Financial Performance and Dividend Strategies: A Study of Leading Non-Banking Financial Companies

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Abstract

The study examines the determinants of dividend policy and the impact of retained earnings on the performance of the top 10 finance companies over the past two years. It highlights the importance of dividend policy in enhancing shareholder value and company performance. Using quantitative methods, the research analyses the relationship between retained earnings, business performance, and various dividend policy factors such as taxation, growth prospects, company size, ROCE, debt levels, EPS, cash flow, and EBIT. The study underscores the significance of retained earnings, which are crucial for financial stability and investment opportunities. It employs financial indicators like market capitalization, P/E ratio, ROA, ROE, and EPS to assess the performance and market perception of these companies. The findings aim to provide insights into optimizing dividend plans and managing retained earnings to bolster market position and shareholder value.

Keywords: Dividend Policy, Retained Earnings, Shareholder Value, Earnings Per Share (EPS), Return on Assets (ROA), Return on Equity (ROE), Return on Capital Employed (ROCE).

Introduction

Dividend policy is a fundamental aspect of corporate financial strategy, precisely delineating the allocation of a corporate's net income between shareholder dividends and retained earnings for reinvestment. This intricate balancing act aims to meet shareholders' financial expectations while fostering the company's long-term growth trajectory. The development of an efficient dividend policy in the intricate non-banking financial services sector poses distinct and considerable problems. This complexity stems from a combination of reasons, including the changing regulatory landscape, the unpredictable market dynamics, and the industry's distinct strategic imperatives.

This research aims to identify the primary factors influencing dividend policy in this sector and to thoroughly evaluate the effect of retained earnings on the financial performance of the ten foremost non-banking financial enterprises. The choice to allocate dividends or preserve revenues for reinvestment is based on a complex interaction of essential elements. This encompasses, but is not restricted to, the company's profitability and development potential, its current capital structure, and the varied and frequently conflicting priorities of its shareholder base. Retained profits, which denote the segment of net income not allocated as dividends, are essential for bolstering the company's financial stability and supplying the necessary money for future investments and strategic endeavours.

A comprehensive grasp of the complex interrelations among these variables is essential for financial managers and investors aiming to optimize shareholder value and guarantee the firm's sustainable growth and success. This study utilizes a stringent analytical framework, analysing key performance indicators (KPIs) such as return on assets (ROA), return on equity (ROE), and earnings per share (EPS) to attain a thorough understanding of the strategic dividend strategies adopted by these prominent firms. The analysis will examine the intricacies of each firm's strategy, taking into account the particular contextual elements that affect their actions.

The expected outcomes of this research aim to deliver significant and practical insights for various stakeholders, including financial managers responsible for developing effective dividend policies, investors aiming to make informed investment choices, and policymakers engaged in influencing the regulatory framework of the non-banking financial services sector. The insights acquired will enhance a more educated and nuanced comprehension of dividend policy within this vital industry, enabling more effective decision-making amid continuous market evolution and regulatory changes.

Review of Literature

Nazarova et al. (2022) examined the impact of financial indicators and business news on the performance of luxury corporations, employing a panel sample of 45 publicly traded companies from Europe, Asia, and America from 2010 to 2019. Their investigation indicated that asset turnover, total revenue, and earnings per share favourably influenced market capitalization, whereas a high debt-to-equity ratio adversely affected it. This study highlights the significance of financial efficiency and profitability in influencing business success.

Sefti (2021) investigated the impact of profitability, liquidity and leverage, on stock returns, utilizing dividend policy as a mediating variable, in a sample of 141 manufacturing firms from 2014 to 2019. The results demonstrated that dividend policy did not moderate the influence of leverage and liquidity on stock returns; instead, profitability exerted a considerable favourable effect. This indicates that investors ought to prioritize corporate profitability when making investment selections.

Singla and Samanta (2019) on Indian building businesses found that profitability, business size and lifespan have a positive influence on dividend payments, while cash flow has a negative influence. Despite limitations, the research provides valuable insights.

Thakur & Kannadhasan's (2018) study on Indian enterprises' dividend policy revealed significant differences between OLS and quantile regression estimates, indicating distinct business characteristics' influence on dividend payments. This provides valuable insights for managers optimizing financial strategies.

Biswas (2018) examined the correlation between profitability and dividend payment ratio among four Indian paint producers from 2008 to 2017. The research identified a significant association between profitability indicators, including return on net worth and net profit, and dividend payout ratios, underscoring the influence of profitability on dividend policy.

Naeem (2016) examined the textile business in Pakistan, analysing the relationship between dividend distribution strategies and variables such as earnings per share, cash flow and leverage. The study determined that dividend payment policy exhibited a positive correlation with profitability and free cash flow, underscoring the importance of these criteria in dividend decision-making.

Roy (2015) examined the influence of ownership structures on dividend policy in Indian corporations, utilizing data from 70 companies over a five-year period. The research indicated that corporate attributes substantially impacted dividend policy, however debt utilization exhibited no significant effect. This study emphasizes the intricate relationship between corporate governance and dividend policies.

Kapoor (2009) performed an empirical study on the determinants of dividend smoothing practices in the IT, FMCG, and service industries in India from 2000 to 2008. The research revealed an inverse correlation between retained earnings and capital structure, although a direct correlation was found between the debt-to-equity ratio and the dividend payout ratio.

Objectives

The aims examined in this research are as follows:

1. To identify the impact of key determinants of dividend policy.
2. To analyse the association between retained earnings and companies' financial performance metrics.

Research Methodology

This study utilizes a research technique aimed at examining the factors influencing dividend policy and the effect of retained earnings on the performance of the top 10 non-banking financial enterprises in India for the years 2022 and 2023.

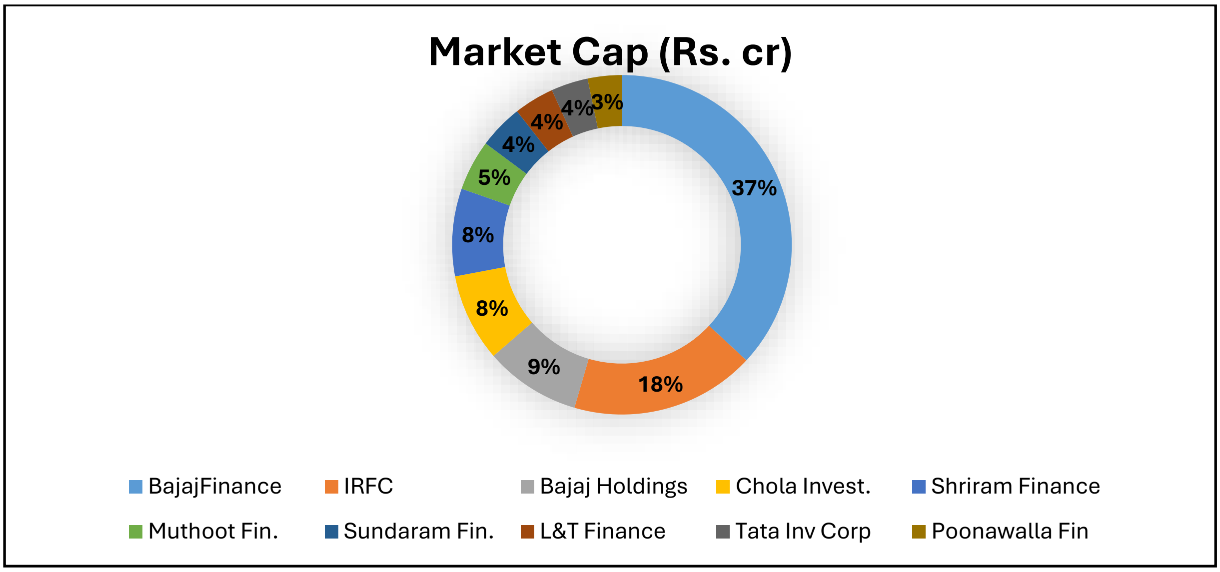
Table 1.

Top ten non-banking financial companies

Company Name	Last Price	%Change	52 wk High	52 wk Low	Market Cap (Rs. cr)
BajajFinance	6,571.00	1.16	8,190.00	5,487.25	4,05,929.92
IRFC	147.35	0.44	192.8	25.45	1,93,479.23
Bajaj Holdings	8,950.00	-1.94	9,354.00	5,791.05	1,00,365.04
Chola Invest.	1,099.60	0.97	1,309.75	709.85	92,046.91
Shriram Finance	2,455.85	0.8	2,535.00	1,190.00	91,686.33
Muthoot Fin.	1,319.85	1.08	1,537.40	911.4	53,072.88
Sundaram Fin.	4,175.80	0.12	4,253.45	2,190.40	46,384.19
L&T Finance	170.55	2	179	78.97	42,150.20
Tata Inv Corp	7,635.10	5	7,635.10	1,735.00	38,630.01
Poonawalla Fin	463	-1.05	519.95	273.95	35,756.17

Source: www.moneycontrol.com

Figure 1.



Research Design

This research employs a quantitative methodology to analyse the correlation between dividend policy, retained earnings, and financial performance. The emphasis is on pinpointing critical financial variables that affect dividend decisions and evaluating their influence on firm performance indicators.

Data Acquisition

The research utilizes secondary data sources to obtain pertinent financial information. Data is sourced from credible financial websites, including monetary.com and screener.in, in addition to the annual reports of the chosen companies. The sample comprises the ten largest non-banking financial enterprises by market capitalization.

Variables and Metrics

The primary financial variable examined in this study is return on equity (ROE), Return on Capital Employed (ROCE), Return on Assets (ROA), Dividend Payout Ratio (DPR), Price-Earnings Ratio (P/E) Ratio, Earnings Per Share (EPS), Earnings Prior to Interest and Taxes (EBIT), Revenue and Net Income, Accumulated Profits. These variables are selected to offer an extensive perspective on the firms' financial performance and dividend strategies.

Analytical Methods

A linear regression model was fitted using the financial metrics as predictors for the DPR. The model's coefficients and intercept were calculated, along with the R-squared value to assess the model's fit. The research utilizes correlation analysis with Spearman's coefficient to investigate the relationship between retained earnings and performance indicators. This statistical method is selected for its capacity to quantify the strength and direction of the relationship between two ranked variables, rendering it appropriate for the non-parametric characteristics of the data.

Analysis and Result

Objective 1: To identify the impact of key determinants of dividend policy:

Of the 9 determinants, 7 adversely affect DPR, whilst only two exert a beneficial influence. This indicates that the majority of the examined financial metrics generally reduce the DPR as they rise.

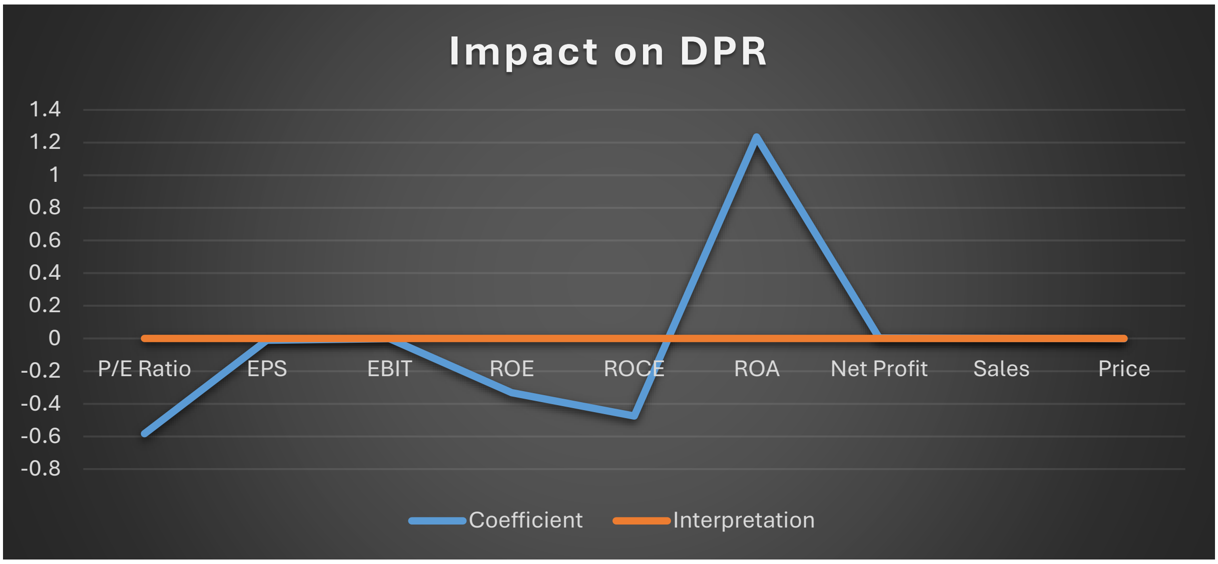
Table 2.

Financial Metrics Influencing Dividend Payout Ratio

Determinant	**Coefficient**	**Interpretation**
P/E Ratio	-0.5834	Negative impact on DPR

EPS	-0.0112	Negative impact on DPR
EBIT	-0.0015	Negative impact on DPR
ROE	-0.3319	Negative impact on DPR
ROCE	-0.4751	Negative impact on DPR
ROA	1.2342	Positive impact on DPR
Net Profit	0.0025	Positive impact on DPR
Sales	-0.0000071	Negative impact on DPR
Price	-0.0021	Negative impact on DPR

Figure 2.



Negative Determinants: The P/E Ratio, EPS, EBIT, ROE, ROCE, Sales, and Price exhibit negative coefficients. This indicates that as these variables rise, the DPR generally declines. This suggests that firms with elevated earnings multiples, earnings per share, operating income, return on equity, return on capital employed, sales, and stock prices may opt to hold earnings for reinvestment or other uses instead of paying them as dividends.

Positive Determinants: ROA and Net Profit have positive coefficients, signifying that a rise in these variables correlates with an increase in the DPR. This indicates that firms with elevated return on assets and net profits are more inclined to allocate a greater share of their earnings as dividends. This may be attributed to these organizations' superior asset use and enhanced profitability, enabling them to distribute dividends to shareholders.

Intercept: The model's intercept is 42.7, indicating the anticipated DPR when all independent variables are null.

Coefficient of Determination (R^2): The R-squared value is 0.8, signifying that 80% of the variability in DPR is accounted for by the model. This indicates a robust alignment.

The analysis indicates that ROA is the most significant positive determinant of DPR, whilst the P/E ratio exerts the most substantial negative influence. This indicates that firms prioritizing efficient asset usage are more inclined to provide bigger dividends, whereas those with elevated growth expectations (reflected by high P/E ratios) typically keep earnings for reinvestment. This indicates that firms prioritizing efficient asset usage are more inclined to provide bigger dividends, whereas those with elevated growth expectations (reflected by high P/E ratios) typically keep earnings for reinvestment. The predominance of adverse effects (7 out of 9 variables) suggests that rises in the majority of financial measures correlate with diminished dividend distributions. This may indicate a prevalent inclination among corporations to favor investing and expansion rather than dividend disbursement when their financial performance enhances. Investors pursuing substantial dividend yields should concentrate on firms exhibiting robust ROA, while exercising caution regarding those with elevated P/E ratios or ROCE. Nevertheless, it is crucial to recognize that dividend policies are intricate decisions shaped by other aspects outside these financial criteria, such as industry standards, the company's life cycle, and prevailing market conditions.

Objective 2: To analyse the association between retained earnings and companies' financial performance metrics:

The correlation matrix elucidates the relationships between retained earnings and several financial performance indicators, including DPR, P/E ratio, EPS, EBIT, and Net Profit.

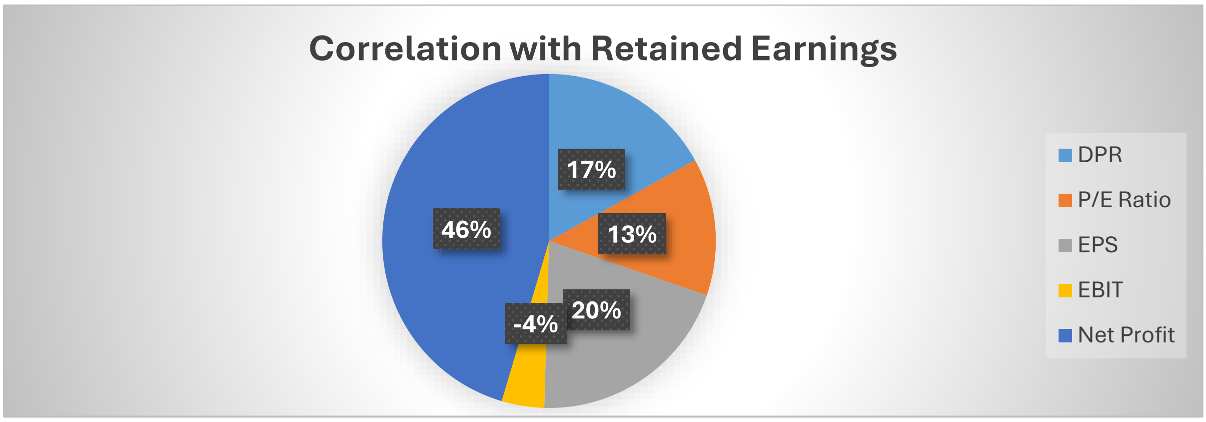
Table 3.

Financial Indicators and Their Relationship to Retained Earnings

Metric	Correlation with Retained Earnings
DPR	0.37
P/E Ratio	0.29

EPS	0.44
EBIT	-0.09
Net Profit	0.99

Figure 3.



Net Profit: A robust positive connection (0.99) exists between retained earnings and net profit. This signifies that an increase in net profit correlates with a substantial rise in retained earnings. This is logical, given retained earnings represent the segment of net profit that is not allocated as dividends.

The Earnings Per Share (EPS) exhibits a modest positive connection (0.44) with retained earnings, indicating that increased EPS is linked to elevated retained earnings.

The Dividend Payout Ratio (DPR) exhibits a moderate positive association of 0.37 with retained earnings. This may appear paradoxical, as a higher Dividend Payout Ratio generally indicates reduced retained earnings. This correlation may suggest that firms with elevated retained earnings possess the capacity to distribute higher dividends.

The P/E ratio exhibits a weak positive correlation (0.29) with retained earnings, suggesting a minor relationship between market valuation and retained earnings.

EBIT (Earnings Before Interest and Taxes) exhibits a weak negative correlation (-0.09) with retained earnings, indicating minimal to no direct association.

In conclusion, although net profit is the primary factor influencing retained profits, additional elements such as EPS and DPR also contribute to the formulation of a company's retention policy. The findings indicate that organizations weigh many objectives—such as profitability, shareholder returns, and growth investments—when determining the amount of earnings to keep. Investors and analysts must take these linkages into account when assessing a company's financial strategy and prospects for future growth.

Findings and Conclusion

The study explores the impact of dividend policy and retained earnings on the performance of leading non-banking financial companies in India, highlighting the significance of dividend policy in enhancing shareholder value. The research indicates that the dividend payout ratio (DPR) often decreases as factors such as P/E ratio, EPS, EBIT, ROE, ROCE, sales, and price rise. Companies with elevated earnings multiples and profitability indicators may opt to retain earnings for reinvestment rather than distribute them as dividends. In contrast, companies with a high return on assets and net profits are more inclined to allocate a larger portion of their earnings as dividends. The study reveals a significant positive link between retained earnings and net profit, indicating that increased profitability results in higher retained earnings. A slight positive correlation exists between EPS and retained earnings, suggesting that elevated earnings per share correspond with augmented retained earnings. The report highlights the significance of retained earnings for financial stability and investment prospects, providing insights into improving dividend strategies and managing retained earnings to enhance market position and shareholder value.

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