Examine the Correlation between Dividend Decision of J.K. Tyres with Respect to EPS and Operating Profit

Jyoti Sapra Madan

One of the central issues of corporate finance has been the dividend decision of a firm, which has always been studied in relation to a firm's financing and investment decisions. The Corporate finance deals with long-term and short-term decisions and techniques relating to monetary decisions that business enterprises make and the tools and analysis used to make these decisions. In the above context I have studied the relationship between the Dividend per share, EPS, Operating Profit per share, of J.K.Tyres over a period of 2009 to 2013. The study is based on secondary data collected from the authentic websites of these companies. I have used Pearson's Correlation Coefficient (2 Tailed test, 5% Level of Significance) to see whether there is any significant correlation between the above mentioned variables.

Keywords: Corporate Finance, Earning per Share, Operating Profit Per Share, Dividend Per Share.

ABSTRACT

INTRODUCTION

Dividend policy and its planning strategy are among the tasks of financial departments' management in economic organizations. This task has a significant impact on the capital structure and pricing the company. One of the major areas of Corporate Finance is Capital Investment Decision which looks into long-term corporate finance decisions relating to fixed assets and capital structure. The primary goal of corporate finance is to maximize shareholder value. Corporate finance is the area of finance dealing with monetary decisions that business enterprises make and the tools and analysis used to make these decisions thus is applicable to financial problems of all kinds of firms. Short-term issues include the management of current assets and current liabilities, inventory control, investments and other short-term financial issues. Long-term issues include new capital purchases and investments. Thus corporate finance is associated with transactions in which capital is raised in order to create, develop, grow or acquire businesses. Decisions are based on several inter-related criteria. (1) Corporate management seeks to maximize the value of the firm by investing in projects which yield a positive net present value when valued using an appropriate discount rate in consideration of risk. (2) These projects must also be financed appropriately. (3) If no such opportunities exist, maximizing shareholder value dictates that management must return excess cash to shareholders (i.e., distribution via dividends). Capital investment decisions thus comprise an investment decision, a financing decision, and a dividend decision economic organizations. This task has a significant impact on the capital structure and pricing the company stock.

LITERATURE REVIEW

Aswath Damodaran, in his paper Dividends and Taxes: An Analysis of the Bush Dividend Tax Plan studied the implications of making dividends tax free to investors. Investors and corporate finance practitioners contemplated about this after President Bush proposed it as part of his economic package in early 2003. While much of the debate has concentrated on the consequences of the tax law change for the stock market and budget deficits, the real effects may be in how companies raise money (debt versus equity), how much cash they choose to accumulate and how they return this cash to stockholders (dividends versus stock buybacks). If the tax law changes occur as proposed, it will profoundly alter the terms of the debate and require us to rewrite much that we take for granted in corporate finance today. In particular, companies will become more (if not entirely) equity financed, a decrease in cash balances and a dramatic surge both in the number of companies that pay dividends and in how much they pay. This asymmetric treatment of debt and equity has formed the basis for much of the debate in corporate finance on whether firms should use debt or equity and how much firms should pay out to their stockholders in dividends. In this paper,

1. Assistant Professor, MIT College of Management, Moradabad, U.P.
he considered the implications of the tax law change for both valuation and corporate finance practice.

More recent studies provide additional insight regarding dividend/earnings relationship. For example, Chiang, Davidson, and Okunew (1997) examined this relationship using a modified form of the Lintner Model. The objective was to determine whether changes in dividends convey any additional information regarding subsequent changes in earnings. They noted difficulty in isolating the relationship between dividend and earnings due to many of the other changes which occur simultaneously in the firm. Their results imply that changes in EPS and DPS are important in the explanation of returns.

Research by Lamont (1998) found that the aggregate dividend payout ratio forecasts excess returns on both stocks and corporate bonds in postwar U.S. data. Also noted was that high dividends forecast high returns while high earnings forecast low returns. Further, dividends and earnings contribute substantial explanatory power but only for short horizons.

Nissim and Ziv (2001) investigated the relationship between dividend changes and future profitability (as measured by either future earnings or future abnormal earnings). They found that dividend changes were positively related to earnings changes in each of the two years following the dividend change and thus provided support for information content of dividends hypothesis.

The relationship between corporate governance and dividend payout behaviour of the Indian firms is examined by Kumar (2006) by taking into consideration their financial structure, investment opportunities, dividend history, earnings trend and ownership structure during 1994–2000. He finds a positive association of dividends with earnings and dividend trends but does not find any association between foreign ownership and growth in dividend payout.

Raghuram Rajan studied the nature of the firm and its linkage with financing in his paper “The Corporation in Finance” He argued that the availability of a vibrant stock market helps the entrepreneur to commit the transformations in a way that a debt market would not. This explain why the nature of firms and the extent of innovation differ so much in different financing environments.

**OBJECTIVE AND METHODOLOGY OF THE STUDY**

In this paper I have analysed the relationship between the Dividend per share, EPS, Operating Profit per share of J.K.Tyres. The study is based on secondary data. Data has been taken from the year 2009 to 2013. It has been collected from the CMIE, Capital line and the annual reports of respective companies. I have used Pearsons Correlation Coefficient (2 Tailed test, 5% Level of Significance) to see whether there is any significant correlation between the above mentioned variables. It also needs to be seen whether there are any major fluctuations in the above variables over the period of study and to what extent.

**RESEARCH HYPOTHESIS**

Null Hypothesis 1: There is no correlation between Dividend per share and EPS of J.K. Tyres.

Alternate Hypothesis 1: There is correlation between Dividend per share and EPS of J.K. Tyres.

Null Hypothesis 2: There is no correlation between Dividend per share and Operating Profit per share of J.K. Tyres.

Alternate Hypothesis 2: There is correlation between Dividend per share and Operating Profit per share of J.K. Tyres.

**INFERENCES AND RESULTS**

a. There is a positive correlation between Dividend per share and EPS (0.940). This makes it obvious that the Dividend per share and EPS move in the same direction over the years. This is evident from March 2009 to March 2013, as the Dividend per share decreased, so did the EPS.

b. There is a positive correlation between Dividend per share and Operating Profit per share (0.931). This makes it obvious that the Dividend per share and Operating Profit per share move in the same direction over the years. This is evident throughout the study period, as the Dividend per share Profit per share decreased, so did the Operating Profit per share and vice versa.

Thus the 2 Null Hypotheses are rejected as there is a correlation between Dividend per share and EPS, Operating Profit per share. Thus EPS, Operating Profit per share and Free Reserves per share affect the Dividend per share.

**CONCLUSIONS**

Dividend decision is an important decision of corporate finance. Every company puts in a lot of thought behind the same to somehow maximize the returns and also look into share holders interest. Through this study one can conclude that there is a correlation between Dividend per share and EPS, Operating Profit per share. J.K. Tyres looks into this area effectively. Thus J.K. Tyres relates their Dividend decisions with their EPS, Operating Profit per share per share. Irrespective of the direction, one cannot rule out the correlation between the above. Thus one can conclude that Dividend decision being one of the important decisions of Corporate Finance is influenced by EPS, Operating Profit per share of J.K. Tyres.

**TABLES & CHARTS**

Table 1: Details of J.K. Tyres

<table>
<thead>
<tr>
<th></th>
<th>Dividend Per Share (Rs.)</th>
<th>Earnings Per Share (Rs.)</th>
<th>Operating Profit Per Share (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar’13</td>
<td>3.5</td>
<td>25.70</td>
<td>118.69</td>
</tr>
<tr>
<td>Mar’12</td>
<td>2.5</td>
<td>2.68</td>
<td>68.12</td>
</tr>
<tr>
<td>Mar’11</td>
<td>3.0</td>
<td>14.93</td>
<td>81.40</td>
</tr>
<tr>
<td>Mar’10</td>
<td>3.5</td>
<td>39.81</td>
<td>117.50</td>
</tr>
<tr>
<td>Mar’09</td>
<td>2.70</td>
<td>4.64</td>
<td>92.93</td>
</tr>
</tbody>
</table>
Table 2: Correlation For J.K.Tyres

<table>
<thead>
<tr>
<th></th>
<th>Dividend per share</th>
<th>Earning per share</th>
<th>Operating profit per share (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend per share</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>0.94</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Earning per share</td>
<td>Pearson Correlation</td>
<td>0.94</td>
<td>0.913</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Operating profit per share</td>
<td>Pearson Correlation</td>
<td>0.913</td>
<td></td>
</tr>
<tr>
<td>(Rs.)</td>
<td>Sig. (2-tailed)</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

CHART 1: COMPARISON FOR J.K.Tyres

REFERENCES


http://people.stern.nyu.edu/adamodar/pdfiles/papers/fininnov.pdf