

# A study on profitability management of restaurants in Tamil Nadu, India

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## Abstract

Several theories have been documented on the relevance and irrelevance of dividend policy. Many authors continue to come up with different findings from their studies on the relevance of dividend policy. The main thrust of this study is to find out the relationship between dividend payout and firm profitability among listed hotels and restaurant companies in the Chennai Stock Exchange (CSE). Regression and correlation analysis were carried out to establish the relationship between dividend payout and firm profitability. The findings indicated that dividend payout was a crucial factor affecting firm performance ( $R = 0.725$  &  $R^2 = 0.526$ ). Their relationship was also strong and positive. This therefore showed that dividend policy was relevant. It can be concluded, based on the findings of this research that dividend policy is relevant and that managers should pay attention and devote adequate time in designing a dividend policy that will enhance firm profitability and therefore shareholder value.

**Key words:** dividend payout, Chennai stock exchange, share holder value.

## INTRODUCTION

The issue of dividend policy is a very important one in the current business environment. Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders. The dividend policy decisions of firms are the primary element of corporate policy. Dividend, which is basically the benefit of shareholders in return for their risk and investment, is determined by different factors in an organization. Basically, these factors include financing limitations, investment chances and choices,

firm size, pressure from shareholders and regulatory regimes.

## RESEARCH PROBLEM

Despite the numerous studies that have been done, dividend policy remains an unresolved issue in corporate finance. Several theories have been proposed to explain the relevance of dividend policy and whether it affects firm value, but there has not been a universal agreement. Researchers continue to come up with different findings about the relationship between dividend payout and firm performance. A study by Amidu (2007) revealed that dividend policy affects firm performance as measured by its profitability. As there was a positive and significant relationship between return on assets, return on equity, growth in sales and dividend policy. Howatt., (2009) also concluded that positive changes in dividends are associated with positive future changes in earnings per share. But in contrast the another, argues that there is limited evidence that dividend paying firms experience subsequent performance improvements.

A number of studies have been done with regard to dividend policy and firm performance, especially in developed economies. Can the findings of those studies (Aivazian *et al.*, 2001 and Al-Haddad, *et al.*, 2011) be replicated in developing countries? In Tamilnadu, India few empirical studies have been done to establish the relationship between dividend payout and firm profitability. This study therefore comes in to fill the gap by establishing whether there is a relationship between dividend payout and firm profitability among listed hotels and restaurant companies' in Tamilnadu, India.

## RESEARCH QUESTIONS

In order to gain an insight and understand the relationship, if any, between dividend payout and profitability in a profit-oriented business, the following questions below are addressed in the course of the study.



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1. What association exists between dividend payout and firm profitability among listed companies in Tamilnadu?
2. What is the extent of the association between dividend payout and firm profitability?

### OBJECTIVES OF THE STUDY

The general objective of the research was to establish the relationship between dividend payout and firm performance among listed companies in Tamilnadu. The research was also guided by the following specific research objectives;

1. To establish the association between dividend payout and firm profitability among listed companies in Tamilnadu.
2. To establish the extent of the association between dividend payout and firm profitability.

### REVIEW OF LITERATURE

#### Theoretical Framework: Bird-in-the-hand theory

The "Bird in Hand" theory argues that outside shareholders prefer a higher dividend policy. They prefer a dividend today to a highly uncertain capital gain from a questionable future investment. A number of studies demonstrate that this mode fails if it is posited in a complete and perfect market with investors who behave according to notions of rational behavior.

#### Signaling Theory

According to the information content of dividends or signaling theory, firms, despite the distortion of investment decisions to capital gains, may pay dividends to signal their future prospects (Amidu, 2007). The intuition underlying this argument is based on the information asymmetry between managers (insiders) and outside investors, where managers have private information about the current and future fortunes of the firm that is not available to outsiders.

#### Agency theory

Even if a firm does not have free cash flow, dividend payments can still be useful for the shareholders in order to control the overinvestment problem of argues that dividends reduce the over investment problem because the payment of dividends increases the frequency with which firms have to go to equity markets in order to raise additional capital. In the process of attracting new equity, firms subject themselves to the monitoring and disciplining of these markets. This lowers agency cost.

#### Empirical studies:

Alii, *et al* (1993) The behavior of dividend policy is one of the most debatable issue in the corporate finance

literature and still keeps its prominent places both in developed an emerging market. Alii, *et al* (1993) Many researchers have tried to uncover issues regarding the dividend dynamics and determinants of dividend policy but we still don't have an acceptable explanation for the observed dividend behavior of firms Alii, *et al* (1993). Dividend policy has been analyzed for many decades, but no universally accepted explanation for companies' observed dividend behavior has been established . It has long been a puzzle in corporate finance.

### CONCEPTUALIZATION

Brigham (1995) stated that a firm's dividend policy is seen as a major determinant for a firms' performance and also stressed the fact that investments made by firms' influences the future earnings and future dividends potential.

Brigham (1995) Showed that dividend increases were directly related to future increases in earnings in each of the two years after the dividend change Likewise, in a related study found out that there is no significant difference among dividend payouts with or without large block shareholders.

(Alii, *et al* (1993) suggested that dividend acts as a signal of the stability of the firm's future cash flows. Their survey of the extant literature reveal that the key determinants of dividend decisions include liquidity, after tax earnings of the firm, cash flow considerations, future earnings, past dividend practices, returns on investment, legal requirements, growth prospects, inflation and interest rates. They stated that dividends provide perhaps the best and most reliable signal. According to them, an increase in dividend signals management' confidence that future earnings will be strong enough to support new and higher dividend and vice versa. This view is corroborated when they noted that there is evidence to support the view that investors respond to dividend changes. For example, Fama found a time series relation between annual dividends and earnings that is consistent with the view that dividend paying firms increase their dividend only when management is relatively confident that their higher payments can be maintained.

### HYPOTHESES OF THE STUDY

The hypotheses below are operationalized as a basis for analysis and conclusion on the relationship between dividend payout and profitability.

**H<sub>1</sub>:** There is significant relationship between the dividend payout and net profit.

**H<sub>2</sub>:** There is significant relationship between revenue and net profit.

**H<sub>3</sub>**: There is significant relationship between total assets and net profit.

**H<sub>4</sub>**: There is significant impact of dividend payout, revenue and total assets on net profit.

Hypotheses 1, 2 & 3 were evaluated based on the correlation analysis while regression was analysis the basis of evaluation of hypothesis 4.

**METHODOLOGY**

**DATA SOURCE:**

The present study used secondary data for the analysis. The data utilized in this study is extracted from the comprehensive income statements and financial position of the sample hotels and restaurant companies quoted in Chennai Stock Exchange (CSE) database. In addition to this, scholarly articles from academic journals and relevant textbooks were also used.

**SAMPLING DESIGN**

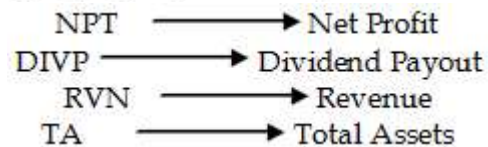
**MODE OF ANALYSIS**

In the present study, we analyze our data by employing descriptive statistics correlation and multiple regression. The statistical package like ‘Statistical Package for Social Sciences’ (SPSS) 16.0 Version was used to analyze the data. The following liquidity and profitability ratios were taken into account.

Multiple regression analysis was performed to investigate the impact of dividend payout on profitability. Which the model used for the study is given below.

$$NPT = \Delta_0 + \Delta_1DIVP + \Delta_2RVN + \Delta_3TA + e \tag{1}$$

where,  $\Delta_0, \Delta_1, \Delta_2, \Delta_3$  are the regression co-efficient



**Table 1.** Used in the Calculations Dependent and Independent variables.

Dependent Variable	
Net Profit (NPT)	= Net Profit After Tax (NPAT) / Total Revenue (TR) X100
Independent Variable	
Dividend Payout (DIVP)	= Total Amount of Dividend Paid during the Particular Period
Control Variables	
Revenue (RVN)	= Amount of Sales
Total Assets (TA)	= Amount of Total Assets

**Table 2.** Dividend Payout Multiple Regression to Predict Net Profit after Tax (NPT) based on Dividend Payout (DIVP), Revenue (RVN) and Total Asset

Model	Dependent	Independent	R	P - value	R <sup>2</sup>	F-Value	Durbin-Watson
1		DIVP	0.441*	0.027			
	NPT	RVN	0.671**	0.004	53	4.433	1.815
		TA	0.747**	0.001		-0.026	

\*, Correlation is significant at the 0.05 level (2-tailed)

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

Sampling design is a definite plan for obtaining a sample from a given population. It refers to the technique or the procedure the researcher would adopt on selecting items for the sample (Kothari 2004). The sample of this study is confined to the trading sector consisting of 16 hotels and restaurant companies listed in the Chennai Stock Exchange (CSE).

It is important to note that the Profitability depend upon Dividend Payout (DIVP); Revenue (RVN) & Total Assets (TA). The following model is formulated to measure the impact of dividend payout on Profitability.

## X. HYPOTHESES TESTING

**Table 3.** Testing of Hypotheses

No	Hypotheses	Results	Tools
H1	There is significant relationship between the dividend payout	Accepted	Correlation
H2	There is significant relationship between	Accepted	Correlation
H3	There is significant relationship between	Accepted	Correlation
H4	There is significant impact of dividend payout, revenue and	Accepted	Correlation

## RESULTS

The above mentioned table indicates the relationship between the various independent and dependent variables used in the study. As it is observed in the table, the correlation values were found to be positive between the variables. Dividend payout has 44.1% relation (moderate positive) with net profit which is significant at 5 percent level of significance. As well as revenue and total assets have 67.1% and 74.7% relation (strong positive) with net profit respectively, which are significant at 1 percent level of significance.

Regression analysis is used to test the impact of dividend payout on profitability of the listed hotels and restaurant companies in CSE. As we mentioned in mode of analysis, a model was formulated and the results are summarized in the above Table-2.

The specification of the three variables such as DIVP; RVN; and TA in the above model revealed the ability to predict profitability ( $R^2 = 0.526$ ). In this model  $R^2$  value of above Mentioned profitability measures denote that 52.6 % to the observed variability it can be explained by the differences in three independent variability namely dividend payout, revenue and total asset. The remaining 47.4 % are not explained, because the remaining part of the variance in profitability is related to other variables which are not depicted in the model.

An examination of the model summary in conjunction with ANOVA (F-value) indicates that the model explains the most possible combination of predictor variables that could contribute to the relationship with the dependent variables. Model created by the researcher is significant at 5% level of significance. F value is 4.433 and respective P value is 0.026 which is

statistically significant at 5 percent level of significance. In this case it reveals that only DIVP has a significant impact on NPT at 5 percent level of significance. However, it should be noted here that there may be some other variables which can have an impact on profitability, which need to be studied. In addition to the above analysis Durbin-Watson test also carried out to check the auto correlation among the independent variables. The Durbin-Watson statistic ranges in value from 0 to 4. A value near 2 indicates non-auto correlation. Model has the value is 1.815. This indicates that there is no auto correlation.

## CONCLUSION

This study basically looked at dividend payout and profitability in Tamilnadu. The study came up with findings that are of salient importance to scholars investigating dividend issues in the Tamilnadu people context. Based on the first hypothesis, the study observed that dividend payout has a significant impact on the profitability of listed firms in Tamilnadu. That is, an increase in the financial well being of a firm tends to positively affect the dividend payout level of firms. Findings from the second hypothesis assure that there is a significant positive relationship between revenue and the profitability of firms. Findings from the third hypothesis assure that there is a significant positive relationship between total assets and the profitability of firms. Also final hypothesis say that all independent variables have significant impact on profitability of the hotels and restaurant companies.

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