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The Impact of Capital Structure and Dividend Policies on Firm Profitability and Shareholders Wealth

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Abstract: The research aimed at assessing the impact of capital structure and dividends on profitability and shareholder wealth through an approach that involved both qualitative and quantitative techniques. In the study, the impact of financial decision-making such as capital structure and dividends on organizational performance was considered important to be known. Primary data collection entailed use of semi-structured interviews with finance managers, executives, and investors' analysts, while the secondary data involved financial information from financial statements and annual reports of the selected companies. The results of qualitative data analysis indicated that capital structure, dividends, and retained earnings are among the most important elements that affect profitability and growth of organizations. From the findings obtained through quantitative data analysis, there exists a significant positive relationship between capital structure and dividends with profitability measures like ROA, ROE, and EPS. Furthermore, it was discovered that the dividend policy played more significance in wealth maximization compared to capital structure. Both the variables had statistical significance, hence making a major influence in the performance of the companies. Generally, it was learned from the study that proper financial management that entails effective use of the optimal amount of debt with dividends plays a major role in maximizing shareholders' wealth.

Keywords: Capital Structure, Dividend Policy, Firm Profitability, Shareholders' Wealth, Financial Performance, ROA, ROE, EPS

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INTRODUCTION

"With regard to the existing corporate finance environment, decision-making on issues concerning capital structure and dividend payments has become a crucial determinant in achieving success by both the company and its stakeholders (Rumasukun & Nochh, 2024). In the context of capital structure, it refers to the mixture of debt and equity used by the firm in carrying out its operations, while dividend payment refers to the amount of earnings paid out to its stockholders (Al-Najjar, 2011). The two decisions are crucial in value generation because they determine the cost of capital and the risks associated with the business. An example of how companies manage their capital structure and dividends is Reliance Industries Limited, which has successfully employed both debt and equity capital in venturing into digital and retail businesses (Ambasana & Thakrar, 2024).

Empirical examples further illustrate the extent to which capital structure strategies may influence corporate results (Parsons & Titman, 2009). Corporations like Tata Steel have faced both positive and negative repercussions due to the use of debt (SR, 2024). Although leveraged funds helped to achieve quick global growth via mergers such as Corus, too much debt at times of economic crisis posed challenges for earnings

and finances (Grave et al., 2012). These examples demonstrate the reality that even though debt could lead to more gains, it also has considerable dangers, making it necessary to find out what capital structure would be the best (Graham & Leary, 2011).

The significance of dividend policies when it comes to gaining investors' trust and increasing the value of the companies cannot be overlooked (Lubis et al, 2024). Companies like Infosys have kept up their reputation by being consistent with their dividend policies, leading to more trust from investors and ensuring the continuous growth in the price of their shares (Krushnanjana, 2021). The dividend policies of Hindustan Unilever Limited reflect the financial stability of the company and its capacity to pay back its shareholders (Unilever, 2010). The theory of 'bird-in-hand' is the most common theory to interpret the behavior of investors concerning dividends (Charbti, 2020).

In recent times, the changing dynamics of the business environment due to globalization, technological developments, and economic instability have increased the challenges involved in decision making (Iriani et al., 2024). For example, the occurrence of the coronavirus pandemic required changes in the capital structure and dividend policies of companies to guarantee survival during tough economic periods (Cejnek et al., 2021). Companies in various sectors were forced to reduce their dividend payouts or consider self-funding. This highlights the importance of studying the relationship between capital structure and dividend policy, as well as its effect on the bottom line of businesses and the wealth of their shareholders (Moussa & Chichti, 2014)."

Objective of the Study

To explore and understand how capital structure and dividend policies influence firm profitability and shareholders' wealth, with a focus on identifying financial strategies that enhance overall firm value.

REVIEW OF LITERATURE

"The link between capital structure, dividends, profitability, and value creation in firms has been thoroughly analyzed in the current body of knowledge regarding its interconnectivity in financial management practices. According to the initial empirical data by Sinaga A. P. D. S. J. (2016), both capital structure and dividends played an essential role in improving the level of profitability and firm value in the context of Indonesian oil palm plantation firms. The results indicate that a balanced combination of liabilities and equity along with proper dividends positively influences financial performance. Similar findings were obtained in the research conducted by Farrukh K. et al. (2017), who proved that dividends increase firm value in Pakistan.

More researches on the impact of the combination of several financial ratios on the value of an organization have been conducted. Sudiani N. K. A. & Wiksuana I. G. (2018) showed that the main factors in determining the value of a company are the capital structure, the investment opportunity set, the dividend policy, and profitability. Also, according to the study conducted by Triyono T. et al. (2019), profitability, firm size, asset structure, and dividend policy greatly affect capital structure decisions.

The current trend in literature research has been on the impact of financial policies taken as a whole on firm value. According to Purwanti T. (2020), there is evidence to show that profitability, capital structure,

company size, and dividend policy influence firm value. The conclusion is that all financial policies must be integrated for firm success. Similar research was conducted by Bataineh H. (2021), where he explored the role of ownership structure in influencing dividend policies, finding that ownership concentration played a role in the dividend decision process and influenced shareholder wealth.

Even more recently, the connection between financial policies and firm value has been supported even further. According to Alfianita A. & Santosa P. W. (2022), firm growth, dividend policy, capital structure, and profitability influence firm value, with dividends acting as an effective signal of performance. Further, according to Akib M. et al. (2023), capital structure, dividend policy, and profitability have a positive influence on stock price, which increases shareholder wealth. Overall, from the literature presented above, it is clear that both capital structure and dividend policies influence firm performance and wealth creation."

Hypothesis of Study

H_0: There is no perceived relationship between capital structure and dividend policies and firm profitability and shareholders' wealth.

H_1: There is a perceived relationship between capital structure and dividend policies and firm profitability and shareholders' wealth.

RESEARCH METHODOLOGY

a) "The use of a mixed methods approach was applied to conduct an extensive analysis of the influence of capital structure and dividend policy on performance and wealth of the companies in question. In particular, the qualitative component ensured that a full understanding of the managers' attitudes toward finance and financial decision making was obtained, while the quantitative part made it possible to test relationships between financial indicators.

b) The target population consisted of firms quoted on leading stock exchanges, such as the Bombay Stock Exchange and the National Stock Exchange. Sample size ranging from 20 to 30 individuals was considered ideal for the qualitative segment of the study, which would include finance managers, corporate executives, and financial analysts. Thirty to fifty firms were included in the study as part of the quantitative segment of the research, based on data availability. The purposeful sampling technique was adopted for this study, to ensure the right set of participants and organizations was involved in the research process.

c) Both primary and secondary data sources were utilised in conducting the study. Primary data were collected through semi-structured interviews and surveys which were used to gather opinions and views from financial experts. Secondary data were collected through annual reports, financial reports, stock exchanges, and relevant academic articles. Such an array of data sources helped triangulate findings and strengthen the validity of the outcomes.

d) The qualitative data was analysed using thematic analysis where answers were coded and classified to establish main themes concerning financial strategy, profitability, and wealth creation. Meanwhile, the quantitative data were analysed using descriptive analysis, correlation, and regression to test the proposed hypotheses and examine the relationship between variables. Such a combination of analyses resulted in a

full understanding of the impact of capital structure and dividend policies on company performance and shareowner wealth."

FINDINGS

Profile of Respondents

Table 1: Profile of Respondents

Category	Number of Respondents	Percentage (%)
Finance Managers	10	40%
Corporate Executives	8	32%
Investment Analysts	7	28%
Total	**25**	**100%**

Key Themes from Qualitative Analysis

Table 2: Key Themes from Qualitative Analysis

Theme Code	Theme Description	Frequency
T1	Optimal capital structure improves profitability	20
T2	Excessive debt increases financial risk	18
T3	Stable dividend policy enhances investor confidence	21
T4	Retained earnings support long-term growth	17
T5	Dividend policy influences market valuation	22

Descriptive Statistics

Table 3: Descriptive Statistics

Variable	Mean	Std. Deviation

Debt-Equity Ratio	1.45	0.52
Dividend Payout Ratio	0.38	0.14
Return on Assets (ROA)	0.092	0.03
Return on Equity (ROE)	0.158	0.05
Earnings per Share (EPS)	12.50	4.20

"From the descriptive statistics, we can see that the mean of the debt-equity ratio is 1.45. This means that on average, firms used more debt than equity financing in their capital structure. The mean of the dividend payout ratio is 0.38. This implies that the average percentage of profit paid out as dividends by the firm is about 38%.

Based on the mean of the return on assets (ROA) and return on equity (ROE), which are 0.092 and 0.158, respectively, it can be noted that the profitability was relatively high for the firms included in the sample. Furthermore, the earnings per share (EPS) mean value is 12.50.

Correlation Analysis

Table 4: Correlation Analysis

Variables	D/E Ratio	Dividend Pay-out	ROA	ROE	EPS
D/E Ratio	1				
Dividend Payout Ratio	-0.25	1			
ROA	0.42	0.51	1		
ROE	0.48	0.46	0.72	1	
EPS	0.36	0.58	0.60	0.67	1

The correlation analysis explains the relationship between the capital structure, dividend policy, profit-making ability, and shareholder wealth. In the case of the debt equity ratio, there is a moderate positive correlation with ROA (0.42), ROE (0.48) and EPS (0.36), implying that there could be a role of leverage in improving the financial results up to a point.

In the case of dividend payout ratio, the strong positive correlation exists with EPS (0.58), ROA (0.51) and

ROE (0.46). This means that the company paying out more dividends performs well financially. Also, ROA and ROE have shown a strong positive correlation (0.72). It seems from the negative correlation of (-0.25) between debt equity ratio and dividend payout ratio that leverage is associated with the retention of earnings rather than their distribution as dividends.

Regression Analysis

Table 5: Regression Analysis Results

Independent Variable	Beta Coefficient	t-value	Significance (p-value)
Debt-Equity Ratio	0.31	2.45	0.018
Dividend Pay-out Ratio	0.44	3.12	0.003
$R^2 = 0.52$			

The regression analysis estimates the effect of independent variables such as debt-equity ratio and dividend payout ratio on the performance of the firm and its ability to improve the wealth of the shareholders. In relation to debt-equity ratio, the β coefficient is positive at 0.31. This means that there is a direct and significant relationship between the variable and dependent variable; hence, leverage enhances the performance of the firm if well managed.

Like the first variable, the second one (dividend payout ratio), β coefficient is also positive at 0.44. This suggests that the role played by the dividend policy in increasing the wealth and profitability of the company is relatively more important than the first one. T-values and p-values show the statistical significance of each variable. Regarding R^2 value (0.52), this means that 52 percent of variation in firm profitability and wealth can be explained by the two variables.

Interpretation of Results

According to qualitative findings, most respondents agreed on a high correlation between capital structure, dividends, and firm performance. Concepts such as ideal ratio between debts and equities, constant dividend payouts, and retained earnings became essential factors for profitability and wealth creation for stockholders. Quantitative data confirmed the above statements. According to correlation analysis, there was a positive correlation between dividends and profitability measures such as ROA, ROE, and EPS. The capital structure itself also positively influenced firm performance. Finally, regression analysis found a significant effect of the debt-equity ratio and dividends payout ratio on profitability and wealth creation.

Concluding from descriptive statistics, correlation analysis, and regression, one can say that capital structure and dividends policies have considerable influence on profitability and wealth of shareholders. However, while leverage helps improve performance, the latter is influenced much more significantly by the dividend policy. Consequently, one can confirm that there is a considerable relationship between all

mentioned variables; therefore, one can reject the null hypothesis and accept the alternative hypothesis."

Results of Hypothesis Testing

Table 6: Results of Hypothesis Testing

Objective of the Study	Hypothesis	Result
To explore and understand how capital structure and dividend policies influence firm profitability and shareholders' wealth, with a focus on identifying financial strategies that enhance overall firm value.	**H_0:** There is no perceived relationship between capital structure and dividend policies and firm profitability and shareholders' wealth.	**Rejected**
	H_1: There is a perceived relationship between capital structure and dividend policies and firm profitability and shareholders' wealth.	**Accepted**

DISCUSSION

The results obtained from the study illustrated a complete and consistent association of capital structure, dividends, profitability of the organization and wealth maximization of the shareholders through the integration of qualitative information and quantitative data. The survey involved finance managers, corporate executives and investors' analysts in order to ensure the presence of relevant perspectives related to practical financial decisions making process. According to qualitative analysis, it was established that optimal combination of debt and equity is needed to maximize profits, but excessive use of debt financing raises financial risks, influencing on firm stability. Moreover, stability in dividend payment was stated to have significant influence on investor's perception and market evaluation of the firm, while the importance of internal generation of funds was also underlined. Quantitative analysis proved the significance of the findings mentioned above since the descriptive statistics showed the moderate use of leverage in companies and fair dividends distribution among the respondents. The positive correlation between capital structure and measures of profitability, like ROA, ROE and EPS, demonstrated that effective use of leverage increases company performance. At the same time, the payout of dividends showed even more positive correlation with profitability and shareholders' wealth. The inverse relationship between debt-equity ratio and the dividend payout ratio provided additional insight that the companies having high levels of leverage are more inclined towards retaining their earnings instead of distributing profits. Regression analysis provided evidence supporting these hypotheses as the regression results showed that both debt-equity ratio and dividend payout ratio have a strong influence on company performance, with the dividend payout ratio being the more influential financial policy since it carries a relatively high beta value. It was seen from the regression results that the explanatory power of the model was quite high ($R^2 = 0.52$), which means that a large proportion of variance in financial performance and shareholder wealth depends on the financial decisions of a company.

CONCLUSION

The researchers reached the conclusion that capital structure and dividend policy play very important roles as factors contributing to business profitability and wealth maximization for stockholders. The outcomes of qualitative and quantitative analysis showed the importance of making an optimal balance between debt and equity financing as a means of improving financial results. In addition, it has been established that proper leverage management helps to reduce financial risks associated with using borrowed funds. The research revealed the importance of proper leverage management and its relationship with other financial factors. In particular, despite the influence of high levels of leverage on company profitability, companies having high debts tend not to pay out their earnings to stockholders but keep them as retained earnings. The existence of significant positive correlation and regression coefficients was evidence of the influence of the above financial factors on the analyzed performance measures such as ROA, ROE, and EPS.

In the light of management theory, the results imply that companies should pursue a prudent approach to finance through balancing capital structure decisions and dividend policies to ensure growth and wealth maximization. It is important that there must be a balanced leverage and consistent dividend policies to build trust among shareholders. Therefore, the research has found sufficient evidence on the positive correlation between capital structure, dividends, and firm performance, hence rejecting the null hypothesis and accepting the alternative hypothesis. The study contributes to existing financial literature and offers recommendations to practitioners in developing sound financial plans.

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