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Strategic Financial Management: Road to sustainability and Corporate efficiency

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Abstract

The capital structure design is a crucial job as it involves a complex tradeoff among several considerations like income, risk, flexibility, control, timing of issue and so on. The dividend policy of a firm determines the proportion of earnings paid to shareholders by way of dividends and the proportion of income ploughed back in the firm for reinvestment purposes. If a firm's capital structure decision making is independent of its dividend payout policy, then a higher dividend payment will entail a greater dependence on external financing. Thus, the dividend policy has a bearing on the choice of financing. The capital structure and dividend payout policy always differ across companies, industries and sectors worldwide. The current study evaluates the impact of capital structure on dividend decisions of select cement companies in India. It was concluded that profitability and risk had significant influence on the capital structure and profitability had influenced the dividend decisions of the Indian cement companies. It was also revealed that there exists a mild correlation between dividend yield ratio and Long term debt to equity ratio and Long term debt to asset ratio.

Keywords: Indian cement industry, Capital structure, Dividend decisions, ANOVA, Correlation

1. Introduction

A capital structure which supports an ideal balance of debt to equity ratio and minimal cost of capital is said to be an optimal capital structure. Generally, an increased debt source lowers the cost of capital due to its tax deductibility whereas it actually increases the company's risk for its potential investors. Equity financing is little advantageous as it does not possess any obligation to repay its investors, but they have to be paid a good return for their investment. Factors such as profitability, growth, asset tangibility, company risk, earning volatility, firm size influence a company's capital structure whereas a company's liquidity, legal restrictions, cash holdings, profitability, solvency ratio, business risk and taxation policy, determines its dividend policies. An ideal capital structure sustained by best dividend payout policies always lead to attain profit maximization and wealth maximization. A research study was undertaken among the cement companies in India to evaluate the impact of capital structure on dividend decisions.

The Indian cement industry has its origination in 1889 and plays a vital role in the growth of nation's economy over decades by providing employment to more than a million people both directly and indirectly. India has the pride of being the second largest producer of cement in the world. According to the data released by Department of Industrial Policy and Promotion (DIPP), cement and gypsum products attracted Foreign Direct Investment (FDI) worth US\$ 3,099.80 million during April 2000 and June 2015. In spite of being the second largest cement producer in the world, India falls in the list of lowest per capita consumption of cement with 125 kg. An ideal capital structure and dividend payout policies could increase the image of the Indian cement companies and their market value, thereby promote sales and individual utilization.

2. Review of Literature

A review of previous studies gives a clear picture about the capital structure practices and dividend payout policies of different sectors and industries throughout the world. Raj S Dhankar and A Jit S Boora (1996)^[4] in their research study entitled "Cost of Capital, Optimal Capital Structure, and Value of Firm: An Empirical Study of Indian Companies" founded that there was no significant relationship between change in capital structure and the value of a firm, at the micro level. They also argued that the relationship between change in capital

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structure and dividend policy was not found definite and statistically significant. Sunil Kumar, R.K Sharma and S Chaturvedi (2010) [5] by their research study entitled “Leverage Capital Structure and Dividend Policy Practices in Indian Corporate – A Case Study” founded that in Coromandel Fertilizers Limited, India the fluctuations in the market price of their share were related to the capital structure decisions and dividend decisions to some extent.

Ahmed Imran Hunjra, Muhammad Bilal, Haroon Shafi, Ikram Ullah and Kashif-Ur-Rehman (2011) [6] in their research study entitled “Patterns of capital structure and dividend policy in Pakistani corporate sector and their impact on organization performance” revealed the application of capital structure and dividend policies in various sectors of Pakistani economy. It showed the awareness of stakeholders about the capital structure decisions and dividend policies and their role to improve the performance and growth of the Pakistani corporate sector. Jun Jiang and Komain Jiranyakul (2013) [7] from their research study entitled “Capital Structure, Cost of Debt and Dividend Payout of Firms in New York and Shanghai Stock Exchanges” argued that equity financing was more pronounced in determining dividend payout of firms in NYSE than those in SSE. The debt financing was less important for firms in SSE than in NYSE. The investors care more for dividend than interest payment of firms.

3. Research objectives and Methodology

The objectives of the research study are, (i) To determine the factors influencing the capital structure and dividend decisions of select cement companies in India and (ii) To evaluate the impact of capital structure on dividend decisions of select cement companies in India during the period 2004–05 to 2013–14. The criteria for selection of sample companies are, (a) the companies should be listed in BSE, (b) the companies should have declared dividend for ten continuous years and (c) there should be continuous

availability of data for ten financial years covering the period of study.

Accordingly 9 companies were selected as sample for the study. The sample companies are, (i) ACC Ltd, (ii) Ambuja Cement Ltd, (iii) Birla Corporation Ltd, (iv) Deccan Cement Ltd, (v) Kakatiya Cement Ltd, (vi) KCP Ltd, (vii) OCL India Ltd, (viii) Ramco Cements Ltd and (ix) Shree Cement Ltd. The research study was based on the published annual reports of the companies collected from Capitaline database. The SPSS software version 16 was used for analysis and statistical tools used are range, mean, standard deviation, variance, ANOVA and correlation.

4. Results and Discussion

A. Descriptive Statistics

The analysis was done using both dependent and independent variables selected based on the theories of capital structure, dividend policy and the review of previous studies. The selected variables and the results of descriptive statistics analysis for the variables are presented in the table-1. From the analysis it was observed that Solvency ratio has a mean of 1.611 with 0.764 as standard deviation are showing the better financial position of these companies over these ten years of the study. Further Long term debt to equity and Asset had a mean of 0.0955 and 0.0757 showing the debt position and the earning efficiency of the companies secured lesser returns over these years.

Long term debts and short term debts indicates these companies abilities to raise profits with the debts and equity such as long term loans or unsecured loans and short term equities. The better liquidity ratio indicates that the financial position of these companies to pay their liabilities and above 1 are showing the efficiency of the companies repaying capability. Leverage ratio has found to be 0.394 with a standard deviation of 0.597 showing the mix of debt and equity funds to raise profits of the Indian cement companies.

Table 1: Descriptive Statistics

	N	RANGE	MEAN	S.D	VARIANCE
Long term debt Ratio	90	0.048	0.0533	0.045	0.305
Short term debt Ratio	90	0.177	0.197	0.467	0.310
Total debt Ratio	90	0.225	0.25	0.477	0.318
Growth	90	0.0432	0.048	0.516	0.344
Risk	90	0.221	0.245	0.548	0.365
Asset Tangibility	90	0.757	0.841	0.570	0.384
Liquidity	90	1.257	1.396	0.633	0.422
Dividend payout ratio	90	0.245	0.272	0.658	0.438
Leverage	90	0.355	0.394	0.597	0.398
Solvency ratio	90	1.45	1.611	0.764	0.509
Long term debt to equity	90	0.086	0.0955	0.880	0.587
Long term debt to asset	90	0.0682	0.0757	0.013	0.009

Source: Published reports of selected companies

B. Factors influencing the capital structure and dividend decisions using ANOVA

ANOVA was done to find out the influencing factors of capital structure and dividend decisions. The result showed that the calculated F ratio value is 9.875 which is higher than the table value of 2.686 at 5% level of significance, inferring that profitability has a significant bearing on the Long term debt ratio. The ANOVA result of short term debt and profitability ratio revealed the calculated F ratio value as 4.327 which is higher than the table value of 2.686 at 5% level showed that profitability significantly influences the

short term debt ratio of the companies. Where as the calculated F ratio value of Total debt ratio to profitability ratio is 2.510 which is lesser than the table value of 2.686 at 5% level reveals non influence of profitability on total debt ratio. F ratio value of long term debt ratio and growth is 2.270 which is lesser than the table value of 2.686 at 5% level inferred that there is no significant impact of growth and the long term debt of the companies. The calculated F ratio value of total debt ratio and Asset tangibility is 1.589 which is lesser than the table value of 2.686 at 5% level. It revealed that there is no significant impact among total debt

ratio and asset tangibility. The F ratio value of Total debt ratio and earning volatility is 2.214 which is lesser than the table value of 2.686 at 5% level. It is inferred that there is no influence among total debt ratio and earning volatility. The calculated F ratio of total debt ratio and Risk value is 13.432 which is higher than the table value of 2.686 at 5% level. It is inferred that there exists a significant influence of Risk on the total debt ratio of the companies.

The ANOVA results also depicted that the calculated F ratio value of dividend payout ratio and profitability is 2.884 which is higher than the table value of 2.686 at 5% level of significance. It is inferred that profitability has a significant influence on dividend payout ratio of the companies. The F ratio value of dividend payout ratio and Liquidity is 1.388 which is lesser than the table value of 2.686 at 5% level. It showed that there is no significant impact among dividend payout ratio and Liquidity. The calculated F ratio value of dividend payout ratio and Leverage is 2.679 which is lesser than the table value of 2.912 at 5% level. It is inferred that there is no significant influence of Leverage on the dividend payout ratio. The calculated F ratio value of Dividend payout ratio and Solvency ratio is 2.214 which is lesser than the table value of 2.686 at 5% level. It is inferred that there is no significant impact among the Dividend payout ratio and Solvency ratio of the companies.

C. Impact of capital structure on dividend decisions using Correlation analysis

Correlation analysis was done to find out the impact of capital structure on the dividend decisions of the cement companies. The correlation matrix results indicated that there is mild level of correlation (less than 0.500) exist between Long term debt to equity ratio and Dividend payout ratio and Dividend yield ratio. While it has been negatively correlated with Dividend payout ratio and Long term debt to asset Ratio which is -0.130 indicates that if dividend payout ratio increases, long term debt to asset decreases and vice versa. The correlation results are depicted in the following table –2.

Table 2: Correlation Analysis

Ratios	Long term debt to equity ratio	Long term debt to Asset ratio
Dividend payout ratio	0.018	-0.130
Dividend yield ratio	0.302	0.201

Source: Published reports of selected companies

5. Conclusion

Many experts have built theories to direct financial policy decision making and to design a perfect financial structure, but still now no theory could be adopted completely for any firm. As any business concern depends on all internal and external environment for its survival and success and every day the investors' preference towards investment and income differs, a firm's capital structure and its dividend policies also changes accordingly. Given the imperfections prevailing in the real world, a firm cannot normally treat its dividend policy as irrelevant. It must carefully evaluate its circumstances and the environment in which it operates while hammering out its dividend policy. It was from the ANOVA, it is determined that profitability and risk had significant influence on the capital structure and profitability had influenced the dividend decisions of the Indian cement companies. It was also revealed from the correlation analysis that there exists a mild correlation between dividend yield

ratio and Long term debt to equity ratio and Long term debt to asset ratio of the Indian cement companies.

6. Scope for further research

More cement companies covering more financial years could be analyzed individually or entirely. A comparative study of domestic and foreign cement companies could help to find the scenario of Indian cement companies globally. New models could be framed or current models could be adopted for in depth study. Variables selected in the study could be applied for other industries may show their applicability and viability.

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