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The Investigaton of Relationship between Dividend Policy, Payout Ratio and Financial Performance

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Extensive Summary

Introduction

Financial statements are the summary of operating activities of the firms at the end of the period. Informations of firm's financial position are presented to financial statement users via these reports. Finanacial reports provide necessary informations related to financial positions of the firm to the interested parties. To sum up financial statements are the communication tool for stakeholders to evaluate the firm in different perspectives and to make a better decision. Besides the other crucial informations in reported financial statements earnings as a summary of period activities are draw attention. Earnings have significant effect in the decision making process in terms of summarizing financial statements for users.

With the importance of earnings amount, it is also important that how earnings are used. Firms decide to distribute earnings to their shareholders or to retain them to use for future investments and project. The managers should use the earnings in the interests of the firm and shareholders which is called dividend policy. Dividend policy is important from the point of view in determining the extent to which earnings are distributed to shareholders or retained the firm (Ross, 2007). Moreover, dividend policy provides informations of firm's financial performance.

When we examined the dividend policy studies, there are controversial results regarding financial performance in the literature. Therefore, examining the dividend policy with respect to financial performance is a vital subject that needs to be investigated in various aspects. Within this framework, the aim of this study is to explore potential association between financial performance indicators (Return On Asset, Return On Equity) with firm's dividend policy (dividend) and dividend payout ratio (payout) on BIST Manufacturing Sector Firms.

Data and Methodology

We used data of BIST Manufacturing Sector firms for the years of 2005-2015 in the study. Firm year observations were obtained from Datastream database and Eviews

8 programme was used to perform analysis. We conducted pooled regression analysis to figure out potential relationship between firms' dividend policy and financial performance. This method can be expressed as a combination of unit and time dimensions (Gujarati, 2009).

Return on asset (ROA in model 1) and return on equity (ROE in model 2) were used as a dependent variables in the models. On the other hand, dividend policy which refers whether firms pay dividend to shareholders or not was used as a dummy independent variable. Other independent variable is payout ratio which can be expressed as dividend per share/earnings per share. We also added control variables to check other factors that might influence firm's financial performance. These variables are firm size (Log of Total Asset), leverage (Total Debt/Total Asset) and growth ((Salest-Salest-1)/Total Asset)).

Findings and Discussion

Obtained results from two models indicate that there is a positive and significant relationship between firm's dividend policy and financial performance. The explanatory power of model 1 is %36 and %32 for model 2. F statistic probability values which are used to indicate overall significance of models are less than 0.05 of model 1 and also less than 0.05 for model 2. It can be stated that both models are overall significant.

When the obtained results from model 1 examined, dividend policy has a statistically positive significant coefficient. This proves that dividend paying firms have higher profitability ratios than non-payers. Payout which is the other variable used to evaluate the dividend policies of firms in the model also has a statistically positive significant coefficient. Within the scope of this coefficient it can be stated that payout ratio has a positively significant effect on firm's profitability.

Some control variables (size and growth) used in the model 1 also have statistically positive significant coefficients. This leads us to interpret that size and sales growth have positive impacts on firm's profitability. However, other control variable used in the model 1 (leverage) has a significant negative coefficient. According to obtained coefficient of leverage, debt ratios of firms have negative effect on firm's profitability.

The results obtained from model 2 show that similar associations between variables as in model 1. High correlation between ROA and ROE (0,88) might be the cause of this similarity. Dividend variable has significant positive coefficient. It can be stated that dividend paying firms have higher return on equity ratios than non-payers. Payout also has significant positive coefficient. This means that firm's payout ratio has significant positive effects on firms' financial performance. Control variables used in the model 2 have also same direction according to obtained results from model 1. Size and growth have positively significant effects on firm's return on equity. Leverage has negatively significant effect on firm's return on equity.

Future researches that using more comprehensive and representative samples of firms would shed more light on issues raised in this study. In addition, the patterns of dividend policy might change not only over time but also across sectors and countries. Future studies may also concentrate on this issue and investigate the variations between time, sector and countries.