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DIVIDEND POLICY AND PAYOUT RATIO. EVIDENCE FROM BUCHAREST STOCK EXCHANGE

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Abstract *Dividend policy is one of the key elements of financial management, a task a responsibility for the company's managers. By dividend policy we refer to the way in which managers decide the size and the distribution method of dividends to shareholders. The main objective of this study is the identification of the behavior of companies listed on the Bucharest Stock Exchange in the period 2005-2012, in terms of dividend policy practiced, be it an invariable dividend, an invariable distribution rate or a residual dividend policy. As a summary, the policies set forth by financial theory do not apply in the practice of companies listed on the Bucharest Stock Exchange, excluding residual dividend policy. The lack of dividend is a signaling instrument of real performances of companies. In these circumstances the absence of attractiveness for companies listed on the stock does not seem to be something surprising.*

Key words:
Dividend policy, residual dividend policy, signal theory

1. Introduction

The distribution of dividends brings a number of advantages listed below: it provides a favorable signal about the state of the company (a company providing dividends is a company that has the financial ability to meet its obligations to investors), dividends are attractive because they provide current and future income to shareholders. A company that has rewarded its investors with annual dividends, if they would announce their decline or the reinvestment of profits, will adversely affect the market price. The main objective of this study is the identification of the behavior of companies listed on the Bucharest Stock Exchange in the period 2005-2012, in terms of dividend policy practiced, be it an invariable dividend, an invariable distribution rate or a residual dividend policy.

The paper is structured as follows: Section 2 is allocated to literature review studies that are the fundamental theoretical of this research and the main determinants of dividend policy are presented, in Section 3 the methodology and the used variables are described, and Section 4 contains the results of empirical testing. The last part is devoted to Conclusions.

2. Literature review

The majority of works *Renneboog and Trojanowski (2006), Travlos et al. (2001), Miller and Rock (1985), Pruitt and Gitman (1991), Wang et al. (2002), Al-Kuwari, D. (2009)* that study the phenomenon of dividend distributed to shareholders concludes by analyzing the distribution practice on 3 levels: an invariable dividend, an invariable distribution rate or a residual dividend policy.

Profits, the key of which the discussion is started is assigned to multiple destinations: capital growth, renewal of equipment, productive activities, and new investment projects to attract entrepreneurs, they leaving low profit areas and moving their capital to those with higher profit. All these arguments support the idea of reinvestment of a part of profit. If dividends are taxed higher, they are not attractive for investors. If they are too few they are not preferred of shareholders. So, why dividends are important? In addition to benefits that investors get from reinvestment of profits, dividends represent actual earnings. On the other hand dividends are a signal offered to the market - the company goes well, then it has profit and distributes dividends, so investors operating in some areas with lower margins will move capital toward those with higher profit.

In the vision of some authors like *Han (1999), Rozeff, M.S. (1982)* an invariable dividend policy can be established in any of the following forms:

- *Invariable dividend per share*: Some companies follow a policy of fixed dividend per share, regardless of profit. Such firms usually create a "dividend equalization reserve" to enable them to pay fixed dividends, even in the year in which profits are not sufficient or when there is a loss. Despite the many advantages constant dividend policy brings some disadvantages. Once a company follows an invariable dividend policy, it is rather difficult to change it. If dividends are not paid to shareholders (insufficient profits) the financial situation of the company is perceived to be damaged in the minds of investors, those wishing, may withdraw their capital. This adversely affects the market price of the shares of the company.

- *Invariable dividend ratio*: ratio between dividend and profit is invariable each year. The amount offered in the form of dividends fluctuates in direct proportion to the company's profits. The invariable remuneration policy is the favorite of companies because it is related to their ability to pay dividends. Although attractive in its simplicity, this distribution policy is easy to promote. However, in terms of underperformance, the company will distribute for recovery / dividends share of profits equal to those they would distribute if that would get great results. This policy is undoubtedly in the interest of shareholders, seen in the role of individuals who want to invest their money to earn more. By providing a certain amount, the company's management has a certain credibility which can attract potential shareholders. Given the fact that the policy is not good enough it can lead to a decrease in the value of the company. Such policy affects the external image of the company, on the market capitalization.
- *Irregular dividend policy***.** Some companies pay irregular dividends on the account of the following decision makers: uncertainty about future profits, lack of liquid resources; fear about the adverse effects of regular dividends on the company's financial situation.
- *No dividend policy* - A company may pursue a policy of not paying dividends now because of its unfavorable position regarding working capital or because of funding requirements for future expansion and business growth.

Establishing a dividend policy for companies listed on the Bucharest Stock Exchange is likely to be a fairly easy task given that on the market capital of Romania the vast majority of companies are held by majority shareholders who want profits not to be distributed as dividends but to be reinvested in profitable investment projects. The Literature *Faccio*, *Lang* and *Young* (2001), *Renneboog and Trojanowski* (2006), *Easterbrook* (1984), *Jensen* (1986) confirms the relationship between the existence of concentrated ownership and residual dividend policy.

3. Data base and results

To create the database associated with the dividend policy study there were used financial and economic information available for 66 companies from category I and II, section Bucharest Stock Exchange in 2005-2012. To achieve this study it was considered necessary research in quantitative terms of dividend policy at the most important companies listed on stock exchanges. Financial data used were taken from the annual reports of listed companies: www.bvb.ro - site of the Bucharest Stock Exchange, www.ktd.ro - website of Investment Consultancy Society KTD Invest SA.

Dividend policy is one of the key elements of financial management, a task and a responsibility for company's managers. By dividend policy we refer to the way in which managers decide the size and the distribution of dividends to shareholders. The data in the table 1 shows a record of all the companies that distributed dividends based on the number of years. Thus 22 companies, representing 33.33% of the sample used, have never paid dividends, and 12 companies have paid dividends in only one year. There is a declining trend in the number of companies which practice a policy of granting dividends in as many years as possible.

Table 1. Analysis regarding the method of annual distribution of dividends by listed companies in Romania during 2005 – 2012

Number of years in which companies have given dividends	0	1	2	3	4	5	6	7	8
Number of companies	22	12	7	4	3	3	6	4	5
Percentage of companies (%)	33.3	18.18	10.61	6.06	4.5	4.55	9.09	6.06	7.58

Most companies do not pay dividends or they grant once during those 8 years. So 33.33% of companies prefer residual policy, while only a percentage of 7.58% (5 companies) of all the analyzed companies paid dividends consistently every year from 2005 -2012.

Table 2. Average annual dividend and average annual ratio of dividends of listed companies

Year	2012	2011	2010	2009	2008	2007	2006	2005
Average dividend in absolute value (lei/share)	0.513	0.478	0.464	0.22	0.203	0.197	0.069	0.035
Average rate of dividend distribution (%)	21.54	33.9	4.50	14.44	18.15	14.67	15.9	15.14

The information in the table 2 is designed to analyze how the net dividend amount has evolved in companies listed on BSE in the 8 years, and the average rate of dividend distribution. Thus in 2005 it is registered the minimum of average value of dividend of 0.035 lei/ share, and the maximum it is reached in 2012 of 0.513 lei/share. It shows a steady increase in the average level of dividend. Average dividend payout for 2010 reaches 4.50%, the lowest value obtained for the period 2005-2012, and the maximum it is reached in 2011, it being 33.99%.

Table 3. Analysis of the number of companies listed on the Bucharest Stock Exchange which had distributed a dividend per share and a dividend rate lower/higher than the average distribution rate during 2005 – 2012

Year	Dividend Rate < Average Dividend Rate (no. of companies)	Dividend Rate > Average Dividend Rate (no. of companies)	Dividend < Dividend average (no of companies)	Dividend >Dividend average (no. of companies)
2012	46	20	63	3
2011	43	23	64	2
2010	47	19	65	1
2009	47	19	63	3
2008	45	21	59	7
2007	48	18	59	7
2006	47	19	56	10
2005	51	15	54	12

The data in Table 3 shows the position most of the companies listed on the Bucharest Stock Exchange adopted in respect of the dividend distribution policy. During the analyzed period 2005-2012 a total of 43-51 companies practice a lower rate than the average rate of distribution (calculated for each year as the simple arithmetic average of the rates of each company of the 66 companies analyzed). A number of 15-23 companies providing a rate that exceed the average rate of dividend. So many companies distribute a dividend rate lower than average which means that a percentage of 23-34 % of the company distributes a dividend rate higher than the power of distribution of the other companies. The information in Table 3 reveals the same position which most of the companies listed on the Bucharest Stock Exchange adopted in terms of dividend volume compared to its average. Thus it is noted that, in 2010, a single company distributes a dividend higher than average which means that 1.5% of companies are increasing the average rate compared to the power of distribution of the other companies.

Table 4. Dividend per share and dividend distribution rate compared to average dividend per share / average dividend distribution rate, in 2005-2012

Average dividend in absolute value 0.243 lei/share	
Dividend < Dividend average 62 companies	Dividend >Dividend average 4 companies
Average rate of dividend distribution 17.29%	
Dividend Rate < Average Dividend Rate 40 companies	Dividend Rate > Average Dividend Rate 26 companies

There is an increasing trend in the number of companies that decreases the amount of dividends. Analyzing the information in Table 4 it is observed that in the whole period analyzed, 62 companies representing 94% gave an average dividend lower than the average value registered by the dividend paid by companies listed on BSE, with continued 8 years analyzed, calculated as average of values of dividends provided by all companies in all the years, an amount equal to 0.243 lei / share. Regarding the average of rate of dividend distribution during 2005-2012 it is 17.29%, and only 26 companies have granted an average of distribution rate higher than the average rate registered by all companies in the sample.

Table 5 Analysis of the number of companies listed on Bucharest Stock Exchange depending on the type of dividend per share/ rate of dividend paid in the period 2005 – 2012

Type of Dividend	No. of companies 2005 - 2012	No. of companies 2010 - 2012	Type of Dividend Rate	No of companies 2005-2012	No. of companies 2010-2012
Zero	22	22	Zero	22	22
Constant	0	0	Constant	0	0
Increasing Rate	0	13	Increasing Rate	0	12
Decreasing Rate	0	9	Decreasing Rate	0	7
Fluctuant	44	22	Fluctuant	44	25

The information in Table 5 shows how the Romanian companies trace their dividend policy. Thus, there is the next trend in the dividend policy in the period 2005-2012: 22 companies (33.33 %) did not distribute dividends, so they practice a residual policy of distribution. Within the same period no company succeeded to pay a growing dividend. In the period 2005-2012 it appears that quite a few companies, specifically 44 entities, practice a fluctuating policy of dividend attributable to a dividend linked to the financial results at the end of each year. In the last three years it is seen that we can distinguish two trends: 13 companies (20 %) allocating an increasing dividend and only 9 companies (14 %) decreasing dividends. Besides the zero dividend practice it is observed great variability of its value, while for companies providing dividends. Such signaling is not appropriate given that there are companies providing increasing dividends, followed by dramatic decreases making the investors sensation not to be one of certitude or of safety.

Using the information in Table 5 we present how companies in Romania draw their dividend distribution policy. Thus, for the period, 2005-2010, 22 companies (33.33 %) did not distribute dividends, so they had a distribution rate equal to zero. At the same time in the last three years 2010-2012, 12 companies (18.18 %) have practiced an increasing dividend distribution rate, and 7 companies (10.6 %) a decreasing rate.

4. Conclusions

As a summary, the policies set forth by financial theory do not apply in the practice of companies listed on the Bucharest Stock Exchange, excluding residual dividend policy. In excess of 33.33 % in the period 2005-2012, companies listed on the Bucharest Stock Exchange preferred residual dividend practice, equal to zero. Residual policy is preferred by companies that focus on business growth. While there will be other investment opportunities characterized by way of a positive NPV, the company will not distribute dividends. It is noted that the practice of residual dividend is preferred by companies listed in Romania. We believe that profits are not sufficient, or shareholders will be paid based on future earnings. Politically, this seems inconsistent with the logic of the stock investors who perceive the dividends reduction or the not allocation of profit as dividends as signals of poor performance, but this is practiced by over 33.33 % companies listed on Bursa Bucharest Stock. It is also noted that companies in Romania are based on the distribution of a fluctuating dividend, which knows exponential increases on the one hand, followed by periods of great decreases.

We believe that the analysis period of the dividend policy in Romania is not sufficient to make a general direction of how dividend policy evolves. Shareholders seem to be unrequited for their investment in the shares of listed companies and they wait understanding for future gains. During the next chapter we will study the information on ownership structure and we'll see that in Romania prevail the concentrated ownership companies which provide greater benefits through ownership of a majority stake than through dividends, dividend not constituting a source of remuneration.

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