

**THE RELATIONSHIP BETWEEN EARNINGS AND CASH
FLOWS WITH DIVIDENDS**

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ABSTRACT

The objectives of this study is to identify whether there are a significant relationship between earnings and cash flows with dividend changes for companies listed on the Main Board of the Kuala Lumpur Stock Exchange (KLSE) and to examine the effect of dividend changes, current earnings and current cash flows as predictors of future earnings. Samples of the study consists of 70 companies listed on the Main Board of the Kuala Lumpur Stock Exchange. Correlation and Regression Analysis are used to analyse the accounting data for the period 1990 – 1996 obtained from the Corporate Handbook Malaysia. The findings indicate that only change in earnings is positively and significantly associated with dividend changes. The other variables are not significantly associated with dividend changes. The findings also reveal that there is no support for the notion that there exists a positive association between dividend increases and future earnings. However, current earnings and current cash flows are significant explanators and are the key predictors of future earnings.

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CHAPTER ONE
INTRODUCTION

1.1 Introduction

Traditionally, corporate finance was seen to involve two distinct areas of decision making i.e the investment decision, where investment projects are appraised and suitable projects selected, and the finance decision, where finance is raised to enable the selected projects to be executed. The dividend decision, which considers the amount of funds to be retained by the company and the amount to be distributed to shareholders, is closely linked to both the investment and financing decisions. For example, a company with few suitable projects should return unutilised funds to shareholders via increased dividends. A company with several suitable projects but maintains high dividend will have to find finance from external sources (Watson and Head, 1998, p.171).

Corporate dividend policy has been the focus of much attention in finance literature. The term 'dividend' usually refers to cash paid out of earnings. Dividends represent a source of cash flow to stockholders and provide them with information about the company's current and future performance. The ability of a company to pay dividends may be measured by current earnings (Lintner,1956) and current cash flows (Fama and Babiak ,1968).