

## CHAPTER 2

### REVIEW OF LITERATURE

The literature review is a critical discussion and summary of related literature that has 'general' and 'specialized' relevance to the particular area and topic of the selected research problem. It is always based on the secondary sources consisting of similar researches done by researchers. It also includes the new concepts, ideas and theories framed earlier in the selected research area. A good literature review helps to identify similar work done within the selected research area, to identify research gaps that demand further investigation, to compare previous findings, to criticize existing findings and suggest further research studies. Various research studies were reviewed relating to selected study area and are summarized as follows.

#### 2.1 THEORIES OF CAPITAL STRUCTURE

The capital structure of a firm should provide for maximization of profits and the wealth of shareholders. An appropriate proportion of debt equity mix ensures, the maximization of value of the firm and the minimizing of the cost of capital. The capital structure theories suggest some combination and proportion of sources of funds that are largely applicable for companies, at times of raising finance. The theories specify some proof for the relationship between the leverage and value of a firm and their impact on its weighted average cost of capital. Some of the major capital structure theories are as follows.

##### 1. Net Income Approach

According to the Net Income Approach proposed by Durand David, the value of a firm and the market price of its equity shares can be increased with a reduction in the weighted average cost of capital by increasing the financial leverage to the possible extent. A decrease in the debt ratio will lead to a decrease in the value of the firm, decline in market price of its equity shares and an increase in the weighted average cost of capital. The approach suggests that

the capital structure decision is relevant to the valuation of the firm. This is based on the following assumptions.

- (i) There are no taxes.
- (ii) The cost of debt finance is less than the cost of equity funds.
- (iii) The risk perception of investors does not change with the use of debt.

The theory states the financial leverage, as an important variable in the capital structure of a firm. An appropriate combination of debt and equity funds in the capital structure will provide for an optimum capital structure and a reduced cost of capital followed by an increased market price of the firm.

## **2. Net Operating Income Approach**

The Net Operating Income Approach proposed by Durand, is diametrically opposite to the Net Income Approach. This theory is another extreme of the effect of leverage on the value of the firm, showing that the capital structure of a firm is irrelevant to its firm value. It also states that the overall cost of capital is independent on the method of financing. Any increase in the proportion of debt, leads to an increase in the financial risk of equity shareholders. This provides for an increase in the rate of return to the equity holders. Thereby, the cost of debt capitalization matches the cost of equity capitalization. Hence, the overall capitalization rate of a firm remains the same at any degree of leverage. This theory assumes that,

- (i) The market capitalizes the value of the firm as a whole.
- (ii) The business risk remains constant at any level of debt equity mix.
- (iii) There are no corporate taxes.

## **3. The Traditional Approach**

The Traditional Approach also called as 'Intermediate Approach', is a midstream between the Net Income and Net Operating Income approaches. The theory states that optimum capital structure can be attained by a judicious debt-equity mix. Accordingly, the value of the firm can be increased with a substantial

reduction in cost of capital and it can be reached by raising debt capital. But if the debt funds are increased continuously, at a certain state it may result in higher financial risk. This will lead to payment of higher return to its investors resulting in higher weighted average cost of capital. At the level of optimum capital structure, the cost of debt will be equal to cost of equity and while crossing the level of leverage, cost of debt exceeds the cost of equity. The traditional view suggests that there is a range of capital structures resulting minimum cost of capital and maximum firm value, with less impact of changes in leverage on the firm value.

#### **4. Modigliani and Miller Approach**

The Modigliani & Miller hypothesis is similar to the Net operating Income approach, when the corporate taxes are ignored and also resembles Net Income approach, when the corporate taxes are assumed to exist.

##### **(i) Proposition I – In the absence of taxes. (Theory of Irrelevance)**

The theory of irrelevance states that the cost of capital is independent of its capital structure and the overall cost of capital does not significantly impacts the value of the firm. The cost of debt is cheaper than the cost of equity but, if the leverage increase beyond a certain limit it increases the cost of equity. Therefore, the overall cost of capital remains constant. The theory emphasizes that a firm's operating income is an important determinant of its total value. According to this approach, two identical firms with different capital structure will have the same market value. This is because of arbitrage process of investors where, they involve in personal leverage against corporate leverage resulting in similar total value of both the firms.

##### **(ii) Proposition II – when the taxes are assumed to exist. (Theory of Relevance)**

The theory of relevance propagates that on using the debt funds, the value of the firm will increase and the cost of capitalization will decrease, because of tax deductibility of interest paid on debt. By maximizing the leverage in a company's capital structure, optimum capital structure can be attained. The

higher the employment of debt capital, higher is the financial risk for investors and it will increase the cost of equity capitalization. Thus the proposition II of Modigliani and Miller, relates the Net Operating Income approach.

#### ▪ **Trade-off Theory**

The Trade-off theory states the benefits of using debt finance to attain optimum capital structure assisting maximum firm value, increased tax benefits and reduced bankruptcy costs. The debt funds are advantageous up to a certain limit, beyond the limit the cost of financial distress trades off the benefit of interest tax shields. At the point of limit, the optimum capital structure is reached and such point varies from firm to firm depending up on its business risk. The theory propounds that the debt ratios will be higher in firms making increasing and stable revenues and it will be lower in risky firms making declining or volatile revenues. It was therefore concluded that the leverage can be used within certain limits of the trade-off theory, to avail the benefits of debt financing.

#### ▪ **Signaling Theory**

In the Signaling theory, Modigliani and Miller assumes there exist information symmetry in any firm. This means both the inside managers and outside investors of a firm, have identical information regarding the operations of the firm. But in real, the managers possess more information about the functioning and future prospects of the firm than the investors. This scenario is known as 'Asymmetric information'. The theory states that greater the asymmetry in information among the managers and investors, greater is the impact on share price of the firm. If new shares are issued, the investors get the opinion that managers feel that the company is overvalued and they want to make profits out of it. Therefore, the investors hesitate to respond the new equity issue.

The announcement of debt issue is considered as 'positive signal' and share issue is considered as a 'negative signal'. The negative signal of share issue by investors would lead to a decline of share price. Therefore the signaling theory suggests that, a firm should maintain some reserve borrowing capacity, by

maintaining low levels of debts than suggested by the trade-off theory. This reserve will assist the firm to procure good investment opportunities in future through debt financing, without causing any adverse impact on its share price.

#### ▪ **Pecking Order Theory**

The Pecking-Order theory reveals the order of source of financing that is preferred by the corporates in practice. The theory conforms the signaling theory regarding, the information asymmetry and the need to bear the floatation costs of new issues. The firms at first, prefer internal financing than external financing, to avoid the floatation expenses. They believe that the companies can earn more with the retained earnings, than the shareholders themselves earn by profits that are distributed as earnings. In case, the retained earnings are not sufficient to meet the investment opportunities, they go for raising external finance.

## **2.2 THEORIES OF DIVIDEND POLICY**

The dividend policy decision is a critical aspect, as it involves two decisions regarding the firm's earnings namely, wealth maximization of the shareholders and ploughing back of profits into the business. The firm should distribute the net profits to the shareholders as dividends, if the payment will lead to wealth maximization of the shareholders. Else, the funds should be retained for funding investment opportunities. The value of the firm can be maximized if the shareholders' wealth is maximized. According to one school of thought, dividends are irrelevant and so the amount of dividends paid does not affect shareholders' wealth and the value of the firm. Whereas according to the other school of thought, dividend decisions affect the shareholders' wealth and the value of the firm. Some of the major irrelevant and relevant dividend policy theories are as follows.

### **1. Irrelevance of dividends**

According to the concept, irrelevance of dividends to valuation, the dividend policy is a part of the firm's financing decisions. The payment of dividend depends upon the availability of the investment opportunities. If

acceptable investment opportunities are inadequate, then the earnings will be distributed to the investors. The rate of return on investments ( $r$ ) is compared with the cost of capital ( $k$ ) to find whether the investments are profitable. If the return exceeds the cost, then the earnings will be retained and utilized for the investments and insufficiency of funds will be met by new issue of equity and debt. The retaining are excess to finance the acceptable investment opportunities and the excess amount of profits will be distributed to the shareholders.

### **(i) Residual Theory of Dividends**

The residual theory suggests that the dividend paid to the shareholders should be viewed as residual that is, the amount left over after financing all acceptable investment opportunities. The earnings are financed to all possible investment projects with positive Net Present value and the left over amount will be paid as dividends. The dividend equalization reserve is created and the funds earned during the surplus years are transferred, to be used at lean years. New equity shares are issued only if the retained earnings are not sufficient to finance the profitable investment opportunities. The theory also concerns with maintaining a target capital structure and the dividend payments thus treated as passive residual, implies that the dividend decisions are irrelevant to the value of the firm.

### **(ii) Modigliani and Miller (MM) Approach**

Modigliani and Miller supports the irrelevance theory of dividend and states that the dividend policy does not affect the share price of the firm. They also states that the value of a firm is determined by its earning capacity and the investment policy. Therefore, the firms can split the earnings to pay dividends and to retain for investment purposes and it will not affect the firm's value or share price. They also specifies that "Under conditions of perfect capital markets, rational investors, absence of tax discrimination between dividend income and capital appreciation, given the firm's investment policy, its dividend policy may have no influence on the market price of the shares". There are some assumptions and criticisms towards the MM hypothesis, they are as follows.

## **2. Relevance of dividends**

The theory of relevance of dividend was proposed by Myron Gordon, Jone Linter, James Walter and Richardson. According to this school of thought, the dividends communicate the investors about the profitability of a firm. Thereby, the value of the firm increases for the firms paying higher dividend payout than the firm that pay low or no dividend. The relevance theory states that the dividend decision is relevant. Some theories that support the relevance of dividend are as follows.

### **(i) Walter's Approach**

Walter's approach states that the investment policy and the dividend policy are interlinked and the dividend decisions affect the value of a firm. The model supports the relationship between the return on investment ( $r$ ) and the cost of capital or required rate of return ( $k$ ). If the return on investment is higher than the required rate of return, i.e.  $r > k$  then the firm should retain the earnings and the optimum dividend payout would be zero. If the required rate of return exceeds expected return investment, i.e.  $k > r$  the earnings should be distributed to the shareholders. This will maximize the share value and such firms are called growth firms. The optimum dividend payout ratio will be 100. For normal firms where  $r = k$ , the dividend policy will not affect the market value of the shares and the value of the firm remains same to the change in dividend rate. For such firms there is no optimum dividend policy (D/P ratio).

### **(ii) Gordon's Approach**

The Gordon's model also states as Walter's model, that the dividends are relevant and the dividend policy of a firm affects its firm value. It was identified that the market value of a share is equal to the present value of future stream of dividends. If the rate of return on investment is greater than the cost of capital or required rate of return, i.e.  $r > k$  the dividend payout decreases and the price per share decreases. In case, the required return is higher than rate of

return, i.e,  $k > r$  the payout ratio increases and the dividend payout would be 100 percent. If the rate of return is equal to the required rate of return, i.e,  $r = k$ , then there is no optimum dividend payout. This theory is based on the following assumptions.

### 2.3 STUDIES ON CAPITAL STRUCTURE

Modigliani. F and Miller. M.H. (1958) have conducted a research study entitled "**The cost of capital, corporation finance and the theory of investment**". They have stated that under a certain market condition, in the absence of taxes, no transaction costs, no asymmetric information and in a perfect market, the cost of capital and the value of the firm are not affected by the change in capital structure. The capital structure decisions are irrelevant as long as the firm's investment decisions are taken. With the assumption of no taxes, the two propositions given are (i) the overall cost of capital and the value of the firm are independent of the capital structure. (ii) The financial risk increase with more debt proportion in the capital structure. It was concluded that, the cost of equity increases to balance the low cost advantage of debt. Therefore, the overall cost of capital remains the same.

Modigliani. F. and Miller. M.H. (1963) have done a research study entitled "**Corporate income taxes and the cost of capital: A correction**". They recognized the importance of the existence of corporate taxes. Accordingly, they agreed that the value of the firm will increase or the cost of capital will decrease with the use of debt due to tax deductibility on interest charges. Thus, the value of corporation can be achieved by maximizing debt component in the capital structure. They had revealed that, the existence of tax shield in a perfect capital market conditions cannot be reached and in an imperfect financial market, the capital structure changes will affect the company's value. It was suggested that the higher debt ratio is more favorable to corporate, but though borrowing increases an interest tax shield it may lead to costs of financial distress.

Myers, S.C. (1984) had conducted a research study entitled “**The capital structure puzzle**”. He argued that adverse selection implied that retained earnings are better than debt and debt is better than equity. Firms prefer internal finance and if external finance is required, firms issue debt first and issue equity only as a last resort. The pecking order explained that most of the profitable firms generally borrow less because they have low target debt ratios but they don't need outside money. It is discussed that equity is preferred less to raise capital as such when managers issue new equity, investors trust that managers think the firm is overvalued and managers take the advantage of this over-valuation. Hence, the investors will place a lower value to the new equity issuance.

Gay B. Hatfield, Louis T.W. Cheng and Wallace N. Davidson (1994) have done a research study entitled “**The Determination of Optimal Capital Structure: The Effect of Firm and Industry Debt Ratios on Market Value**”. The objectives of the study were to examine the hypothesis by classifying firms' leverage ratios as being above or below their industry average prior to announcing a new debt issue and to test whether that has an effect on market returns for shareholders. They revealed that the relationship between a firm's debt level and that of its industry does not appear to be of concern to the market. The High Debt firms had significant negative market reactions; however, the difference between the group and the Low Debt firms were not significant. Firms in a given industry tend to have similar capital structures. The results showed that the market does not consider industry averages for leverage as discriminators for firms' financial leverage.

Raj S Dhankar and A jit S Boora (1996) have conducted a research study entitled “**Cost of Capital, Optimal Capital Structure, and Value of Firm: An Empirical Study of Indian Companies**”. The objective of the study was to find out whether there exists an optimal capital structure either at the micro and/or at the macro level in Indian private sector companies. It was concluded that no significant relationship was found between change in capital structure and the value of firm, at micro level. The results also support the existence of an optimal

capital structure at the macro level but in the absence of a model on capital structure, it is not possible to determine its exact range. It was suggested that though cost of capital decreases when leverage increases, this decrease is very moderate and not proportional to debt level.

Samuel G. H. Huang and Frank M. Song (2001) have attempted a research study entitled "**The Determinants of Capital Structure: Evidence from China**". The objectives of the study were to examine whether corporate financial leverage decisions made in Chinese listed firms are different from those made in firms in economies where private property right is more popular and market mechanism have been the rule for years and to find the factors that affect cross-sectional variability of capital structure in other countries have similar effects on Chinese firms' capital structure. The accounting data of more than 1000 Chinese listed companies up to the year 2000 were analyzed. It was concluded that leverage, as measured by long-term debt ratio, total debt ratio and total liabilities ratio, decreases with profitability and increases with company size. It was found that Chinese companies have less long-term debt, less total liabilities and higher shareholders' equity compared to their counterparts in both developed countries and developing countries.

Guven Sayilgan, Hakan Karabacak and Guray Kucukkocaoglu (2003) done a research study entitled "**The Firm-Specific Determinants of Corporate Capital Structure: Evidence from Turkish Panel Data**". The objective of the study was to determine the firm-specific factors affecting the capital structure decisions of Turkish firms. The sample of this study covers 123 Turkish manufacturing firms and the analysis is based on the year-end observations of ten consecutive years running from 1993-2002. They revealed that size and growth opportunity in total assets, have a positive association with the debt level. On the other hand, profitability, growth opportunities in plant, property and equipment, non-debt tax shields and tangibility are inversely related with the leverage ratio. Among the independent variables of study - size, profitability and growth opportunities in plant, property and equipment, growth opportunities in

total assets, non-debt tax shields and tangibility - are significant determinants for the capital structure decisions of Turkish firms.

Tom Kuczynski (2005) has attempted a research study entitled “**The Determinants of Capital Structure, an Empirical Study of Japanese Companies**”. The main purpose of the study was to present the results of the study on the patterns and directions of company finance in 13 manufacturing industries of Japanese manufacturing industry in years 1988–2003. It quantifies these tendencies, and explains the variables which determine capital structure in these companies. The study concluded that the capital structure of the Japanese manufacturing industry is significantly affected by: profitability, dividend, tangibility, market-to-book ratio and size. Coefficients of tangibility were found to be statistically significant, which may support the assumptions of agency cost and static optimal capital structure. Firms with high tangible asset ratios tend to raise leverage due to the abundance of assets they can easily put up as collateral.

Mahdi Salehi and Kumars Biglar (2009) have done a research study entitled “**Study of the Relationship between Capital Structure Measures and Performance: Evidence from Iran**”. The objective of the study was to evaluate the impact of the main variables of capital structure and performance on experimental results. A sample of 117 corporates listed in Teheran Stock Exchange were selected for the period 2002-2007. It was concluded that market value and adjusted value measures of capital structure in comparison with book value measures have stronger link with performance. The debt level was over than optimized level and in comparison to advantages of tax shield, incurrence of financial distress costs has more significance. The reasons found for using of debts by Iranian companies was constant interest and it was concluded that company that has high profitability and good performance have less debt.

Anup Chowdhury and Suman Paul Chowdhury (2010) have conducted a research study entitled “**Impact of capital structure on firm’s value: Evidence from Bangladesh**”. For the purpose, 77 companies belonging to 4 different

dominant sectors of Bangladesh capital market were analysed from January 1, 1994 to December 31, 2003. The objective of the study was to evaluate the impact of capital structure on the value of firm. It was revealed that capital structure has a definite impact on the market value of a firm. It is observed that by changing its current ratio, operating leverage, EPS, dividend payout ratio and share capital, a firm may increase its value in the market. It was suggested that maximizing the wealth of shareholders requires a perfect combination of debt and equity, whereas cost of capital has a negative correlation and it has to be as minimum as possible.

Balasundaram Nimalathan and Valeriu Brabete (2010) conducted a research study entitled “**Capital Structure and its Impact on Profitability: A Study of Listed Manufacturing Companies in Sri Lanka**”. The objectives of the study were, to identify the profitability of listed manufacturing companies for 5 years during 2003 to 2007, to find out the relationship between capital structure and profitability and to recognize the capital structure. The study revealed that Debt/Equity ratio was positively and strongly associated to all profitability ratios except Return on Capital Employed and Return on Investment. Capital gearing ratio also positively correlated to Gross Profit Ratio and Net Profit Ratio, Interest Coverage ratio was significantly correlates to Return on Capital Employed and Net Profit Ratio. The capital structure showed great impact on all profitability ratios.

Anifowose Mutalib (2011) has analysed a research study entitled “**Determinants of Capital Structure in Cement Industry: A case of Nigerian Listed Cement Firms**”. The main objective of this study is to identify the potential determinants of capital structure in the listed cement firms in Nigeria. The population of the study comprises of five listed cement firms in Nigeria out of which four were randomly selected representing 80% of the entire population and the annual financial reports from 2004 to 2008 were analysed. The study revealed that Profitability is the most significant explanatory variable and is negatively related to leverage. The prediction of trade-off theory was confirmed

by the result that creditors prefer the security of specific claim on fixed assets. Growth potential and age variable are both having positive relationship with capital structure. The liquidity had negative relationship and size showed a positive coefficient. It was concluded that firms in the sample consider their sizes as an active variable in deciding the leverage level.

Mahira Rafique (2011) has done a research study entitled “**Effect of Profitability & Financial Leverage on Capital Structure: A Case of Pakistan’s Automobile Industry**”. The objective of the study was to investigate the effect of the profitability of the firm and its financial leverage on the capital structure of the automobile sector companies in Pakistan. The sample consists of 11 automobile firms listed on the Karachi Stock Exchange for a period from 2005 to 2009. It was concluded that though firm’s profitability is strongly negatively related to capital structure and financial leverage positively by Pearson’s correlation coefficient analysis but statistically in p-value, both these findings were insignificant to establish any valid relationship of the two independent variables with the dependent variable of capital structure. It was concluded that in automobile sector of Pakistan, profitability and financial leverage of firms are insignificant in bringing about any changes in their capital structure.

Faruk Hossain and Ayub Ali (2012) done a research study entitled “**Impact of Firm Specific Factors on Capital Structure Decision: An Empirical Study of Bangladeshi Companies**”. The objectives of the study were to identify the firm specific factors affecting capital structure decisions of listed firms in Dhaka Stock Exchange, to analyze how the factors affecting capital structure decision are related to leverage and to analyze whether each of the factors has significant impact on leverage. A sample of 39 non-financial firms listed in Dhaka Stock Exchange Ltd were analysed for the period during 2003-2007. They revealed that profitability, tangibility, liquidity, and managerial ownership have significant negative relations with leverage. Growth and non-debt tax shield are positively and significantly related with leverage whereas size,

earnings volatility, and dividend payment were not found to be significant explanatory variables of leverage.

Michael Angelo Cortez and Stevie Susanto (2012) have done a research study entitled “**The determinants of Corporate Capital Structure: Evidence from Japanese Manufacturing Companies**”. The objective of the study was to determine the relations between the firm specific experience and debt level in Japanese firms. A sample of 21 Japanese Manufacturing Companies listed in the Tokyo Stock Exchange were examined for the period 2001-2010. From the study, a new theory was suggested in which the companies will keep comparing the cost of the debt and the equity such as in the static trade off theory. But, if the difference between the cost of equity and the cost of debt does not reach a certain level, even if the cost of the equity is higher, companies will keep using equity as their main source of fund. The theory can be named as Trade-off Adjusted Order theory, because the order of the use of equity was same but subject to a change if the difference between the cost of debt and the cost of equity passes a certain threshold.

Muhammad Umar, Zaighum Tanveer, Saeed Aslam and Muhammad Sajid (2012) have conducted a research study entitled “**Impact of Capital Structure on firms’ Financial Performance: Evidence from Pakistan**”. The objective of the study was to examine the impact of capital structure on firms’ financial performance. The sample consists of top 100 companies listed in Karachi stock exchange, were analysed for the period 2006-2009 were selected. It was concluded that Net profit margin was negatively affected by the leverage level, as increasing debt will increase interest cost. It results in lower net income. The result showed that greater value of total assets enhances the firm performance and increase in leverage negatively affects the performance of firms’. The results recommend that managers shall not use excessive amount of leverage in their capital structure. They must try to finance their projects with retained earnings and use leverage as a last option.

Nor Edi Azhar Bte Mohamad and Fatihah Norazami Bt Abdullah (2012) have attempted a research study entitled “**Reviewing Relationship between Capital Structure and Firm’s Performance in Malaysia**”. The objective of the study was to explore the impact of debt and equity financing on the performance of the firms in five selected sectors in Bursa Malaysia Main Board. A sample of 130 companies randomly selected from the list of companies listed in Bursa Malaysia for 9 year period from 2002 to 2010 with 1170 observations. They concluded that capital structure is negatively significant with firms’ performance from the sample of Malaysia firms. The leverage has negatively related with firm’s profitability, as high level of debt decreases the financial performance of business. Based on the result, it was assumed that larger firms constructively, have an impact on profitability, as they can get benefited from the economies of scale.

Onyemachi Maxwell and Francis Kehinde (2012) have conducted a research study entitled “**Capital Structure and Firm Value: Empirical Evidence from Nigeria**”. The objective of the study was to provide evidence on the impact of capital structure on a firm’s value. A sample of 124 companies quoted on the Nigerian Stock Exchange (NSE) for the year ended 31st December 2007 were examined. They revealed that long-term-debt impact more positively on firm value, while equity capital does not impact positively. Hence, the firms were advised to raise more of long-term debt than equity capital in financing their operations, as it will increase the firm value. Firms were suggested to compare always the marginal benefit of using long-term-debt to the marginal costs of long-term-debt before deciding on using it in financing their operations. The study revealed that in Nigeria, equity capital as a component of capital structure is irrelevant to the value of firm.

Rametulla Ferati and Elsana Ejupi (2012) have conducted a research study entitled “**Capital Structure and Profitability: The Macedonian Case**”. The objective of the study was to examine the influence of the capital structure of Macedonian companies regarding the factor profitability. The sample consists of

150 small and medium enterprises that operate in the region of Polog, Macedonia. The financial reports of the respective firms were analyzed for the past 10 years. They found that, the larger the debt, the lower will be the profitability. The short term funds should be raised to provide for sufficient working capital. They are the type of resources offered with relative abundance and easiness by financial institutions. The relative participation of the equity in the capital structure of the company, represented by the index equity divided by the total liability, was significant and indicated positive relationship with profitability.

Samuel Antwi, Ebenezer Fiifi Emiire Atta Mills and Xicang Zhao (2012) have done a research study entitled “**Capital Structure and firm value: Empirical evidence from Ghana**”. The objective of the study was to find out the impact of capital structure on the firm’s value. They studied the annual reports of all the 34 companies quoted on the Ghana stock Exchange as at 31st December 2010. It was found that capital structure decisions have various implications and one of them is, its effect on the value of the firm and long-term-debt impacts positively on firm’s value just like equity capital. The study also revealed that in Ghana, equity capital as a component of capital structure is relevant to the value of a firm. They recommend the firms to compare always the marginal benefit of using long-term-debt to the marginal costs of long-term-debt before taking decision on using it in financing their operations.

Sayla Sowat Siddiqui (2012) conducted a research study entitled “**Capital Structure Determinants of Non-Bank Financial Institutions (NBFIs) in Bangladesh**”. The objective of the study was to examine the relative importance of eight factors in the capital structure decisions of Non-bank Financial Institutions in Bangladesh. A sample of 24 firms (NBFIs) for the period of 2006-2008 were selected and appropriate financial statements were analyzed. It is revealed that all the leverage ratios increase with the increase in growth rate and firm size and debt service coverage, operating leverage and age are negatively related to all of the three debt ratios. Long term debt ratio increases with the

increase in liquidity and tangibility ratios, whereas short term and total debt ratio decreases with the increase in liquidity and tangibility ratios.

Goyal .A.M. (2013) done a research study entitled “**Impact of Capital Structure on Performance of Listed Public Sector Banks in India**”. The objectives of the study were to measure the impact of capital structure on banking performance to provide empirical evidence regarding listed Public Sector Banks in India and the study focuses on the relationship between capital structure & profitability of listed PSU banks in India. A sample of 19 PSU banks listed on National Stock Exchange are selected and analysed from 2008 to 2012. The results of the study identified strong positive dependence of short term debt to capital on all profitability measures. Long term debt to capital and total debt had a negative relationship with return on assets, return on equity and earnings per share. Firm size implied an optimistic connection with variables (ROA, and EPS) and negative with ROE. Assets growth revealed a positive relationship with return on asset and return on equity and earning per share. It was concluded that there exist positive relationship among short term debt and profitability of Indian PSU banks.

Jaelani La Masidonda, M.S. Idrus, Ubud Salim and Djumahir (2013) done a research study entitled “**Determinants of Capital Structure and Impact of Capital Structure on Firm Value**”. The objective of the study was to analyze the influence of CEO ability, profitability, Non Debt Tax Shield, cash flow and CEO ownership on capital structure and Long Term Debt to Asset, and the impact of capital structure (LTDE and LTDA) on firm value. A sample 20 manufacturing companies listed in Indonesia Stock Exchange (IDX) were selected for a period 2006-2010. They revealed that companies rely more on their own capital and overall assets, to finance for its activities so as to enhance firm value. Capital structure of manufacturing companies in Indonesia had not reached the optimum point, because of the increased long-term debt usage. It was concluded that if company requires additional funds, it can prefer long-term debt because it can

increase the firm value. The companies should avoid the use of optimal debt limit because it can decrease the firm value.

S. A. Jude Leon (2013) has conducted a research study entitled “**The impact of Capital Structure on Financial Performance of the listed manufacturing firms in Sri Lanka**”. The objectives of the study were to analyse the impact of the capital structure on the financial performance and to examine the relationship between capital structure and financial performance. The sample was confined to 30 manufacturing firms listed in Colombo Stock Exchange and the appropriate secondary data was analyzed for the period 2008 to 2012. It was concluded that the leverage had significant relationship with ROE and there was no relationship between leverage and ROA. Owners haven't enough capital to achieve firm's financial performance. It was suggested that firms should keep control over their debt capital and by controlling the debt capital, firms can achieve the desired level of performance.

Khalaf Taani (2013) conducted a research study entitled “**The Relationship between Capital Structure and Firm Performance: Evidence from Jordan**”. The objectives of the study were to reveal the impact of capital structure on financial performance and to evaluate the interrelationship between capital structure and performance. The sample consisting of 45 manufacturing companies listed on Amman Stock Exchange for the period of 2005-2009 were selected. It was concluded that, capital structure represented by short-term debt to total assets, long-term debts to total assets and total debt to equity were not the major determinants of firm performance. There was no statistically significant relationship between capital structure and firm performance and it was recommended that managers should be careful while using debt as a source of finance as negative relationship exist between capital structure and performance variables applied in the research study.

Khalid Ashraf Chisti, Khursheed Ali and Mouh-i-Din Sangmi (2013) conducted a research study entitled “**Impact of Capital Structure on Profitability of Listed Companies (Evidence from India)**”. The objectives of

the study were to identify the profitability of listed automobile companies over the period of study and to identify and analyze the relationship between profitability and capital structure. The sample consists of 10 automobile firms studied for the period from 2007-08 to 2011-12. They revealed that Debt to Equity ratio is negatively correlated to profitability ratios implied that if the debt content is increased aggressively it will adversely impact the profitability. Debt to Assets ratio and Interest coverage ratio were positively and significantly correlated with the profitability ratio implying that those ratios had positive impact on profitability ratios and thus significantly contributing to the profitability of the selected companies under study.

Mehdi Mohammadzadeh, Farimah Rahimi, Forough Rahimi, Seyed Mohammad Aarabi and Jamshid Salamzadeh (2013) have conducted a research study entitled **“The Effect of Capital Structure on the Profitability of Pharmaceutical Companies the Case of Iran”**. The objective of the study was to examine the relationship between the capital structure and the profitability of pharmaceutical companies in Iran. A sample of top 30 Iranian pharmaceutical companies were selected and their financial data were analyzed for the period of 2001-2010. It was revealed that managers and decision makers are forced to use internal financing since external source may cause some information to be released to the outside investors, leading to the company to be probably under the control of the outside investors. So they prefer inside financing comparing to the outside one.

Nadeem Ahmed Sheikh and Zongjun Wang (2013) have done a research study entitled **“The impact of Capital structure on Performance – An empirical study of non-financial firms in Pakistan”**. The objective of the study was to investigate whether capital structure affects the performance of non-financial firms in Pakistan. The sample comprises of 240 non-financial firms listed on Karachi Stock Exchange (KSE) for a period of 6 years (2003-2009). The results showed negative relationship between capital structure and performance indicates that capital structure had material effects on financial performance. It

indicated that agency issues may lead firms to utilize higher than appropriate levels of debt in their capital structure. It inferred that the financial managers should consider the effects of leverage on performance before adjusting the debt levels. Hence it was advised that the investors should consider the firm's debt level before making investment decisions.

Patrick Ogebe, Joseph Ogebe and Kemi Alewi (2013) done a research study entitled "**The Impact of Capital Structure on Firms' Performance in Nigeria**". The main objective of this study is to examine the impact of leverage on the value of the selected firms. The sample of the study were 6 firms selected into two classes; highly geared (Total Nigeria PLC, Mobil Oil and Forte Oil) and lowly geared firms (May and Baker, GSK, NEIMETH). The study employed panel data spanning from 2000 to 2010. They concluded that leverage in both the highly and lowly geared firms was statistically significant and is an important determinants of firm's performance. Leverage in both the highly and lowly geared firms was statistically significant and is an important determinants of firm's performance. It was shown that high gearing had a larger impact on firm's performance compared to low gearing. The macroeconomic variables showed significant impact on the performance of highly geared firms, but it was not significant for lowly geared firms. Gross domestic product and inflation revealed higher impact on firm's performance in the highly geared firms compared to lowly geared firms.

Rajni Kant Rajhans and Kawalpreet Kaur (2013) have conducted a research study entitled "**Financial Determinants of Firm's Value evidence from Indian Firms**". The main objective of the study was to identify the factors affecting the value of a firm. The sample comprises of 16 companies belonging to 4 different sectors in India. Required secondary Data from 2002 to 2011 was examined. It was concluded that profit, sales, fixed assets and Weighted Average Cost of Capital have affected the firm value significantly. Out of these, profit impacts value of a firm most, followed by sales and then WACC. It was

suggested that if objective of profit creation for the shareholders is fulfilled by a company, it will increase the value of the firm.

Sukhdev Singh and Rajni Luthra (2013) have done a research study entitled “**Impact of Leverage on the Capital Structure Practices of Selected Telecommunication Companies**”. The objectives of the study were to calculate the leverages i.e. financial, operating and combined of selected telecommunication companies in India, to examine the impact of leverages on the capital structure via profitability and to evaluate the relationship between financing mix and EPS. Top nine Indian Telecommunication companies were analysed for 10 years 10 years from 2003-2012. They concluded that there was a relationship between DFL and EPS, DOL and EPS, DCL and EPS and DER and EPS. Fixed operating expenses and financing mix decisions of the firm were significantly influencing the earning capacity. The leverage had great impact on the capital structure practices of the companies.

Anshu Handoo and Kapil Sharma (2014) conducted a research study entitled “**A study on determinants of capital structure**”. The main objective of the study was to identify factors considered by companies before financing decisions. The annual reports of 870 listed Indian firms comprising both private sector companies and government companies were analysed for the period 2001-2010. They revealed that profitability, asset tangibility, size, tax rate and debt servicing capacity had significant impact during raising of short term debt. Profitability, growth, asset tangibility, size, tax rate and debt servicing capacity had significant impact while considering total debt and making capital structure decisions of Indian companies. It was suggested that companies facing high uncertainty because of vigorous growth or the cyclical nature of their industries should carry less debt, so that they can get enough flexibility to take advantage of investment opportunities or to deal with negative events.

Erasmus Fabian Kipasha and James Josephine Moshi (2014) have attempted a research study entitled “**Capital Structure and Firm Performance: Evidences from Commercial Banks in Tanzania**”. The objective of the study

was to assess the impact of capital structure on bank performance in Tanzania. The study used panel data for the period 2007-2011 of 38 banks operating in Tanzania. The results of the study showed that banks in Tanzania use more debts as their source of finance than equity financing. Banks in Tanzania prefer to use more short term debts in the form of deposits other than commercial debts. Hence the banks still had opportunity to improve as the debts to asset ratio was found to have significant positive impact on return on equity.

Ishaya Luka Chechet and Abduljeleel Badmus Olayiwola (2014) have conducted a research study entitled “**Capital Structure and Profitability of Nigerian Quoted Firms: The Agency Cost Theory Perspective**”. The objectives of the study were to assess the impact of debt ratio on firms’ profitability and to study the impact of equity financing on firm profitability in Nigeria. A sample of firms listed on the Nigerian Stock Exchange (NSE) for a period of 10 years (2000 – 2009) was analysed. It was concluded that debt ratio affects the level of Nigerian firms' profitability negatively and significantly. They suggested that for firms experiencing agency conflicts and wishing to raise fund for operations or expansions, higher debt ratio should not be given priority. An appropriate combination of equity and debt must be ensured with equity given priority over debt.

Maryam Masnoon and Abiha Saeed (2014) have conducted a research study entitled “**Capital Structure Determinants of KSE Listed Automobile Companies**”. The main objective of the study was to explore the various factors that determine the choice of financing sources for public limited companies in the automobile sector of Pakistan. A sample of 10 automobile companies listed in Karachi Stock Exchange were analysed for a period of 2008 to 2012. They revealed that the companies finance first from internal equity and then they go for debt. In the event of higher profits, firms fulfill their funding requirements by retaining the earnings. It was also found that profitability and liquidity had significant negative impact whereas size and tangibility had insignificant negative

effect on capital structure and Earning variability had insignificant positive association with capital structure.

Nishi Sharma and Gurmail Singh (2014) have done a research study entitled “**Capital structure and Firm’s Characteristics: Evidence from Indian Automobile Industry**”. The objective of the study was to investigate the relationship of capital structure with characteristics of Indian automobile firms that faced major oscillations in recent years. A sample of 46 Indian automobile companies were analysed for a period of 10 years from 2003-2012. It was revealed that growth, size and tangibility had positive impact on leverage. Liquidity and effective tax rate had negative impact upon total leverage. The Indian automobile companies favored Pecking order theory like other Asian companies. They concluded that companies having more tangible assets, bigger in size and enjoying growth in net sales were expected to have more debt ratio, as they were in a better position to shield their investors and provide collateral to the debt.

Mawih Kareem Al Ani, Maha Saud Al Amri (2015) have done a research study entitled “**The determinants of capital structure: An empirical study of Omani listed industrial companies**”. The objective of the study was to investigate the determinants of capital structure of Omani food, construction and chemical companies. A sample of 71 companies including 29 large companies and 42 small companies were examined for the year 2013. It was concluded that higher fixed assets, higher risk and size encourage firms to use debts in the capital structure. The Omani companies and investors prefer dividends more than reinvesting the profit in the capital structure. It was also revealed that smaller size, less risky and profitability firms in the sector use more debt and less equity.

Nelson Vergas, Antonio Cerqueira and Elisio Brandao (2015) conducted a research study entitled “**The determinants of the Capital Structure of Listed on Stock Market Nonfinancial Firms: Evidence for Portugal**”. The objective of the study was to analyse the determinants of capital structure of companies and

to evaluate the explanatory capacity of the major theoretical perspectives, namely, the trade-off theory, the pecking order theory, the agency costs theory, and the market timing theory. The sample consisted of the Portuguese non-financial companies listed on Euronext Lisbon index over the period 2005 to 2012. They concluded that profitability and growth opportunities are the main factors of corporate debt. The changes in the determinants of market valuation and tangibility are highlighted, as the main effects of the financial crisis in the period under analysis.

Divya Aggarwal and Purna Chandra Padhan (2017) have done a research study entitled “**Impact of Capital Structure on Firm Value: Evidence from Indian Hospitality Industry**”. The objective of the study was to examine the effect of capital structure and firm quality on firm value 22 Indian hotel companies which are listed on the BSE for a period of 15 years from 2001 to 15. It was revealed that quality, size, leverage and liquidity had a significant influence on the enterprise value. Firm size and cost of financial distress were measured through a firm quality score that showed a significant influence on the firm value. The results also implied that hospitality firms preferred debt funds for expansion and an increase in GDP had a significant positive impact on firm value of the hospitality firms.

## **2.4 STUDIES ON DIVIDEND PAYOUTS**

Mohammed Amidu (2007) has conducted a research study entitled “**How does Dividend Policy affect Performance of the Firm on Ghana stock Exchange?**”. The objective of the study was to examine whether dividend policy influences firm’s performance. The results showed a positive relationship between return on assets, dividend policy, and growth in sales. A sample of 25 firms that listed on the Ghana stock Exchange (GSE) over eight year period (1997-2004) was considered. The study supported the second school of thought that dividend policy is relevant to the performance of firms. It was found that bigger firms on GSE perform less with respect to return on assets. There existed

negative associations between return on assets and dividend payout ratio, leverage and growth.

Justyna Franc-Da browska (2009) has done a research study entitled **“Does Dividend Policy Follow the Capital Structure Theory?”**. The objective of the study was to examine the correlation between dividend payout and financing of economic activity with company equity in Polish publicly traded companies operating in the food sector. The sample consists of 15 joint stock companies belonging to agricultural and foodstu industry, listed on the Warsaw Stock Exchange, Poland between 2001 and 2006. It was found that Polish companies of the agricultural and foodstu industry listed on the Warsaw Stock Exchange made decisions concerning dividend policy, in the situation of choosing the sources of financing, on the basis of relationships typical for the hierarchy theory. The management of companies preferred internal sources of activity financing, at the same time limiting the payment of dividends.

Amitabh Gupta and Charu Banga (2010) have done a research study entitled **“The Determinants of Corporate Dividend Policy”**. The objective of the study was to examine the impact of various factors on the dividend decision of Indian companies. The sample was confined to 150 companies belonging to 16 industries from BSE 500 Index were selected and analysed with the criteria that the companies had continuously paid dividend during the study period. The results revealed five factors influencing dividend policy namely leverage, liquidity, profitability, ownership structure and growth. These factors were then subjected to multiple regression with dividend rate as the dependent variable. They concluded that leverage and liquidity were found to have a strong relationship with dividend rates of Indian companies. While leverage was found to be negatively associated, liquidity was positively related. However in practice, some non-financial factors such as foreign collaborators' shareholding, attitude and behavior of management, company policies, etc., may also have a bearing on the dividend decision of a firm.

Anupam Mehta (2012) has conducted a research study entitled “**An Empirical Analysis of Determinants of Dividend Policy - Evidence from the UAE Companies**”. The objectives of the study were to find out whether certain determinants as per the available literature have any influence on the dividend payout policies of UAE firms and to examine to what extent various determinants of dividend payout policy can explain the dividend decisions. The sample consists of 145 firms listed in Abu Dhabi Stock exchange for a period of 5 years from 2005-2009. The study revealed that Size and Risk are the two most important considerations in deciding on dividend policy by UAE companies. The firms with high PE ratio have lower risk and high growth prospects. Profitability measured by ROA and EPS are negatively associated with the dividend payout ratio. It was suggested that, higher the firm's PE, lower will be the risk, and higher is its payout ratio. The study rejects the hypothesis that profitability, liquidity and leverage affect dividend decisions.

Zahangir alam. MD and Mohammad Emdad Hossain (2012) have done a research study entitled “**Dividend Policy: A Comparative Study of UK and Bangladesh Based Companies**”. The objectives of the study were to present the theories of organizational dividend policy, to produce arguments for and against that, a high cash dividend payout ratio as possible would reflect positively on the market value of shares. The secondary data have been collected from the annual report of the sample enterprises, namely TESCO plc, BP plc and BT plc, listed in London Stock Exchange for ten years, ranging from 2001 to 2010. It was concluded that a high cash dividend payout ratio as possible would reflect positively on the market value of shares for the reasons of certainty, higher future dividend, information content, clientele effect, certainty about the company's future earnings. They suggested that dividend payment should be avoided as they would lead to decrease in shareholders wealth for the reason of tax consequences, cost of policy formulation, transaction cost, and cost of capital, default risk, and tax free.

A.Ajanthan (2013) has attempted a research study entitled “**The Relationship between Dividend Payout and Firm Profitability: A Study of Listed Hotels and Restaurant Companies in Sri Lanka**”. The objectives of the study were to examine the association between dividend payout and firm profitability among listed companies in Sri Lanka and to establish the extent of the association between dividend payout and firm profitability. The sample was confined to trading sector consists of 16 hotels and restaurant companies listed in the Colombo Stock Exchange (CSE) for a period of 5 years (2006-2011). It was revealed that dividend payout has a significant impact on the profitability of listed firms in Sri Lanka. There was significant positive relationship between total assets and the profitability of firms. There was significant impact of dividend payout, revenue and total assets on net profit. Hence, all independent variables have significant impact on profitability of the hotels and restaurant companies.

Fakhra Malik, Sajid Gul, Muhammad Tauseef Khan, Shafiq Ur Rehman and Madiha khan (2013) have conducted a research study entitled “**Factors influencing Corporate Dividend Payout Decisions of Financial and Non-Financial Firms**”. The objectives of the study were to examine the determinants of dividend policy of firms listed on Karachi stock Exchange and are part of KSE-100 index and also to examine whether or not there exists any relationship among different financial characteristics and decision regarding dividend payments. The sample financial data covers the period 2007– 09 for 100 companies listed at Karachi Stock Exchange are part of KSE 100 index. They concluded that corporate dividend paying companies in Pakistan are very low as compared to other emerging economies. They also found that profitability, liquidity, earning per share and size of the firm positively affects the probability of paying dividend, whereas firm sales growth has negative impact on the probability of dividend payment.

Maniagi G. Musiega, Ondiek B. Alala, Musiega Douglas, Maokomba O. Christopher and Egessa Robert (2013) have done a research study entitled “**Determinants of Dividend Payout Policy among Non-Financial Firms on**

**Nairobi Securities Exchange, Kenya**". The objectives of the study were to determine the impact of current earnings on non-financial firm's dividends policy decisions, to identify the relationship of Growth, profitability and liquidity on non-financial firm's dividends policy decisions and to establish the impact of firm's size and business risk on dividends policy decisions of non-financial firms listed on Nairobi Securities exchange. A sample of 50 listed non-financial companies listed in Nairobi Securities Exchange, Kenya were selected and studied for the period 2007 -2011. They revealed that profitability, Growth opportunities, firm's size and business risk were the main determinants of dividend payout for non-financial firms. Return on equity, current earnings and growth opportunities are both positively correlated to dependent variable dividend payout.

Manjunatha. K (2013) has done a research study entitled "**Impact of Debt-Equity and Dividend Payout Ratio on the Value of the Firm**". The objectives of the study were to ascertain the Debt-equity and Dividend payout ratio of the samples, to explain the dividend distribution the debt-equity patterns of the samples, to examine the possible effects that a firm's dividend policy might have on the market value of the firm and to study the effect of capital structure decision on the value of the firm. For the study, 29 companies belonging to different industries which were listed in Bombay stock exchange and National stock Exchange, India for 2000-01 to 2009-10 were analyzed. It is found that there was no significant effect of dividend payout and debt equity ratio on share prices, debt-equity and share prices do not had a notable relationship between each other, only three companies were fit for formulating relation between dividend payout and return on equity. It is also found that software companies were showing a deviation from others by having least debt equity and least Dividend Payout Ratio and still maintaining a good rate of return on share prices.

Ozuomba Chidinma N., Okaro S.C. and Okoye Pius V.C. (2013) have attempted a study entitled "**Shareholder's value and firm's dividend policy: Evidence from public companies in Nigeria**". The objectives of the study were to analyze the effect of firm's dividend policies on shareholders' value of public

companies in Nigeria and to empirically examine the linkage of dividend payout with information asymmetry. The study covers 10 quoted companies in the Nigeria stock exchange and covers over a 12 years period (2000-2011). The findings of the research study showed that earnings per share and market price per share (dividend policies) has an effect on dividend per share (shareholders wealth) given the very high correlation. The study also showed that earnings per share, market price per share both have significant positive impact on the shareholders' wealth of the quoted firms. Nigerian firms apportion more earnings to retention for the ploughing back in the firm to support growth. It was concluded that investors prefer the bird-in-hand form of dividend payment against the retention approach by management as well as a steady dividend payment. A high dividend increases the market value of shares thus, shareholders value and vice versa. Shareholders prefer current dividends to future capital gains. Hence, dividend is an important factor which determines the shareholder's wealth.

Timothy Mahalang'ang'a Murekefu and Ochuodho Peter Ouma (2013) have conducted a research study entitled "**The relationship between Dividend Payout and Firm Performance: A Study of Listed Companies in Kenya**". The objectives of the study were to establish the relationship between dividend payout and firm performance among listed companies in Kenya and to establish the extent of the relationship between dividend payout and firm performance. The annual reports of 41 companies listed in the Nairobi Securities Exchange for a nine year period from 2002 to 2010 were analysed. The results of the study shows that cash dividends were the most commonly used form of dividend among listed firms in Kenya. They suggested that major factors that affect the dividend policy of listed firms are; profitability, pattern of past dividends, legal rules, financial leverage, investment opportunities, growth stage and capital structure. Other factors such as ownership structure, shareholder's expectations, tax position of shareholders, industry practice growth stage capital structure and access to capital markets can also be considered in designing a dividend policy.

Christopher Maladjian and Rim El Khoury (2014) done a research study entitled “**Determinants of the Dividend Policy: An Empirical Study on the Lebanese Listed Banks**”. The objective of the study was to investigate the factors determining the dividend payout policy in the Lebanese banks listed on the Beirut Stock Exchange. A sample of 4 listed Lebanese banks listed on the Beirut Stock Exchange were selected for the period 2005 to 2011. It was revealed that large banks choose to pay more dividends to diminish agency conflicts and maintain bank’s reputation. The political instability of the country obliges banks to use the surplus earnings to allocate most of them into retention for the plugging back for harsh economic periods. It was concluded that Lebanese listed banks consider the firm size, last year’s dividends, profitability, and growth and to a less extent the risk, more than the leverage and liquidity, when they are making decisions to pay dividends.

Ibrahim Elsiddig Ahmed (2014) has done a research study entitled “**The Impact of Liquidity on the Dividends Policy**”. The objective of the study was to investigate the factors influencing dividend decisions and more specifically to test the relationship between dividend payout ratio and dividend declared on one hand with net cash, liquidity, and profitability on the other hand. A sample of 30 banks listed in the Dubai Financial Market and Abu Dhabi Securities Exchange were selected for the study for one year period (2012). It was concluded that majority of the banks declare dividend, when they estimate their profitability or based on the profits reported in the previous few years. Around 80% of the banks in UAE are found to be profitable and the dividend declared by the profitable bank has a linear and positive relationship with the net income. It was revealed that there was no relation between liquidity and dividends declared by the respective banks.

Saima Qamar and Zuhaib Ahmed Bazaz (2014) have attempted a study entitled “**Factors Influencing Dividend Decision: A Study of Listed Companies in India**”. The objectives of the study were to identify various factors influencing dividend decision and to determine the relation between firm

characteristics and corporate dividend policies. NSE (NIFTY50) listed companies belonging to 9 different industry types were analysed for the period 2006- 2010. They concluded that dividend yield was positively and significantly correlated with pattern of past dividends, age of the companies, current and previous year's earnings after tax and the rest of the explanatory variables have shown either fluctuation throughout the study period. It was revealed that dividend rate is more or less explained by a good number of interdependent variables. But the explanatory power of these variables comes down in the matter of their relation with dividend payout or dividend yield.

## **2.5 STUDIES ON CAPITAL STRUCTURE AND DIVIDEND PAYOUT**

Sunil Kumar, R.K Sharma and S Chaturvedi (2010) have conducted a research study entitled "**Leverage Capital Structure and Dividend Policy Practices in Indian Corporate – A Case Study**". The objectives of the study were to examine operating, financial and combined leverage of Coromandel Fertilizers Limited (CFL) during the period 2003- 2009, to know about the impact of fixed charges on Earnings Before Interest and Taxes (EBIT) and Earnings Per Share (EPS), to understand the capital structure policies and practices and its impact on Market Price per Share (MPS) and to know about the dividend policy of the company and its influence on Price - Earning (P / E) and MPS. It was concluded that Coromandel Fertilizers Ltd. had abundant internal resources. It has been following a stable debt equity ratio and maintaining an increased trend in its dividend payout. Operating leverage of the company has more ups and downs. But the financial leverage is more or less stable. The fluctuations in the market price of the share were related to the capital structure decisions and dividend decisions to some extent.

Ahmed Imran Hunjra, Muhammad Bilal, Haroon Shafi, Ikram Ullah and Kashif-Ur-Rehman (2011) have done a research study entitled "**Patterns of capital structure and dividend policy in Pakistani corporate sector and their impact on organization performance**". The objectives of the study were to examine the patterns and level of application of capital structure decisions and

dividend policy in Pakistani corporate sector. The companies in each sector were selected on the basis of listing at Karachi stock exchange, profitability and consistent dividend payments. A total of 91 questionnaires were distributed to different companies of selected areas and 73 filled questionnaires were collected and 61 properly filled questionnaires were processed in this study. They concluded that a substantial number of firms in Pakistani corporate sector are not following these practices either partially or completely.

Jun Jiang and Komain Jiranyakul (2013) conducted a research study entitled “**Capital Structure, Cost of Debt and Dividend Payout of Firms in New York and Shanghai Stock Exchanges**”. The objectives of the study were to identify factors influencing dividend payouts of firms in NYSE and SSE and to compare the decision on dividend payout of listed firms in the two stock markets. The panel data of 378 listed firms in SSE and select 537 listed firms in NYSE were analyzed. The results showed that equity financing was more pronounced in determining dividend payout of firms in NYSE than those in SSE and debt financing was less important for firms in SSE than in NYSE. It was concluded that the investors care more for dividend than interest payment of firms in an emerging stock market and it was implied that firms in an emerging stock market, SSE should consider the optimal capital structure by relying more on debt financing so that investors can invest more on fixed-income securities.

Asad Abbas, Shujahat Haider Hashmi and Anwar Fazal Chishti (2016) have conducted a research study entitled “**Dividend policy and capital structure: Testing endogeneity**”. The objectives of the study were to explore the relationship between dividend payout and capital structure and to explore the determinants of dividend policy and capital structure of manufacturing sector of Pakistan. The sample of 100 manufacturing firms in Pakistan for the period from 2006 to 2011 were analysed. It was concluded that the capital structure and dividend policies have impact on each other. Firm’s size, profitability, liquidity, tangibility, income variability, tax saving other debt, growth opportunities and dividend payout were the explanatory variables of capital structure. Firm’s size,

profitability, liquidity and financial leverage were the explanatory variables of dividend policy. Tangibility has no impact on dividend payout policy of the manufacturing firms in Pakistan.

Mula Nazar Khan, Farooq Ali Khan Sherwani, Afshan, Fahad Islam and Ghulam Kabbir (2016) have done a research study entitled “**Impact of capital structure and dividend payout policy on firm’s financial performance: evidence from manufacturing sector of Pakistan**”. The objectives of the study were to investigate the impact of capital structure on firm performance, to investigate the relationship between the capital structure variables and firm performance, to examine the relation between dividend policy and firm performance of Pakistani firms listed in Karachi stock exchange with the annual reports of the companies. They have concluded that there exists significant relation between short term leverage and long term leverage on the return on assets. There also exist relationship between dividend policy and return on assets.

Obaid Ur Rehman (2016) has done a research study entitled “**Impact of capital structure and dividend policy on firm value**”. The objective of the study was to propose a new integrated theory of capital structure and dividend policy decision that would empirically predict their effect on value of the firm. The sample comprises of 111 non-financial listed companies listed in Karachi stock exchange during the period 2006-2013 were analysed. He concluded that selected Pakistani firms using more debt can create more worth but up to a fixed limit. Hence it was suggested to find cheaper sources of debt unlike fixed interest bearing debts. It also revealed that fixed asset turnover ratio has no impact on the firm value and an increase in the earnings per share has resulted in the increase of firm value.

Saif ul Rahman, Muzammal Ilyas Sindhu, Muhammad Irfan Khadim and Alia Malik (2017) conducted a research study entitled “**How Capital Structure influences the Dividend Policy? An Empirical Investigation of Banking Sector**”. The objective of the study was to examine the relations between the

capital structure and the dividend payments of 31 listed banks in Pakistan that continuously declared dividends for the nine years from 2008 to 2016. It was revealed that the factors such as financial leverage, earnings per share and size significantly influences the distribution of dividends. Institutional lending by banks to meet their short-term needs negatively affects dividends of Pakistan banks. It was concluded that higher financial leverage could be converted into higher deposits. Banks are capable of paying higher dividends with increased deposits. Such deposits help them to increase their investment portfolio and promotes towards higher profits.

## **2.6 Summary**

The review of literature exhibits similar studies in the current area of research. Some studies have concentrated on analysing the determinants of capital structure, some analysed the dividend policies, and some showed the relationship of capital structure and firm's performance. Few other studies analysed the combined effect of capital structure and dividend policies on different industries also. But there was no study concentrating the impact of capital structure on the dividend decisions of industries analysing the companies individually. Many industries belonging to different categories have been studied but there was no category of Construction Associated Industries.

As the factors that determine the capital structure and dividend payouts differs for each company in a particular industry, a research study is essential to reveal the impact of capital structure on the dividend decisions company wise. This research gap made the researcher to analyse the **“Impact of capital structure on dividend decisions with specific reference to select Construction associated Industries in India”**.