Dividend Policy and Corporate Governance: An Analysis of listed Indian Firms

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Abstract : *In this paper, we investigate the possible association between the firm's ownership structure and dividend policy and whether the corporate governance practices adopted by the firm have any impact on dividend policy. In India the presence of family run firms, with concentrated ownership, is a reality and we try to understand whether such firms have any significantly different approach to dividend policy compared to non-family run companies. The use of debt by firms in its capital structure acts as an additional monitoring mechanism and we propose to analyse whether this has any impact on dividend policy. We explore the determinants of dividend policy of Indian firms. Thus, firm characteristics which seem to have an impact on dividend policy, like profitability, liquidity, growth, income volatility, size, and age are investigated. We use a panel of 51 top Indian listed firms, in terms of market capitalization (BSE 100 and NSE 100), over the five year period from 2007-08 to 2011-12 for our analysis. We conclude that foreign institutional ownership, board size and the proportion of non-executive directors on the board have significant impact on the dividend policy of the firm. Enterprise value to profits and the proportion of cash and cash equivalent to total assets also has an influence on the dividend policy. Growth opportunities and the size of the firm also impact the dividend policy of firms.*

Keywords: *Dividend Policy, Ownership Structure, Corporate Governance*

JEL Classification: *G32, G35*

Dividend usually refers to the cash distribution of the firm's earnings (past and / or present) in real assets among the share holders of the firm in proportion to their ownership. Dividend policy refers to the payout policy of the firm, which managers pursue in deciding the size and pattern of cash distribution to shareholders over time. The goal of the firm is to maximize the wealth of the present shareholders. Shareholders wealth is represented by the market value of the firm's equity shares and this, in turn, reflects the firm's major decisions in the areas of financing and investment. To achieve this goal firms pay dividends. Dividends impact share price because they communicate information, or signals, about the firm's profitability.

Dividend policies of firms may follow different patterns. First, dividends tend to lag behind earnings, that is, increases in earnings are followed by increases in dividends and decreases in earnings sometimes by dividend cuts. Second, dividends tend to be "sticky" because firms are typically reluctant to change dividends; in particular, firms avoid cutting dividends even when earnings drop. Third, dividends tend to follow a much smoother path than do earnings. Finally, there exist differences in dividend policy over the life cycle of companies, resulting from changes in the firm's growth rates, cash flows, and project investment opportunities in hand. Companies that are affected by systematic risk, like those in cyclical industries, are less likely to set a relatively low maintainable regular dividend so as to avoid the consequences of lower dividend in a particularly bad year, in terms of profit (Damodaran, 2011).

The critical question in dividend policy is, given the investment decision of the firm, do dividends have an influence on firm value. When we treat dividend policy as strictly a financing decision, the payment of cash dividends is a passive residual. The proportion of earnings paid out as dividends will fluctuate from year to year in keeping with fluctuations in the amount of acceptable investment opportunities available to the firm. This treatment of dividend policy as a passive residual, determined solely by the availability of acceptable investment proposals, implies dividends are irrelevant. Thus, in residual dividend policy the amount of dividend is the cash left after the firm makes desirable investments using the

Net Present Value criterion. In this case the amount of dividend is going to be highly variable and often zero. Alternatively, if managers believe dividend policy is important to their investors and it positively influences share valuation, they normally tend to adopt a managed dividend policy.

Dividend decisions have been the primary puzzle of corporate finance since the work of Black (1976). Dividend literature has primarily relied on two lines of hypothesis: agency cost and signalling. Agency costs arise when the interests of managers and interests of shareholders diverge. This may give rise to tensions ranging from the rate at which managers reinvest profits to the nature and level of managerial remuneration. Shareholders prefer dividends and they tend to reward managers who pay regular increasing dividends. However, the more pertinent issues here are how much cash should firms give back to their shareholders and should the firm pay their shareholders through dividends or through buyback of its shares. Stock repurchase is the least costly form of payout from the tax perspective. Firms must take these important decisions on regular basis.Dividend policy may reduce agency costs. Dividend payout guarantees equal payout for both "insider" and "outsider" equity holders of the firm. However, information asymmetry between the "insider" and "outsider" may also lead to agency cost (Jensen and Meckling, 1976). One of the mechanisms suggested to reduce "outsiders" expropriation is to reduce cash flows available to managers through high payout.

The cash flow hypothesis states that since insiders have more information about firm's future cash flows than do the outsiders they, therefore, have an incentive to use it as a signal to the outsiders. Dividends can be an ideal device for limiting rent extraction of minority shareholders (Jensen and Meckling, 1976). Large block holders, by granting dividends, may signal their unwillingness to exploit the minority shareholders. Further, the payment of dividends reduces the amount of discretionary funds available to managers of the firm for perquisite consumption and investment opportunities and requires managers to seek financing from the capital markets. This in turn leads to monitoring of the firm by the external capital markets and this will encourage the managers of the firm to be more disciplined.

Dividend decisions are recognized as centrally important because of the increasingly significant role of finance in the overall growth strategy of companies. The objective of the firm should be to find out an optimal dividend policy that will enhance firm value. According to the signaling effect, mangers have private and superior information about future prospects and choose a dividend level to signal that private information. It is often argued that the share prices of a firm tend to be reduced whenever there is a reduction in the dividend payments. It has been observed that announcements of dividend increases generate abnormal positive security returns, and announcements of dividend decreases generate abnormal negative security returns. This is based on the idea that the reported accounting profits of the firm may not be a proper reflection of the firm's economic profits and to the extent that dividends offer information on economic profits not provided by reported profits, share prices will respond.

Dividend policy has implication for all the stakeholders of the firm. From the investors' perspective dividends are relevant as it may be a source of regular income or if it's accumulated then it is reflected through capital appreciation. Similarly, managers' flexibility to invest in projects is also dependent on the amount of dividend that they can offer to shareholders as more dividends may mean lesser funds available for investment. Lenders of the firm may also be interested in the amount of dividend declared. Higher the dividend paid less would be the amount available for debt servicing and redemption of the claims. Therefore, dividend payments are an illustration of the agency problem as its impact is borne by various claimholders of the firm.

Formally, the word "Corporate Governance"(hereafter, CG) was first used by Richard Eells (1960) to mean a set of customs, policies and laws used to direct and control a corporation. Jensen and Meckling (1976) came up with a working definition of CG when they stated that "the purpose of CG is to minimize the total cost in aligning managers and shareholders' incentives and in unavoidable self-interested managerial behaviors".

CG was initially centered on board of director independence and effectiveness. Following a series of corporate collapses that occurred in the last two decades, the roles played by supervisory committees and auditors as mechanisms of CG, along with managementethics, have increased in importance. The Cadbury Committee Report in 1992, regarding the voluntary regulation of CG, was a milestone report, and Sir Cadbury defined CG as "the system by which companies are directed and controlled". Shleifer and Vishny (1986) came up with a working definition and stated that "Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment". While this is hardly a rigorous definition of CG, it did capture the essence of the common concern in the finance literature with agency costs and their resolution. Examples are the boards' usage of dividend payout policy in combination with CG structures to curb over-investment, or of a combination of governance structures and incentive contracts to align managers' interests with those of shareholders or lenders. However, finance literature also contemplated on actions being taken by external parties, such as substantial shareholders or financial institutions, to address agency costs that can arise when the firm's "controllers" pursue their own interests to the disadvantage of others with legitimate claims. The role of legislation and government interference also began to emerge.

Since the late 1990s, significant efforts have been taken by Indian regulators, as well as by industry representatives and companies, to overhaul CG in the country. The Securities Exchange Board of India (hereafter, SEBI) came up with the following definition; "CG is about ethical conduct in business". "CG deals with conducting the affairs of a company such that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. It is about openness, integrity, and accountability" (SEBI, 2003).

CG in India differs dramatically from the dominant form of CG in developed economies and within the country also CG practices are not homogenous. Some firms operate within family group while others are independent and professionally managed. In family run companies (hereafter, FRC) ownership is concentrated with the promoter family. The presence of controlling shareholders also leads to

a conflict of interest between them and the outside minority shareholders if the former seeks to extract and optimize private benefits for themselves at the expense of the minority shareholders (Sarkar and Sarkar, 2012). This may give rise to Type II or Horizontal Agency Problem. In FRC the controlling shareholders, by virtue of their substantial equity holding, would have a strong incentive to monitor and mitigate Type I or Vertical Agency problem. Further in Indian context CG also poses a challenge due to horizontal agency problem and due to difference in depth and breadth of inter-company relationship and related party involvement. Further, imperfect product market, rigid labor laws and regulatory environment, and lack of adequate contract enforcing mechanisms in turn lead to additional governance complexities.

Dividend policy represents one of the broad set of tools for managing the agency problem. When boards reassess their CG policies they normally tend to put dividends at the top of the list. Available literature on dividend policy and CG try to address the issues arising out of the agency problem. In this regard the identity of the shareholders is an area of concern. The role of family ownership, foreign ownership, and institutional ownership in determining the norms of dividend policy are required to be explored. Further, does dividend signal any conflict between the insider shareholders and outside shareholders also require due attention. Do FRC in India pay higher dividends than stand-alone firms, dampening insider expropriation? Does CG practice have any impact on the dividend policy of the firm? In determining the quantum of dividend, firms analyse a number of factors like capital impairment, reinvestment rates, liquidity, and ability to borrow. These factors largely dictate the legal and other boundaries within which dividends can be paid. It is in this context, we investigate Indian firms in order to provide new evidence on how ownership structure, CG practices, and other relevant factors influence the dividend policy.

The principal objective of this study is to examine, empirically, the relationship between dividend policy and CG practices adopted by the firm using data of listed Indian firms over a five year period from 2007-08 to 2011-12. The research plan is as follows:

i. To find the impact of CG and the ownership structure of the firm on dividend policy.

ii. To find out whether the use of debt, as an additional monitoring mechanism, has any impact on dividend policy.

iii. To analyze the influence of firm specific characteristics, like profitability, liquidity, growth, income volatility, size, and age on the dividend policy of the firm i.e. to identify the various determinants of dividend policy.

We conclude from this study that foreign institutional ownership, board size and the proportion of non-executive directors on the board has significant impact on the dividend policy of the firm. Enterprise value to profits (before depreciation interest taxes and amortization) and the proportion of cash and cash equivalent to total assets also has an influence on the dividend policy of the firm. Growth opportunities and the size of the firm also seem to impact the dividend policy of the firm.

The remainder of the paper is organized as follows. In the following section we have presented a brief review of the existing literature and it also provides a brief introduction to economic and legal framework within which Indian firms operate and its implication on dividend policy. The methodology used and the obtained results are presented in thereafter. Finally, concluding remarks are presented in the last section.

REVIEW OF RELATED LITERATURE

The review of the literature is organized into various schools of thought on dividend policy and are presented below.

Dividend policy and the agency theory

A substantial theoretical literature, including, Linter (1956), Bhattacharya (1980), and Miller and Rock (1985), suggests that corporate dividend policy is designed to reveal earnings prospects to investors. Fama and Babiak (1968) argued that firms set their target dividend level and try to stick to it. In addition there may be interrelation between dividend policy and agency cost (Jensen and Meckling, 1976 and Easterbrook, 1984).

Easterbrook (1984) presented the agency cost explanations for changes in dividend policy. The level of dividend payments is in part determined by shareholders preference as implemented by their management representatives. However, the impact of dividend payments is borne by a variety of claim holders. The agency relationship exists between the following groups: (i) shareholders and debt holders, and (ii) shareholders and management. Shareholders prefer to have large dividend payments, all else being equal; conversely, bondholders prefer to restrict dividend payments to maximize the firm's resources that are available to repay their claims. Lalay (1982) investigated a large sample of bond indentures focusing on conflict between shareholders and bondholders on the dividend decision. The empirical evidence discussed is consistent with the view that dividends transfer assets from the corporate pool to the exclusive ownership of the shareholders, which negatively affects the safety of claims of debt holders.

Shareholders, debt providers and management form firms for mutually beneficial reasons but one party may later gain at the other's expense. Due to the potential conflict between debt providers and shareholders, the former would like the later to leave as much cash as possible in the firm so that this cash would be available to pay the debt providers during times of financial distress. Conversely, shareholders would like to keep the extra cash for themselves and this is where dividends have a role to play. To eliminate agency costs the managers of the firm, acting on behalf of the shareholders, may pay dividends or resort to buy back of shares in an effort to keep the surplus cash away from the creditors. Thus, dividends may be viewed as wealth transfer from the debt providers to the shareholders.

De Angelo et al., 1990 found that even firms in financial distress are reluctant to cut dividends. Managers may also keep the cash away from the debt providers through share repurchases.

Similarly, managers may also pursue selfish goals at the expense of the owners of the firm. If the firm has plenty of free cash flow managers may take on pet projects even if they have negative NPVs. Rozeff, 1994 suggested that dividends can serve as the way for the board to reduce agency costs by paying dividends equivalent to the amount of surplus cash flow thereby reducing management's ability to squander the recourses of the firm.

In terms of owner-manager relationships, ceteris paribus, managerial remuneration depends on company profitability and size; and will encourage managers to aim for low dividend payout. Low dividend payout maximizes the company's assets under the control of the management. This will maximize management's flexibility in choosing investment opportunities, thereby reducing the requirement to turn to capital markets to fund such investments. Shareholders expecting managerial efficiency in capital budgeting decisions prefer to leave lesser amount of discretionary cash in the hands of the firm's management. This will induce mangers to turn to capital markets for funding investment proposals. Therefore, capital markets will provide for monitoring services thereby disciplining managers of the firm. Shareholders can prudently use dividend policy to their advantage and encourage managers to look after their own interests. In other words, from the shareholders perspective higher dividends provide greater monitoring by the capital markets and more managerial discipline.

La Porta et al. (2000) and Shleifer and Vishny (2000), in their studies, have argued that if the country's legal environment provides for strong investors' protection it will force companies to give up cash. The implication is that effective monitoring by shareholders should be associated with higher dividend (this study, however, was on firms in the UK where legal protection is strong). Renneboog and Trojanowski (2005) found that the relationship between dividends and ownership structures is rather limited, and empirically showed that there is a negative

relationship between insider ownership and dividends. Evidence regarding financial institutional holding and dividend policy is not only limited but also contradictory. While Short et al. (2002) reported a positive relationship between dividends and shareholding by financial institutions in their study, Renneboog and Trojanowski (2005) found and reported a negative relationship.

Dividend policy and corporate control by ownership groups

If the firm indulges in substantial dividend payment, it may need to raise capital at a later stage through the sale of shares to finance profitable investment opportunities. Under such circumstances, controlling interest of the firm may be diluted if the controlling shareholders are not in a position to subscribe for additional shares. These shareholders may prefer lower dividends and financing of investment needs using retained profits. Control can also operate in another way in the context of prospective acquisition. When a firm is being targeted for takeover by another firm, low dividend payments may work to the advantage of the prospective acquirer seeking control. The acquirer may be able to convince the shareholders of the target firm that existing management is not maximizing shareholders wealth and that post takeover they may offer higher dividends. Consequently, firms in danger of takeover may offer high dividend payout to please shareholders. However, the market for corporate control is weak in India.

In India ownership structure is characterized by the strong presence of FRC like in any other market. It is difficult to define family run business as in India family shareholding is disguised in the name of promoters in the company reports. Broadly promoter is perceived as a person who brings about the incorporation and organization of a corporation and retains the overall control power of the company. The immediate relative of the promoter, among others, form the promoter group. We will consider as family run business as those companies which share the following common characteristics: (i) Promoters control the company's ownership and business by holding 25% or more of the share capital. We will consider promoter's share as the share of insiders or the combined share of family, and (ii) The controlling promoter's family members are currently active

in top management and the chairperson of the board is from the promoter group (Bhattacharyya, 2009). Concentrated ownership plays a predominant role in the way firms are governed. Majority control gives the largest shareholder, namely the promoter family group of FRC, the incentive and control over key decisions, like dividend payout.

The empirical evidence concerning the possible association of owners and payout policy is extremely limited and especially so in case of emerging economies like India. Faccio et al. (2001) provide quantitative evidence on the expropriation that takes place within business group and on the differences in expropriation between Europe and Asia. Short et al. (2002) examined the link between dividend policy and institutional ownership for UK firms. They find a positive association between dividends and institutional share-holders and negative association with managerial ownership. In Indian context, Narsimhan and VijayLakshmi (2002) analyzed the influence of ownership structure on dividend payout of 186 firms in the manufacturing sector. They concluded that promoters holding (as of September 2001) have no influence on average dividend payout (during the period of study from 1997-2000).

Dividend policy and asymmetric information

In a symmetrically informed market, all interested participants (like managers, bankers, shareholders, and prospective investors) have access to the same information on the firms. Evidence seems to suggest that the firm's managers possess superior information compared to the other interested parties. This gap whereby one group gets access to superior information about the firm leads to information asymmetry.

Dividends are relevant because they have an informational value. Empirical studies in this area documented that announcements of dividend increases are followed by significant price increases and that announcements of dividend decreases are followed by significant price drops (Allen et al, 2000). The market value of the share gets affected not due to the change in dividends, but possibly

due to the information about the change in the future earnings prospect that is conveyed through such decisions. The decisions may not necessarily be restricted to dividends alone but also on account of future investments decisions announced by the company.

Information about the prospects of a firm may include the firm's current projects and its future investment opportunities. The firm's dividend policy, either exclusively or in combination with other signals, such as capital expenditure announcements, may communicate this information to a less informed market. Empirical studies in this area documented that announcements of dividend increases are followed by significant price increases and that announcements of dividend decreases are followed by significant price drops (Allen et al, 2000).

Studies of large changes in dividend policy include Asquith and Mullins (1983) (dividend initiations), Michaely et al. (1995) (dividend omissions) showed that the market reacts dramatically to such announcements. Empirical studies however showed mixed evidence, and all these studies use data from developed economies. A number of studies found that stock price has a significant positive relationship with dividend payments (Kato and Loewenstein, 1995), while others found a negative relationship (Easton and Sinclair, 1989). Dividends are meant to convey private information to the market. Predictions about the future earnings of a firm based on dividend information would possibly be superior compared to forecasts made without dividend information. A number of studies have also tested these implications of the informational content of dividends (Michaely and Swaminathan, 2002).

Determinants of dividend policy

Previous studies and empirical evidence suggest that a number of factors influence dividend policy decisions of firms. Primarily profits have long been regarded as the primary indicator of the firm's capacity to pay dividends. Lintner (1956) concluded from his study of 28 US firms that current year's earnings and previous year's dividends influence the dividend payment pattern

of firms. According to Fama and Babiak (1968) net income seems to provide a better measure of dividend than either cash flows or net income and depreciation included as separate variables in the model. Baker et al. (1999) 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. Pruitt and Gitman (1991) concluded from their survey of financial managers of the 1000 largest US firms that current and past year's profits are important factors influencing dividend payments and found that risk (year to year variability of earnings) also determine the firms' dividend policy. Baker et al. (1999) concluded from their survey of NYSE-listed firms that dividend determinants are industry specific and anticipated level of future earnings is a major determinant.

D'Souza (1999) showed a positive but insignificant relationship in the case of growth and negative but insignificant relationship in case of market to book value. Studies also revealed that dividend payments depend more on cash flows, which reflect the company's ability to pay dividends, than on current earnings, which are less heavily influenced by accounting practices. Some studies also questioned the irrelevance argument and investigated the relationship between the dividends and investment and financing decisions. Studies have shown that dividend decision is taken along with investments and financing decisions and the firm's investment decision is linked to its financing decision. Many authors have also documented no interdependence between investments and dividends. Studies have also indicated a direct link between growth and financing needs. According to them rapidly growing firms have external financing needs because working capital needs normally exceed the incremental cash flows from new sales. Barclay et al. (1995) analyzed the relationship between leverage and dividends choice.

Arnott and Asness (2003) based their study on US stock markets (S&P500) found that higher aggregate dividend payout ratios were associated with higher future growth. Zhou and Ruland (2006) examined the possible impact of dividend payouts on future earnings growth. Their study used a sample of active and inactive stocks listed on NYSE and NASDAQ with positive, non- zero payout ratio companies covering the period from 1950- 2003. Their regression results

showed a strong positive relation between payout ratio and future earnings growth. Mancinelli and Ozkan (2006) undertook an empirical investigation of the relationship between the ownership structure of companies and dividend policy using 139 firms listed in Italian exchange. Their results suggested that the dividend payout ratio is negatively associated with the voting rights of the largest shareholders.

Dividend policy and the market value of shares of firms

The traditional view proposed by Gordon (1959), in his seminal work, stated that the price of shares is dependent on the dividend policy of the firm in the presence of perfect capital markets and the existence of uncertainty about the future cash flow.

Miller and Modigliani (1961) (henceforth, M&M) in their seminal work analyze the effect of dividend policy on the current price of its shares. They showed that firms' dividend policy does not affect its value under certain set of assumptions. The basic premise of their argument is that firm value is determined by choosing optimal investments. The net payout is the difference between earnings and investments, and simply a residual. Since the net payout comprises dividends and equity re-purchases, a firm is in a position to adjust its dividends to any level with an offsetting change in the number of shares outstanding. From the perspective of investors, dividends policy is irrelevant, because any desired stream of payments can be replicated by appropriate purchases and sales of equity holding. Therefore, investors will not be willing to pay premium for any particular dividend policy. M&M concluded that given the firm's optimal investment policy, the firm's choice of dividend policy has no impact on shareholders wealth. In other words, all dividend policies are equivalent. The most important insight of M&M's proposition is that it identifies the situations in which dividend policy can affect firm value and which is only when the assumptions underlying the theory are violated and not because dividends are "safer" than capital gains, as was traditionally position.

Black and Scholes (1974) tested the effect of dividend yield on the stock returns, after dividend announcements. Feldstein and Green (1983) provided a model of market equilibrium to explain why firms that maximize the value of their shares pay dividends. Miller and Rock (1985) extend the standard finance model of the firm's dividend policy by allowing the firm's manager `insider' to know more about the firm's financial health than `outside' investors.

Dividend policy and taxation

M&M proposed that under perfect capital markets dividend policy does not affect firm value. Under this setting, investors can replicate any stream of dividend payments through the purchase and sale of appropriate equities. Thus, as already pointed out, investors may view dividend polices as irrelevant and will not be willing to pay premium for any particular policy adopted by the firm. With taxes, dividends and capital gains generally face different tax rates, and these rates also tend to vary across individuals, an equity holding provides different after tax returns for individuals in different tax bracket and they will have different after tax valuations for the same asset. M&M hypothesized that such differences lead to the formation of "dividend clienteles," in which investors have tax-based preferences over equities that possibly differ only in their dividend policies. According to the dividend clientele hypothesis, firms with high (low) dividend-payout ratios attract investors with low (high) marginal tax rates. In the aggregate, an individual's portfolio dividend yield, i.e., the ratio of dividend income to the value of equity holdings, should decrease with income.Traditional theories also suggest that distribution of dividends being from after tax profits, tax considerations do not matter in the hands of the payer firm.

In India, however, the position has changed with the arrival of Corporate Dividend tax (henceforth, CDT). Since CDT is levied on the firm there is a consequential cash flow due to their dividend decision. In the hands of the investor too, the position has changed with total exemption from tax being made available to the receiving investor and such exemption has made equity investment more attractive. Now if the firm were to distribute dividends, shareholders of the firm

will indirectly bear the burden of CDT on their income. On the other hand if the firm were to provide return to the shareholder in the form of appreciation in market price, by way of bonus dividend, then shareholders will have reduced tax burden. In such a case an investor may prefer to get less dividends paid and earnings to be retained by firm, as they can always get the amount by selling the shares in equity market, in form of `home-made dividend' (Black, 1976). For securities covered by Securities Transaction Tax, short term capital gains tax will be payable while long term capital gain is exempted from tax. We conclude that, if the firm indulges in the payment of more dividends, while it still has reinvestment opportunities, then to get the same tax return shareholders will expect more before tax return and this will further reduce the market price of the shares.

Taxation policy is supposedly a key determinant of dividend payout in developed countries (Short et al., 2002). According to the tax-preference theory dividend payout may be beneficial, if used to offset tax liability against the capital loss, as after dividend payments the prices of shares fall. Ownership structure in Indian firms is characterized by FRC, having controlling stake. Majority control gives the largest shareholder incentive and control over key decisions, like dividend payout. The dominance of family ownership may affect the dividend payout given Indian tax laws. In this regard it is worth mentioning that Reddy, 2002 did not find any evidence in favor of tax-preference theory and the implication of dividend tax on corporate financial policies.

Available literature, in general, have tried to explain the dividend behaviour over time with the help of past dividend payouts and earnings. None of the studies, especially those relating to India, explain the behavior of dividend policy with respect to ownership structure and CG. None of the studies have tried to explain firm heterogeneity, which we feel is a key factor for the differences among dividend policy across firms. Also the impact of the CG mechanism of the firm on its dividend policy is still quite unexplored.

Dividend policy of Indian firms

Dhameja (1978) in his study tested the dividend behaviour of Indian companies by classifying them into size group, industry group, growth group and control group. This study found that there was no statistically significant relationship between dividend policy, on the one hand and industry and size on the other. Growth was inversely related to dividend payout and was found to be significant.

Mahapatra and Sahu (1993) found cash flows as a major determinant of dividend followed by net earnings. Bhat and Pandey (1994) undertook a survey of managers' perceptions of dividend decisions and found that mangers perceived current earnings as the most significant factor. Anand (2002) analyzed the results of 2001 survey of 81 CFOs of Business Today 500 companies in India to find out the determinants of the dividend policy decision of India firms. CFO's use dividend policy as a signaling mechanism and thus it affects the market value of the firm. Managers design dividend policy after taking into consideration the investors' preference for dividends and clientele effect.

Reddy and Rath (2005) examined dividend trends for a large sample of stocks traded on Indian markets indicated that the percentage of companies paying dividend declined from over 57% in 1991 to 32% in 2001, and that only a few firms paid regular dividends. Dividend paying companies were less likely to be larger and more profitable than non-paying companies, though growth opportunities do not seem to have significantly influenced the dividend policies. Sharma (2007) empirically examined the dividend behavior of select Indian firms listed on BSE from 1990 to 2005.The study analyzed whether or not dividends are still relevant in India in the context of the prevailing tax laws. The findings offered mixed and inconclusive results about tax theory indicating that the change in the tax structure does not have a substantial effect on dividend behavior of firms.

RESEARCH QUESTIONS AND HYPOTHESES

We focus our attention on the Indian corporate sector to understand the effects of ownership structure (shareholding pattern) and CG on dividend policy. The Indian corporate sector offers the following advantages over other emerging market economies. The Indian corporate sector has large number of firms, lending itself to a large sample statistical data for analysis. It is large by emerging market standards and the contribution of the manufacturing and service sectors (in terms of value addition) is close to that of several advanced economies. Unlike several other emerging markets, Indian firms, maintain their shareholding pattern over the period of study, making it possible to identify the ownership affiliation of each sample firm with clarity.

India has a well-established regulatory framework which forms the foundation for the CG system. The legal framework for all corporate activities including governance, disclosures, share-holders rights, and dividend announcements that has been in place is fairly stable. The listing agreement of stock exchanges has also been prescribing on-going conditions and continuous obligations for companies. Numerous initiatives have been taken by SEBI to enhance CG practice, in fulfilment of the twin objectives: investor protection and market development. Although the Indian corporate sector is a mix of state run and private firms (which are again a mix of firms owned by families, multi nationals and professionally managed stand-alone firms), it has not suffered from the problems that has dominated some of the developing economies, nor it possess the characteristics of the Korean "chaebols" (OECD, 2001). Accounting system in India is also well established and accounting standards are similar to those followed in most of the advanced economies (Bhattacharyya, 2010).

Corporate ownership is one of the internal mechanisms of CG. The ownership and control structure of a firm is the source of the agency problem and from the CG perspective the focus is on how ownership by different groups of shareholders can separately or in conjunction reduce the agency cost in a firm. The goal of CG is to ensure that suppliers of finance to companies receive a return on

their investment. While suppliers of equity can receive a return through dividends or capital gains, agency theory suggests that shareholders may prefer dividends, particularly when they fear expropriation by insiders, especially in the case of FRC. The agency model tells us that when shareholders have greater rights, they can use their power to influence dividend policy. Shareholders can receive greater rights either through a legal protection or through a firm's adaptation of better CG practices. This paper shows that firm-level CG has an influence on dividend policy suggesting that both mechanisms help reduce agency problems.

Large firms in India have three main blocks of shareholders; (i) Indian promoter group or family, (ii) foreign promoter group and (iii) financial institutions both domestic as well as foreign. In FRC higher insider ownership may reduce expected agency costs and hence dividend policy may become less important as a monitoring vehicle. However, the presence of institutional debt holding is likely to increase monitoring of the firm. In order to study the relationship between ownership structure and dividend policy we use the following variables (i) promoter group holding, (ii) family firm, (iii) domestic institutional holding, and, (iv) foreign ownership. In view of these, we propose to study whether ownership structure has on impact on the dividend policy of the firm and accordingly hypothesis that:

Hypothesis 1 (H1): *There is a positive relationship between the ownership structure variables and dividend policy.*

The analysis of the relationship between dividend policy and CG compliance is a novel way of testing the agency explanation for dividend policy. We capture CG in this study by analyzing the structure of the board. In a dynamic environment, boards become very important for the smooth functioning of firm. Boards are expected to perform different functions viz., monitoring of management to mitigate agency costs, hiring and firing of management, providing and giving access to resources, and providing strategic direction for the firm. Board composition consists of board demographics, size, structure, board recruitment, board member motivation, board education and board leadership. Board composition is one of the important factors affecting CG.

The board of modern corporations comprise of (i) executive or inside directors and (ii) non-executive or outside directors. Executive directors are employees of the company and are entrusted with the day to day management of the company. Non-executive directors essentially play an advisory role in board meetings. In India, non-executive directors may be grouped into (i) affiliated or grey directors primarily comprising of former employees, relatives of promoters or nominees of investors (nominee directors), and (ii) non-affiliated or non-executive independent directors. Consistent with literature we have captured CG in our study using the following variables (i) board size, (ii) proportion of independent directors on the board, and (iii) proportion of non-executive directors on the board. In view of this we hypothesise that:

Hypothesis 2 (H2): *There is a positive relationship between the corporate governance variables and dividend policy.*

Firms use a mix of equity and debt to fund its activities. The use of debt affects the financial performance of the firm and also results in firm governance issues. The use of debt provides the firm with "trading on equity" benefits as interest on debt is tax deductible. The use of debt also leads to governance issues for the firm. The use of debt has a disciplining effect on the firm (known as "control hypothesis" as stated by Jensen (1986). The disciplining effect of debt arises from the fact that debt can constrain managerial expropriation in a situation where firms have more internally generated funds than investment opportunities in terms of the availability of projects with positive net present value.

The disciplining role of debt as stated in the control hypotheses, however, apply mostly in the context of agency problems that exist in widely held firms with a separation of ownership and control between shareholders and managers (McConnell et al, 1990). However, in corporations where the separation between ownership and control is weak, as in the case of FRC, and the management is often drawn from a controlling block, the strategic use of debt undergoes a role reversal. In such firms, the typical agency problem arises not between outside shareholders and management, but between controlling insiders, namely the promoter group,

and minority outsiders, wherein insider shareholders strategically issue debt in order to expropriate (known as the expropriation hypothesis) outside minority shareholders (Harvey et al., 2004). With an increase in insider shareholders' voting rights the ability to expropriate increases, which in turn can be increased through increasing the proportion of debt relative to equity in the capital structure (Stulz, 1990). Further, FRC also typically re-enter the debt market at specified intervals of time for financing and given their reputational considerations expropriation may not be a desirable course of action for such firms (Faccio et al., 2001).

In Indian debt is primarily offered by banks and financial institutions. They prefer representation on the company board and hence they have access to decision making, including dividend decisions. Besides these lenders may also have equity holding in the firm concerned, and thus they have access to insider information as well. This reduces the importance of dividends as a signal of firm's financial health. With regard to the governance role of the debt providers evidence seems to suggest towards passive role. Keeping in view the above position, we propose to study the impact of debt in the capital structure of the firm and hypothesis that:

Hypothesis 3 (H3): *There is a positive relationship between the extent of debt in the capital structure of the firm and dividend policy.*

Firm specific characteristics, like liquidity, growth, income volatility, size, and age also seem to have an influence on the dividend policy of the firm as suggested in literature. We now propose to identify which of the above factors are help in determining the dividend policy of a firm. The dividend policy of a firm is strongly influenced its liquidity position. The payment of dividends means cash outflow. Thus the cash position of the firm is an important consideration; as greater the cash position and overall liquidity of the firm, the greater will be its ability to pay dividends. In our study we have used the ratio of cash and cash equivalent to total assets to capture the liquidity aspect. In line with the above position the hypothesis that:

Hypothesis 4 (H4): *There is a positive relationship between the firm's liquidity position and dividend policy.*

Prior literatures also suggest that dividend policies of firms are also significantly affected by firm profitability, age, size of the firm and its growth prospects. Profits of the firm are available for distribution subject to the provisions of the Companies Act, 1956. Normally, firms which are in the advance stage of their life cycle tend to distribute more dividends. Similarly growth firms tend to retain profits to sustain growth and fund such growth by ploughing back profits. The size of the firm also seems to influence dividend policy. Keeping in view the above position, we propose to study whether firm profitability, age of the firm, its size and growth prospects tend to influence the dividend policy of firms and accordingly hypothesis that:

Hypothesis 5 (H5): *There is a positive relationship between firm profitability, growth opportunities, size and age of the firm and its dividend policy.*

DATA AND METHODOLOGY

Sample selection

The sample consisted of companies that were a part of S&P BSE 100 and NSE CNX 100 for the period from 2007-08 to 2011-12, i.e. five years. We have considered 68 companies. These are large listed firms which enjoy greater market confidence and are also subject to greater regulatory scrutiny. All banks and financial services companies were eliminated from the list but state-owned enterprises (public sector undertakings) were included in the sample. We have excluded banks and financial institutions (11firms) from the scope of our study due to use of different accounting policies and practices and to ensure uniformity in the computation of accounting ratios that we have used in our study. Six firms may not have declared any dividends during the period of our study and were excluded. The final list for analysis consisted of 51 companies. The sample contained large firms from different industries with a variety of ownership structures. Of the 51 firms

selected, 27 firms are FRC while rest are non-FRC. Public sector organizations are included in the non-FRC category. In 16 firms foreign institutional investment exists, of which six are FRC and the rest are non-FRC. Some data was hand-collected from the annual reports of the companies. Although hand collection of data involved spending more time, it allowed a detailed study of the disclosure levels of the companies. This study also uses data from CMIE Prowess. This database has been extensively used by researchers and academia all over the world for data on Indian companies.

Table1. Classification of sampled companies

Total number of companies included in our sample from BSE 100 and NSE 100	68*
Banks and Financial institution (*excluded*)	11
Balance	**57**
Dividends not paid by firms during the period of study (*excluded*) *(Cairn, Coal India, Idea Cellular, Ranbaxy, Reliance Capital and Reliance Power)*	6
Sampled companies	**51**
Family Run Companies (FRC)	27
Non Family Run Companies (NFRC)	24
FRC in which Foreign Ownership exists	6
NFRC in which Foreign Ownership exists	10

Methodology

We have used descriptive statistics, correlation and multiple regression analysis in our study. Multiple regression analysis was conducted to identify the attributes that have significant impact on the dependent variable.The empirical model is as follows:

$$DPR=\alpha_1+\alpha_2PGH+\alpha_3INSTH+\alpha_4FORNH+\alpha_5FF+\alpha_6BS+\alpha_7IND+\alpha_8NED$$
$$+\alpha_9EVtoPBDITA+\alpha_{10}CCEtoTA+\alpha_{11}ROTA+\alpha_{12}DE+\alpha_{13}GW1GMTA$$
$$+\alpha_{14}GW2MVtoBV+\alpha_{15}AGE+\alpha_{16}SDofTI+\alpha_{17}LOGofTA+error.....(1)$$

$$DYR=\alpha_1+\alpha_2PGH+\alpha_3INSTH+\alpha_4FORNH+\alpha_5FF+\alpha_6BS+\alpha_7IND+\alpha_8NED+\alpha_9EVtoPBDITA+\alpha_{10}CCEtoTA+\alpha_{11}ROTA+\alpha_{12}DE+\alpha_{13}GW1GMTA+\alpha_{14}GW2MVtoBV+\alpha_{15}AGE+\alpha_{16}SDofTI+\alpha_{17}LOGofTA+error \quad (2)$$

Where, DPR is Dividend Payout Ratio and DYR is Dividend Yield Ratio. PGH represents the percentage of Promoter Group Holding of share capital; INSTH is the percentage of domestic institutional ownership; and dummy variables (i) FORNH representing whether foreign ownership exists in the firm and (ii) FF representing family firm as defined. The CG variables are (i) Number of directors on the board or board size (BS) (ii) IND is percentage of independent directors on the board and (iii) NED the percentage of non-executive directors on the board. The control variables are (i) EV to PBDITA is Enterprise Value to Profit before Depreciation, Interest, Taxes and Amortisation (PBDITA) (ii) CCE to TA is Cash and Cash Equivalent to Total Assets (iii) ROTA is Return on Total Assets (iv) DE is Debt-Equity Ratio (v) GW1GMTA is Geometric Mean of Total Assets (vi) GW2MVtoBV is Market to Book Value (vii) AGE is Age of the Firm (viii) SD of TI is Standard Deviation of Total Income and (ix) LOG of TA is Log of Total Assets.

The dependent variable in equation (1) is dividend payout ratio (henceforth, DPR) and in equation (2) is dividend yield ratio (henceforth, DYR). Dividend payout is the ratio of total ordinary annual dividends declared (interim plus final) to after-tax earnings (before extraordinary items) and dividend yield is the ratio of dividends to the market price per share. The dividend payout ratio relates dividends paid to the earnings of the firm. This ratio may be used in different ways. First, in valuation, it is used as a way of estimating future dividends. Second, the retention ratio (retention ratio = 1 minus payout ratio) shows the proportion of earnings reinvested in the firm and is useful in estimating future growth in earnings. Third, the payout ratio tends to follow the life cycle of the firm, initially zero when the firm is in the growth phase and gradually increasing as the firm matures and its growth prospects decrease. The dividend yield ratio provides a measure of that component of total return that comes from dividend. Investors use the dividend yield as a measure of risk. Studies have shown that stocks with

high dividend yields, after adjusting for market performance and risk, earn excess returns (Damodaran, 2011).

Both the ratios, DPR and DYR, have been constructed from five years data and are the median ratio. Historically, mean payout ratio was preferred to annual payout figures, to reduce the effects of transitory and noisy components in short-term earnings. The focus was on measurement of long term dividend payout, given the evidence, from a series of studies dating back to Lintner (1956), that firms typically stabilize dividends around a long-term payout objective. However, more recent studies prefer the use of median values as median values tend to be lower than mean values and hence are considered to be statistically more appropriate (since the multiples, DPR and DYR, exhibits a positively skewed distribution, its average value will be higher than median values, Damodaran, 2011).

Observations with DPR in excess of one or negative are excluded due to the lack of economic significance of these values. The choice of a five-year period balanced the trade-off between the advantage of using of a longer period to provide a more accurate measure of the long term dividend ratios, and the costs associated to the survivorship bias problems arising from the requirement of longer series of data for each firm in the sample.

As already stated, to study the relationship between ownership structure and dividend policy we use the following variables (i) promoter group holding, (ii) family firm, (iii) domestic institutional holding, and, (iv) foreign ownership. Family ownership in FRC is captured by using a dummy variable in our study. If a firm satisfies the explanation of being family run as given in the preceding paragraph then it is assigned "1" otherwise "0". Foreign ownership is also a dummy variable which is assigned "1" if foreign ownership exists, otherwise "0". We have captured CG in our study using the following variables (i) board size, (ii) proportion of independent directors on the board, and (iii) proportion of non-executive directors on the board.

The remaining variables that have been used in our study are control factors that either (i) have been observed in literature to influence dividend payments, (ii) can be seen as alternative or complementary mechanism for managerial monitoring or (iii) can proxy for the presence of potential agency problems.

We have used the ratios based on market value and Profit before Depreciation, Interest, Taxes and Amortization (henceforth, PBDITA) of the firms as a robustness check. Enterprise Value to PBDITA (henceforth, EV to PBDITA) has been considered for two reasons that make it a more accurate measurement of a firm's true value. First, the inclusion of PBITDA in the ratio allows for a comparison of earnings between different industries by omitting the effects of interest and taxes on earnings, which vary between industries. Second, enterprise value uses net debt in its calculation, which allows for the ratio to be used to compare firms with different capitalization structures. The multiple cash and cash equivalent to total assets represents the proportion of cash held by the firm to its total assets.

We have considered the debt equity ratio as the measure of the financing mix used by the firm and also as a measure of the solvency of the firm by comparing total debt to total equity. However, the implicit assumption is that there exists a "safe debt level" for each firm. The notion of "safe debt level" allows a firm to provide for higher return to equity holders as long as it is able to earn a return on capital which is higher than the cost of debt in a world with taxes, although debt brings risk.

Return on Total Assets (hereafter, ROTA) is used as a measure of the overall profitability of the firm in terms of the rewards (dividends and interest) to the suppliers of capital. ROTA is an accounting-based performance measure (Demsetz & Villalonga, 2001) and is included in several studies for its robustness. Phani et al. (2006) compared the results of various empirical studies and also statistically tested the relative merits of using ROTA. According to them, even in situations where the worst performing companies are included in the sample for econometric testing, ROTA tends to provide robust result in spite of it suffering

from an inherent bias due to historical valuation of assets. Further, if investors anticipate the effect of CG on performance, then long term stock returns will not be significantly correlated with CG even if a significant correlation between CG and performance exits. Accounting measures of performance, by contrast, do not suffer from any such anticipation problem.

Standard deviation of total income has been considered as a proxy for volatility of return while the natural log of total assets has been used a proxy for firm size. Past growth may be "organic" using ploughed back profits or "inorganic" through acquisitions. Organic growth may have implications on the dividend policy. Growth has been captured in our study using two variables, past growth using total asset growth and possible future growth using market to book value of equity. First, the variable GW1GMofTA, defined as the geometric mean rate of growth of the firm's total assets for five years. It is included on the grounds that higher historic growth may render dividend policy less relevant for inducing primary market monitoring mechanism, given the likelihood that growth may already be inducing external fund raising (and associated monitoring). Second, a similar argument applies to the variable GW1MVtoBV, measured as the ratio of market to book value of equity for future growth opportunities. This is consistent with the assertions of Rozeff (1982) and in that study there was a negative association between dividend payouts and the variables used as proxy for past or future growth opportunities.

Observations and analysis

The descriptive statistics is presented in Table 2. Promoter group holding for FRC is in the range of 25% to 79% with a mean of 47%. The nature of Indian FRC is such that promoters, through complicated group structures and pyramid holding, prefer to keep control in their hands. In NFRC the range is from zero to 84% with an average of 53%. This is relatively higher for non FRC compared to FRC. In this study we have included PSUs as part of non FRC. Due to the high stakes of the government (being the promoter) in these PSUs, the average promoter holding tends to be higher. Domestic institutional holding is in the range

of 4% to 54% with an average of 31% in FRC whereas in non FRC it is in the range of 11% to 51% with an average of 30%. FRC tend to have smaller board size and in our sample it is in the range of 5 to 18 with an average of 13. Non FRC have boards in the range of 8 to 22 with a mean of 14.

The proportion of independent directors on the board of FRC is in the range of 36% to 80% with a mean of 54%. For non FRC it is in the range of 12% to 69% with an average of 46%. FRC tend to have more independent directors on the board compared to non FRC. The proportion of non-executive directors on the board of FRC is in the range of 20% to 93% with an average of 69% compared to non FRC having 32% to 92% and an average of 57%. Thus FRC tend to exhibit better corporate governance than NFRC as is evident on the basis of the above parameters. FRC tend to rely more on debt capital compared to non FRC as is evident from the higher debt-equity ratio. FRC also have lower ROTA compared to non FRC. FRC tend to have lower EV to PBDITA and this may be explained by the fact that they have lower equity base and profits due to lower scale of operations. This is also be substantiated by lower market capitalization and asset base of FRC compared to non FRC leading to lower market to book value. The average dividend payout ratio of non FRC is higher than FRC.

Table2. Descriptive Statistics

	MINIMUM		MAXIMUM		MEAN		MEDIAN		STANDARD DEVIATION	
	NFRC	FRC	NFRC	FRC	NFRC	FRC	NFRC	FRC	NFRC	FRC
DPR	0.08	0.06	0.86	0.68	0.32	0.27	0.3	0.26	0.17	0.16
DYR	0.003	0.002	0.031	0.032	0.014	0.014	0.014	0.011	0.01	0.01
Ownership Variables										
PGH	0	0.25	0.84	0.79	0.53	0.47	0.55	0.49	0.23	0.15
INSTH	0.11	0.04	0.51	0.54	0.30	0.31	0.29	0.29	0.12	0.12
Corporate Governance Variables										
BS	8	5	22	18	14	13	14	13	4.15	3.33
IND	0.12	0.36	0.69	0.80	0.46	0.54	0.47	0.53	0.11	0.09
NED	0.32	0.2	0.92	0.93	0.57	0.69	0.55	0.74	0.16	0.16
Other Variables										
EV to PBDITA	4.37	5.72	167.1	35.51	21.41	14.46	13.86	12.53	33.42	6.87
CCE to TA	0.0364	0.0189	0.5321	0.9543	0.1936	0.2046	0.1632	0.1572	0.13	0.19
ROTA	0.04	-0.04	0.63	0.3	0.15	0.1	0.11	0.08	0.12	0.08
DE	0	0.01	2.23	1.24	0.4	0.47	0.09	0.37	0.64	0.34
MV to BV	1.95	0.97	23.97	11.72	4.99	4.08	3.24	2.95	4.59	2.89
AGE (in years)	17	5	102	110	45.7	45.6	38	39	22.65	30.46
TOTAL ASSETS (Rs. Millions)	39783.62	17124.32	1645891.36	2454953.96	376492.75	282969.67	265610.83	121266.64	386528.18	482622.57

We have calculated the correlation among the various attributes to observe the parity between them and are presented in Table 3. Institutional ownership is negatively correlated to promoter group holding (-0.847, p=0) signifying that domestic financial institutions do not prefer to invest in firms where promoter control is high. Board size is negatively correlated to the number of independent directors on the board (-0.391, p=0.005) signifying that smaller boards tend to have greater proportion of independent directors on their boards. Board size is negatively correlated to EV to PBDITA (-0.310, p=0.027) and this means that firms with compact boards tend to have a positive impact on this ratio. However, bigger firms with greater asset base (represented by log of total assets) tends to have positive correlation with board size (0.401, p=0.004) indicating that bigger firms have bigger boards and this is in consistency with literature. The debt equity ratio is also positively correlated to board size (0.342, p=0.014) indicating that firms with bigger boards tend to assume bigger amount of debt. Markets tend to penalise firms for assuming higher level of debt which adversely affects profitability explained by the negative relationship between ROTA and debt equity ratio (-0.394, p=0.004).

FRC tend to have greater representation of independent (0.393, p=0.004) and non-executive (0.369, p=0.008) directors on their board. Promoter group holding tends to be higher in relative younger firms as is evident from the negative relationship between this variable and firm age (-0.443, p=0.001) whereas domestic financial institutions show strong preference for mature firms (0.377, p=0.006). Future growth opportunities have been captured in our study using MV to BV ratio and it tends to favourably impact ROTA (0.465, p=0.001). This means that firm profitability is significantly driven by better future prospects. However, such growth represented by MV to BV is negatively correlated to the debt equity ratio (-0.314, p=0.025) signifying that firms that enjoy greater market capitalisation tends to have lower debt. Similarly growth, defined by growth in total assets, is significantly and positively affected by the volatility of total income (0.731, p=0). Firms which are affected by high volatility of income tend to have higher growth in assets.

Firms with higher dividend payouts tend to have a positive impact on the market and this is explained by the significant correlation between the payout ratio and dividend yield (0.492, p=0). Firms with bigger boards tend to pay more dividends (0.328, p=0.019). Better dividend payout ratio also favorably impacts the MV to BV ratio (0.371, p=0.007). Firms with better dividend yields tends to possess greater liquidity (0.458, p=0.001). Finally, the firm size indicated by total assets in this study has a positive correlation both dividend payout (0.301, p=0.032) and dividend yield (0.345, p=0.013).

Table 4: Results of Correlation Analysis

		DPR	DYR	PGH	INSTH	FORNH	FF	BS	IND	NED	EV to PBDITA	CCE to TA	ROTA	DE	Gw1 GM of TA	Gw2 MV to BV	AGE	SD of TI	Log of TA
DPR	Pearson	1	**.492****	0.01	0.049	-0.031	-0.131	**.328***	-0.018	0.231	0.033	0.131	0.198	-0.21	-0.088	**.371****	0.132	-0.147	**.301***
	Sig.		**0**	0.944	0.734	0.827	0.361	**0.019**	0.901	0.103	0.816	0.359	0.164	0.139	0.541	**0.007**	0.357	0.305	**0.032**
DYR	Pearson		1	-0.036	0.105	-0.178	-0.033	0.235	-0.054	0.197	-0.206	**.458****	0.215	-0.129	0.069	0.172	0.21	-0.077	**.345***
	Sig.			0.802	0.463	0.212	0.817	0.096	0.705	0.166	0.147	**0.001**	0.13	0.368	0.63	0.227	0.14	0.59	**0.013**
PGH	Pearson			1	**-.847****	0.096	-0.145	-0.041	0.082	-0.158	0.121	-0.125	0.134	0.024	0.183	0.079	**-.443****	-0.068	0.07
	Sig.				**0**	0.502	0.31	0.774	0.568	0.267	0.399	0.38	0.348	0.87	0.199	0.583	**0.001**	0.637	0.626
INSTH	Pearson				1	-0.167	0.059	0.065	-0.06	0.142	-0.113	0.192	-0.074	-0.005	-0.188	-0.092	**.377****	0.025	-0.047
	Sig.					0.24	0.68	0.651	0.676	0.321	0.428	0.178	0.606	0.97	0.186	0.52	**0.006**	0.862	0.742
FORNH	Pearson					1	-0.209	-0.207	-0.011	0.158	-0.064	-0.035	-0.007	-0.063	-0.23	0.106	-0.087	-0.125	0.09
	Sig.						0.141	0.146	0.938	0.269	0.658	0.806	0.96	0.661	0.105	0.46	0.546	0.38	0.532
FF	Pearson						1	-0.171	**.393****	**.369****	-0.149	0.034	-0.21	0.072	-0.11	-0.122	-0.002	0.08	-0.193
	Sig.							0.23	**0.004**	**0.008**	0.296	0.814	0.138	0.618	0.442	0.396	0.988	0.578	0.175
BS	Pearson							1	**-.391****	-0.005	**-.310***	-0.088	0.024	**.342***	0.251	0.022	0.085	0.095	**.401****
	Sig.								**0.005**	0.97	**0.027**	0.54	0.865	**0.014**	0.076	0.879	0.551	0.506	**0.004**
IND	Pearson								1	0.138	0.052	-0.107	-0.064	-0.112	-0.025	-0.077	-0.127	-0.022	-0.221
	Sig.									0.335	0.716	0.454	0.656	0.433	0.86	0.594	0.374	0.876	0.12
NED	Pearson									1	-0.176	-0.095	-0.042	-0.089	-0.249	0.085	0.194	-0.031	-0.098
	Sig.										0.218	0.506	0.771	0.536	0.078	0.551	0.173	0.828	0.496
EV to PBDITA	Pearson										1	0.04	0.015	-0.135	-0.121	0.126	-0.152	-0.1	0.029
	Sig.											0.783	0.915	0.343	0.398	0.378	0.288	0.485	0.839
CCE to TA	Pearson											1	0.237	-0.217	-0.205	0.074	0.058	-0.062	0.084
	Sig.												0.095	0.127	0.148	0.606	0.685	0.665	0.556
ROTA	Pearson												1	**-.394****	-0.114	**.465****	-0.105	0.032	0.239
	Sig.													**0.004**	0.426	**0.001**	0.463	0.825	0.092
DE	Pearson													1	0.137	**-.314***	-0.002	0.076	0.069
	Sig.														0.337	**0.025**	0.987	0.595	0.632
Gw1 GM of TA	Pearson														1	-0.262	-0.09	**.731****	0.102
	Sig.															0.063	0.529	**0**	0.476
Gw2 MV to BV	Pearson															1	-0.01	-0.09	-0.027
	Sig.																0.945	0.529	0.849
AGE	Pearson																1	-0.03	-0.167
	Sig.																	0.832	0.241
SD of TI	Pearson																	1	-0.144
	Sig.																		0.315
Log of TA	Pearson																		1
	Sig.																		

. Correlation is significant at the 0.01 level (2-tailed). *. Correlation is significant at the 0.05 level (2-tailed).

We now use regression analysis to understand the relationship between dividend policy, ownership structure, and corporate governance and the results are presented in Table 4. The regressions yield R-squares, 47% using dividend payout and 64% using dividend yield as the dependent variable, respectively, for the two equations. This signifies that 47% of the variability of DPR and 64% of the variability in DYR is accounted for by the models, respectively, after taking into account the number of predictor variables used in the model. These results are in accordance with the notion that the dividend policies of top Indian listed firms, in terms of market capitalization, are significantly influenced by the set of variables considered in this study.

Promoter group holding, domestic institutional holding and the existence of family control seem to have no impact on the dividend policy of firms. This result is consistent with Narsimhan et al. (2002) who had also concluded that a promoter holding has no influence on dividend policy. However, the presence of foreign institutional holding has a significant but negative impact on dividend yield. Given the monitoring role of foreign ownership it helps to explain the agency perspective of dividend policy. Thus, we reject our first hypothesis. None of the ownership variables, other than foreign ownership (which also has a negative influence), seems to impact dividend policy.

The corporate governance variables, namely board size and the proportion of non-executive directors on the board, have a positive impact on dividend policy. The co-efficient of board size tends to have a positive influence on DPR. Similarly, the co-efficient of non-executive directors on the DYR is significant and positive. Good governance has a positive impact on dividend payouts and yield. This result is consistent with the idea that firms with better internal corporate governance rules are also those that use dividend policy more intensely and the results are consistent with existing literature. Bigger boards offer better monitoring. The role of non-executive directors are advisory in nature given they are outsiders with expertise in the field of knowledge. Thus, greater non-executive director representation on the board ensures better governance and this seems to have a positive impact on market perception of the firm. This validates our second hypothesis. Further better

CG ensures greater investor protection. This is similar in spirit to findings by Laporta et al (2000), who observed that in countries where investor protection is greater, dividend payouts and yields tend to be higher as well, suggesting that the legal environment and dividend policy may complement each other in terms of their disciplining effects on managers.

The debt equity ratio has been used as a measure of firm's leverage. Leverage may influence firms' choices of payout policy because debt can also be used to alleviate potential cash flow problems (Jensen, 1986), as we have already discussed. High leverage and the implied financial risk should be associated with lower dividend payout because it discourages both the paying out of dividends and taking further loans. Furthermore, highly levered companies may prefer to pay lesser dividends in order to contain default risk. The debt-equity ratio, however, has no impact on dependent variables on the sampled firms included in this study. Thus, we reject our third hypothesis.

The ratio EV to PBDITA has a significant but negative impact on DYR. As already pointed out, comparing the firm's performance based on profits leads to a bias due to differences in accounting policies and capital structures. This is because some firms may charge depreciation on written down value basis, which leads to high depreciation costs in the initial years. In addition, some firms have a high debt in their capital structure leading to high interest costs. Such depreciation and interest costs tend to depress the net earnings. PBITDA discards such difficulties due to varying depreciation policies and debt-equity mix. This measure of earning is also sometimes used as a proxy for cash flow as it adds the non-cash expenditure (depreciation). The proportion of cash and cash equivalent to total assets is significantly related to DYR. This is consistent with literature and we accept our forth hypothesis that there exists a positive relation between the dividend policy of the firm and its liquidity position.

ROTA was used as a measure of profitability. ROTA seems to have no impact on the dividend policy. La Porta et al. (2000) used growth as a control for a corporation's growth opportunities, which might call for retention of earnings

to finance investment projects internally. Thus, for those companies with high growth prospects we assume a negative relation to the dividend payout ratio. However, in this study the co-efficient of historical growth depicted by growth in total assets has a positive and significant impact on dividend yield. Similarly, the coefficient market to book value, which portrays future growth, is also positively and significantly related to both DPR and DYR. However, the age of the firm and income volatility of the firm seems to have no significant impact on our sampled firm.

We control for firm size which is often considered as a proxy for firm maturity and has been shown to affect dividend policy (Grullon et al., 2002). Large firms are well diversified, and further growth opportunities are often exhausted. Thus, we assume that large companies are more likely to use free cash flows to pay out dividends than to invest in growth opportunities. Moreover, firms with more assets tend to have higher dividend payout ratios (Smith and Watts, 1992). Thus, we anticipate that firm size has a positive effect on the dividend payout. The natural logarithm of total assets, which is used a proxy for firm size, has a positive impact on dividend yield. Thus we accept the hypothesis that growth opportunities and firm size has a significant impact on the dividend policy. This result is different from the study of Allen and Michaely (1995) who observed a negative relationship between firm size and dividend policy in the context of UK firms.

Table5. Results of Regression Analysis

	DPR	**DYR**
Ownership Variables		
PGH	0.156 (.558)	0.031(.886)
INSTH	0.088(.732)	-0.004(.983)
FORNH	-0.090(.587)	-0.263(.058)*
FF	-0.173(.345)	-0.173(,251)
Corporate Governance Variables		
BS	0.362(0.058)*	-0.072(0.637)
IND	0.225(0.153)	0.118(0.356)
NED	0.262(0.104)	0.389(0.005)*
Control Variables		

EV to PBDITA	0.074(0.626)	-0.224(0.078)*
CCE to TA	0.148(0.306)	0.547(0)*
ROTA	-0.159(0.386)	-0.041(0.786)
DE	-0.212(0.191)	0.036(0.786)
Gw1 GM of TA	-0.004(0.990)	0.470(0.050)*
Gw2 MV to BV	0.333(0.041)*	0.276(0.040)*
AGE	0.138(0.363)	0.169(0.177)
SD of TI	-0.045(0.860)	-0.328(0.120)
Log of TA	0.263(0.141)	0.334(0.026)*
R2	0.469	0.643
Constant	0.029	0.024

Conclusion

This paper aims to contribute to the literature of CG by expanding the effect of CG on dividend policy. It addresses the crucial ownership and CG issues related to dividend policy in an emerging market economy, such as India. After revisiting existing literature and the regulatory corporate and taxation framework on dividend distribution, the paper presents an exhaustive analysis of dividend policy of India's top companies for a five year period (2007-08 to 2011-12) using a sample of 51 listed firms (BSE 100 and NSE 100).

The study identifies five issues (as posed through hypotheses) that need to be examined. In the context of ownership structure, we found that promoter group holding and domestic institutional holding have no influence over the dividend policy of the firm. We conclude that only foreign institutional ownership has an impact on the dividend policy of the firms. Due to high ownership concentration in Indian firms the conflict between controlling family owners and the outside shareholders is one of the main issues in CG literature. Though insider ownership and the alignment between different classes of owners are thought to be important factors influencing the dividend policy our results do not support it. We reject the view that insider ownership (family representation) affects dividend policies in a manner consistent with a managerial entrenchment perspective, drawn from the agency literature, and is not applicable to our sampled firms.

The goal of CG is to ensure that suppliers of finance to companies receive a fair return on their investment. While suppliers of equity can receive a return through dividends or capital gains, agency theory suggests that shareholders may prefer dividends, particularly when they fear expropriation by insiders, as in the case of FRC. The agency model tells us that when shareholders have greater rights, they can use their power to influence dividend policy. Shareholders can receive greater rights either through a legal protection or through a firm's adaptation of better CG practices. This paper shows that firm-level CG is associated with higher dividend suggesting that both mechanisms help reduce agency problems. Board size and the proportion of non-executive directors on the board have significant impact on the dividend policy of the firm. Bigger boards offer better monitoring and non-executive directors bring with them wealth of knowledge and expertise from which the firm benefits. The results suggest that when shareholders are well protected capital may be allocated more efficiently.

The debt equity ratio has been used as a measure of firm's leverage. High leverage and the implied financial risk should be associated with lower dividend payout because it discourages both the paying out of dividends and taking further loans. Furthermore, highly levered companies may prefer to pay lesser dividends in order to contain default risk. In our study the use of debt has not affected the dividend policy. However, the hypothesis that the liquidity position of the firm needs to be strong for paying dividends is responsible for its positive association with dividend policy and our study vindicates this. Growth opportunities, both historical growth depicted by growth in total assets and future growth captured by market to book value ratio, have a significant impact on dividend policy. The size of the firm (represented by the total asset base) is also found to have an impact the dividend policy of the firm.

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