УДК 658.155.2

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DIVIDEND POLICY AND FINANCIAL LIQUIDITY OF A COMPANY

This article treats the issue of generated profit distribution by a company taking into consideration planned investments. The goal of this article is to show a need of taking into account the fact that in a structure of dividend policy there is not only a capital demand for future investment projects, but also for company's security in case of losing liquidity which may result from unpredictable economic events.

Key words: Dividend policy, investments, liquidity of a company.

Problem statement. This article treats of the issue of generated profit distribution by a company taking into consideration planned investments. Companies which work out a positive financial result within a scope of their business activity can allocate profit to investments and development or they can distribute the whole profit or its part among shareholders in the form of a dividend. An amount of capital transfer beyond an entity – in the form of dividend – should consider needs of the entity within the range of its development and financial liquidity. Paying out a dividend which is too high without planning a capital demand may result in disturbing financial liquidity.

Therefore, the problem of financial liquidity of a company and its maintenance taking into consideration the payout policy for shareholders and fixed assets investments was additionally raised in this article.

Analysis of the latest publications. Dividend policy and repurchase of own shares with the aim of depreciation [1] constitute the policy of payouts for shareholders. Repurchase of own shares with the aim of depreciation is often treated as an alternative to paying out a dividend.

Dividend policy is a decision about dividing a company profit into two parts: the first part distributed to shareholders and the other one allocated to developmental objectives. [2]

Views on the influence of dividend policy on goodwill are considerably divided among the ones who are interested in the issue of profit and dividend distribution itself. In general there are three trends which have been scientifically applied to date: [3]

[1] A term frequently used in a literature is Buy-Back.

[2] Tarczyński, W. Capital Market. Effective investing, University of Szczecin, Szczecin 2007, p. 277.

[3] Sierpińska M., Dividend policy in join-stock companies // PWN. – Warszawa ; Kraków 1999, p. 131 and subsequent.

- conservative group (pro-dividend) – goodwill will be maximized by a hight rate of dividend payouts. The main representatives of this group are M. Gordon and J. Litner;
- radical group (anti-dividend) – an increase in dividend payouts decreases goodwill. This group is represented by R. Litzenberger and K. Ramaswamy;
- middle group (neutral) – a dividend policy has no impact on either a share price or a cost of company capital. Such views were first presented by M. Miller and F. Modigliani.

According to the representatives of the first group, a dividend has always been and still is the most desired form of receiving profits from a capital invested in shares. This theory was proved in the results of capital market observations, which allowed to make a statement that there was a greater demand among investors for shares characterized by high dividend payouts than for shares with low payouts. However, in the opinion of the representatives of the radical group shareholders pay a lot of attention to taxes. Therefore, shareholders will prefer profits from capital until taxation on profits from sales is lower than taxation on dividend.

The representatives of the neutral group (F. Modigliani and M. Miller) published a work [4] in which, having made a lot of assumptions on market characteristics and nature of investors, they came to conclusion that with a given investment policy a dividend policy of a company does not have any impact upon either a current market price of shares or total income of shareholders.

Works to date on dividend policy included issues connected with an impact of a paid-out dividend on goodwill and behavior of share prices of those companies which paid out, ceased to pay out dividends or increased/ decreased a value of paid-out dividend.

Dividend policy of a company and decisions of management boards of companies connected with a change in dividend policy are carefully analyzed by investors and have significant influence on their investment policy. Hence, in specialist literature [5] there exist results of research on portfolios consisting of

[4] Miller M., Modigliani F., Dividend Policy, Growth and the Valuation of Shares // Journal of Business. – 1961, nr 34, p. 411–433.

[5] The author of the article conducted research under the patronage of *Gazeta Bankowa* on the analysis of investments only in dividend companies on the Warsaw Stock Exchange in the period 1991–2009, which imply that in a long run they are characterized by a higher rate of return than companies which do not pay out the dividends, but have been selected for the portfolios according to the same criteria. The results of the research on the profitability of portfolios composed of dividend companies on the Warsaw Stock Exchange in the period 1991–2009 are described in: B. Jabłoński, Significance of the Selection of Groups of Shares to the Investment Portfolio upon an Example of the Warsaw Stock Exchange in the Period 1991–2009 in: Achievements of the Contemporary Economic Thought – Significance of the Selection Categories in Economic Theories and Economic Practice, ed. by U. Zagóra-Jonszt, Publishing House of the Karol Adamiecki University of Economics in Katowice, Katowice 2010, B. Jabłoński, Optimization of a Dividend Portfolio of Securities in: Risk in Finances and Banking in the Conditions of the Economic Crisis, ed. By Dylewski M.,

dividend companies and their properties. Portfolios comprising solely of dividend companies are characterized by not only a higher rate of return in a bull market period, but also by lower depreciations during a bear market period.

Earlier unsolved part of the problem. Current studies connected with dividend policy do not resolve a problem of building an optimal model of dividend policy which would be stable in time. Signaling effect, which is widely discussed in the literature of the subject, weighs in favour of such a solution.

Informational contents of dividends is a factor whose impact was not explicitly resolved. It results in appearing the effect of signaling.[6]

Therefore, in practice, decisions about increasing dividends or maintaining them at a steady level occur far more often than decisions about decreasing dividends or total cease of payouts. By contrast, a dividend smaller with comparison to a previous year is interpreted as a pessimistic forecast of a management board as far as making profits is concerned. Therefore, decisions about changes in dividend payouts are interpreted by the market as forecasts for the future condition of a company. Information about increasing or commencing dividend payouts are interpreted by investors as a signal that managers predict an increase in company's income in the nearest period.

Despite a lot of discrepancies in interpreting the impact of other factors on dividend Policy, researchers almost agree completely on the issue of signals sent by dividends. Dividends are a source of important information which is not known to the market.[7]

Taking into account the frequency of dividend payouts, a role of dividend policy for raising capital stock in an exchange market and raising lending capital of a dividend can be divided into:[8]

- common dividends – usually paid-out on yearly basis by virtue of possessing shares;
- additional dividends – paid-out in the periods of high profits which, however, are so unstable that payment of such dividends will not be maintained in the future;
- special dividends – paid-out in extraordinary circumstances, which makes it impossible for investors to expect another payment of such dividend in the future;

Publishing House of Poznań School of Banking, Poznań 2010, B. Jabłoński, Model of a Securities Portfolio, *Gazeta Bankowa* 2010 No. 3, B. Jabłoński, Dividends in Companies, part 2, *Gazeta Bankowa* 2009 No. 35, B. Jabłoński, Dividends in Companies, part. 1, *Gazeta Bankowa* 2009 No. 34, B. Jabłoński, How to Invest 2, *Gazeta Bankowa* 2009 No. 21, B. Jabłoński, How to Invest, *Gazeta Bankowa* 2009 No. 20, B. Jabłoński, Purchasing Time, *Gazeta Bankowa* 2008 No. 42, B. Jabłoński, Dividend Attractiveness, *Gazeta Bankowa* 2008 No. 39.

[6] See more: M. Miller, K. Rock, Dividend Policy under Asymmetric Information, "Journal of Finance", Sept. 1985, vol. 40.

[7] S. Elfakhani, An Empirical Examination of the information content of balance sheet and dividend announcements: A signaling approach, "Journal of Financial And Strategic Decisions", Summer 1995, vol. 8, nr 2, s. 65.

[8] Own study based on: M. Sierpińska, op.cit., p. 58–60.

- liquidation dividends – paid-out at the time of company's liquidation.

Various forms of dividend payouts strategies have been worked out up to now (a steady amount of dividend, a steady rate of payment, a surplus policy of dividends, a target rate of payouts, a policy of a hundred per cent payment rate and a policy of zero rate dividend payout).[9] However, these strategies do not provide a solution to the problem of dividend payment in a model way and they do not take into consideration the issues described in the article such as a demand for future investments, cost of capital, liquidity of a company, or changeability of results in future.

A famous statement by Black Fisher in which he compares the policy of dividends to *a puzzle with pieces that just don't fit together* [10] has become particularly significant nowadays. A. Damodaran [11], in turn, defines the problem of distribution of generated profit into a part to be invested and a part which is going to be paid out in a form of a dividend, as a core of a dividend rule.

Article's goal. The goal of this article is to show a need of taking into account the fact that in a structure of dividend policy there is not only a capital demand for future investment projects, but also for company's security in case of losing liquidity which may result from unpredictable economic events.

Main material. Research which has been carried out so far confirms the attractiveness of investing in dividend companies, especially when received dividends are reinvested in these companies. Therefore, it is so important to work out by companies a proper dividend policy which will consider not only capital demand for investments and growth of an entity, but also bonuses for investors for capital invested by them. Thus, a dividend policy should be a compromise between company's needs and investors' expectations.

It is possible for a developing company, which carries out investing projects of positive NVP for which ROC > WACC, to pay out in future higher dividends from a part of generated profit and reinvest the remaining part in subsequent projects. Therefore, a capital demand for investments in this type of projects should be assumed as a priority in a dividend policy, and this will result in future dividend payouts which will be higher than the ones that might be paid out in the near future and at the same time could restrict development abilities of an entity.

Investing is not an isolated activity but an integral part of a total activity of an enterprise. To a larger or smaller extent it is connected with all other kinds of

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[9] See more: E.F. Brigham, Fundamentals of finances management, PWE, Warszawa 2005, vol. 2, p. 204, T. A. Marsh, R.C. Merton, Dividend behavior for the aggregate stock market. Journal of Business, 1987, 60(1), pp. 1–40, R.A. Brealey, S.C. Myers, Principles of Corporate Finance, 7th edition, McGraw-Hill, New York., 2003, p. 438, A. J. Brav and others, Payout policy in the 21st century, Journal of Financial Economics, 77, 2005, 483–527, H. K. Baker, G. E. Powell, E. T. Veit, Revisiting Managerial Perspectives on Dividend Policy, Journal of Economics and Finance, 26(3), 2002, pp. 267 – 283, A. N. Duraj, Factors of the implementation of dividend payouts by public companies, University of Łódź Publishing House, Łódź 2002, p. 93, S. Z. Benninga, O. H. Sarig, Company finances, Methods of valuation, WIG-Press, Warsaw 2000, p. 285.

[10] F. Black, The Dividend Puzzle, "Journal of Portfolio Management", 1976, vol. 2, p. 5–8.

[11] See more: A. Damodaran, Corporate Finance: Theory and Practise, John Wiley & Sons, Inc. 2000.

enterprise activities. The investment activity, therefore, creates and is created by a lot of other decisions and actions which make up operations of an enterprise.[12]

Moreover, a dividend policy should also consider issues connected with maintaining financial liquidity. Transferring from an enterprise an amount which will be too high, even with consideration of future investment demands, may bring about unbalance of liquidity, and in the worst instance a loss of financial liquidity which will as a consequence lead to bankruptcy. Therefore, without any doubt a crucial factor which has an impact on a level of dividend payouts is a cash level in a company. Developing enterprises may have a weak cash position owing to a very quick growth of sales, which is accompanied by a growth of reserves and receivables; thus, such enterprises may give up or pay out minimum amounts of dividend. Therefore, while creating a dividend policy, its assumptions should consider a problem of potential cash reserves along with a problem of a capital demand for investments. Such reserves should be invested in liquid securities which generate specified financial revenues and which can be quickly redeemed if necessary.

Results of carried out research suggest that investors treat extra dividends with reserve and as a signal from managers of future profitability of a company, and as a result, a reaction of market to unexpected special dividends is weaker than a reaction to higher amounts of common dividends.[13]

Conclusions. It is advisable for an enterprises which carries out project of positive NPV for which ROC is higher than WACC to lower a level of a dividend payout and allocate means to carrying out those projects.

The only reasonable solution for an enterprises which intends to pay out a dividend is to make use of a dividend which takes into consideration future results, planned investments including their impact on results, capital cost and liquidity.

A dividend policy drawn up in a proper way gives a company flexibility in a scope of ordering a capital, and investors are given a possibility to consume or reinvest a received dividend. This approach to the policy of results distribution eliminates a negative impact upon investors of changeability of a paid-out dividend.

Whereas, a dividend payout and financing projects from a capital obtained through the issue of shares make sense only if a management board is thoroughly controlled by a supervisory board in the scope of effectiveness of investments and ROC of projects > WACC of a company.

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Анотація

Стаття розглядає питання розподілу прибутку компанії з урахуванням запланованих інвестицій. Метою даної статті є показати необхідність прийняття до уваги той факт, що у структурі дивідендної політики існує не тільки потреба у капіталі для майбутніх інвестиційних проектів, а і у безпеці компанії у разі втрати ліквідності, що може стати результатом непередбачуваних економічних подій.

Отримано 08.09.2011