R <sup>2</sup>               | 0.44                                      | 0.47                                       |                                         |                                                                       |
| F / Chi <sup>2</sup>         | 31.73<br>(0.000)                          | 99.08<br>(0.000)                           |                                         |                                                                       |

\*Significant at 5% level

ROA: Return on Assets, NP: Net Profit, Firm Size: Firm Size, DP: Dividend Payment

*Source:* Authors' own calculation

model is explaining 47% variation of ROA. The p-values of the Coefficients of Net Profit (0.91), Ln\_Firm size (0.56), & Dividend pay-out Ratio (0.02) are lying above the significance level 0.05, except Net Profit. So, we can reject the null hypothesis in case of Net profit and can say that the Net profit have statistically significant effect on ROA. But in case of Ln\_Firm size & Dividend pay-out Ratio, we accept the null hypotheses and can say that the Dividend Pay-out have no significant effect on ROA.

Table 4 shows the result of Panel Data Analysis under both Fixed and Random effects models. The

Hausman Test accepts the Random Effects Model as the expected model for panel data analysis. The p-value (0.000) of the Chi<sup>2</sup> (66.94) of the Random effects model shows that the model is a good fit for the study. The value of R<sup>2</sup> indicates that the model is explaining 53% variation of ROCE. The p-values of the Coefficients of Net Profit (1.05), Ln\_Firm size (3.12), & Dividend pay-out Ratio (0.07) are lying below the significance level 0.05. So, we can reject the null hypotheses and can say that the Net Profit, Ln\_Firm size and Dividend pay-out Ratio have statistically significant effects on ROCE. But

**Table 4:** Regression Analysis (Dependent Variable: ROCE)

| Model / Independent Variable | Fixed Effect Model Coefficients (p-value) | Random Effect Model Coefficients (p-value) | Hausman Test Chi <sup>2</sup> (p-value) | Preferred Model                                                       |
|------------------------------|-------------------------------------------|--------------------------------------------|-----------------------------------------|-----------------------------------------------------------------------|
| Constant                     | -34.81<br>(0.002)                         | -24.93<br>(0.003)                          | 2.86<br>(0.4131)                        | Random Effect Model<br><br>(As the p-value of Chi <sup>2</sup> >0.05) |
| NP                           | 1.19<br>(0.000)                           | 1.05<br>(0.000)                            |                                         |                                                                       |
| Ln_Firm Size                 | 3.87<br>(0.001)                           | 3.12<br>(0.000)                            |                                         |                                                                       |
| DP                           | 0.06<br>(0.018)                           | 0.07<br>(0.014)                            |                                         |                                                                       |
| R <sup>2</sup>               | 0.54                                      | 0.53                                       |                                         |                                                                       |
| F / Ch <sup>2</sup>          | 21.21<br>(0.000)                          | 66.94<br>(0.000)                           |                                         |                                                                       |

\*Significant at 5% level

ROCE: Return on Capital Employed, NP: Net Profit, Firm Size: Firm Size, DP: Dividend Payment

*Source:* Authors' own calculation

all the variables have significant positive impact on Return on Capital Employed. For every 1% change in the Net Profit, the ROCE will increase by 1.05% and for every 1% change in Firm Size and Dividend Payout ratio; the ROCE will increase by 3.12% and 0.07% respectively.

## CONCLUSION

In this study, we have dealt with the impact of dividend policy on Financial Performance of selected Indian IT Companies, and we may conclude that Net profit has a statistically significant effect on ROA; but Firm size & Dividend pay-out have no significant effect on ROA. However, Net Profit, Firm size and Dividend payout Ratio have significantly positive impact on Return on Capital Employed.

In this study two regression models are also used (i) Model I (where ROA is the dependent variable) and (ii) Model II: (where ROCE is the dependent variable). In both cases the random effect regression model is appropriate and significant. So, we may conclude that the dividend policy has a significant impact on performance of the firms, when ROCE is considered as proxy of financial performance.

## LIMITATION OF THE STUDY

The study was conducted only on the 10 Indian IT Companies for 10 years study period 2011 to 2020. Besides, the study is based on historical data; historical data is not always represented accurate results. Another important limitation that we have not captured in this study include government policies, tax rates, inflation, economic condition of the country, etc., that effect directly or indirectly the Dividend Payout, Firm Size and Net Profit. The tools and techniques used in this study may also have some limitations.

## SUGGESTIONS

Keeping the limitations set aside, it is to be hoped that the study has thrown light on the Liquidity, Profitability and Dividend Policy of Selected Indian Information Technology Companies to measure the Financial Performance so as to attract attention of all those who are concerned for a better solution of the problem at the academic and professional level, on the one hand, and at the Government level, on the other.

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