Dividend policy determinants and dividend stability

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A key decision that a company is faced with is the timing and the size of the distribution of wealth it has created to its shareholders. The company has to choose between paying out dividends now, or reinvesting it and paying it out at a later date. This choice forms the background for the dividend policy decision.

This study examines the corporate cash dividend policy behaviour in Sri Lankan listed companies in two different dimensions: the type of dividend policy and major determinants of the dividend decisions, incorporating both primary and secondary data. Furthermore, it investigates the role that dividend policy plays in Sri Lanka.

Primary data were assimilated through a formal questionnaire sent to 41 listed companies to assess management belief on distribution of dividends and the most influential factors that shape dividend policy decisions of investors. The Lintner Model was used to assess the stability of the dividend payouts, using panel data methodology. Secondary data on dividend information and stock prices were assimilated from information available with the CSE (Colombo Stock Exchange) for a ten year period.

The analysis revealed that the most significant factors that influence the dividend policy include level of current earnings, free cash flow, stability of earnings, firm’s liquidity and financial leverage. Compared to studies in developed markets, the companies are less conscious with lagged dividend and target payout ratio, which are the main signals of stability of one’s dividend policy. Supporting the findings, the fixed effects regression model also showed that the current dividend has positive but comparatively low relationship with lagged dividends.

It was also revealed that mature companies are less stable in their dividend payout than the new companies. The research findings provide evidence that Sri Lankan companies have less stable dividend policies and are less aligned with signaling effect and clientele effect on dividends.