

# The Influence of Pecking Order Theory to the Dividend Policy of Han's Laser

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**Abstract.** Through consulting the company annual reports, computation statistics finance data and so on, the analysis research obtains the finance policy and dividend policy of Han's Laser in recent years: (1) Han's Laser increased its internal financing in the recent five years and the financing policy tends to a stability mode; (2) Han's Laser implements a fixed dividend policy, to every 10 shares for fixed cash dividend 2 Yuan. According to the Pecking Order Theory, obtains the influence of Han's Laser financing policy to the dividend policy, analyzes the advantages and disadvantages of it, and proposes to its policy improvement suggestion.

## 1. Background

Financing activity is one of enterprise basic financial control activities, which guarantees the enterprise can have the enough funds to carry on investment. Regarding an enterprise, its financing way may divide into internal finance and external finance. Internal finance mainly refers to the retaining of the net operating cash flows after the dividend assignment, and the external finance may divide into debt finance and equity finance. The different capital source has decided its capital cost difference, the company must consider its capital cost to the company overall income influence if it hopes to obtain its ideal return...

Han's Laser is the first Laser Company in Asia and one of the most advanced countries in the world. It is also one of China's outstanding national leading enterprises. In the past five years, the performance of Han's Lasers has steadily increased, and production and investment capabilities have continued to increase. In 2017, the income and profits of Han's Laser increased rapidly, and its stock price also increased from 22.4 Yuan per share at the beginning of the year to 49.4 Yuan per share at the end of the year. Han's Laser Company, an outstanding laser company, has also received more and more attention.

This article will use Han's Laser as an example to investigate its dividend policy and financing policy in the past five years. Based on Pecking Order Theory, this paper analyzes the impact of this theory on Han's Laser financing policy and its dividend distribution policy and proposes improvement on dividend policy advice.

## 2. Researching Method

### 2.1 Han's Laser Dividend Policy.

Firstly, we study the dividend distribution of Han's Laser in the past five years as shown in the table below.

Table 1. Han's Laser earning per share and dividend policy for 2013-2017

Year	PAT	Share capital	DPS(inclu.tax)	EPS	Dividend yield
2013	573,967,968.92	1,055,498,624	0.20	0.54	0.37
2014	716,693,750.26	1,055,974,944	0.20	0.68	0.29
2015	746,370,580.57	1,066,212,326	0.20	0.70	0.29
2016	754,365,598.79	1,067,065,245	0.20	0.71	0.28
2017	1,710,756,561.31	1,067,065,245	0.20	1.60	0.12

From the above data, it can be seen that Han's Laser adopted a fixed dividend policy from 2013 to 2017. Fixed dividend policy refers to the dividend policy that the company pays fixed dividends per share over a longer period of time. Since 2013, based on the total share capital, the company has distributed a dividend-inclusive cash bonus of RMB 2 for every 10 shares. This dividend is still maintained for the 2017 fiscal year.

Dividend payout ratio=dividends per share/Earnings per share. From the 2013-2017 five-year data, the overall dividend payment rate of Han's Lasers has decreased. This is related to the company's growing net profit. Net profit increased, and net income per share increased. However, dividends per share remained at a fixed level, and the dividend payment rate decreased.

## **2.2 Han's Laser Financing Policy.**

### **2.2.1 Internal Financing.**

The internal financing is mainly the cash flow generated by the company's own operating activities. According to Table 2, it can be seen that the net cash flow of Han's Laser business activities is on the rise. The cash flow received from its sales of goods and provision of labor service grew faster than the cash flow from the purchase of goods, the payment of labor services, and cash flow to employees. The cash flow generated through operating activities provides enterprises with a steady stream of inwards funds. There are two advantages to internal funds: regarding to the profitability, such funds do not need to pay interest and dividends, and thus the cash cost tends to be a tread for enterprises, nearly zero; on the other hands, from the perspective of risk, this kind of fund use has no repayment object, so there is no financial risk. Thus, the cash flow obtained through the company's operations is the best source of financing for the company.

Table 2. Source details of Han's Laser internal funding, for 2013-2017

unit: yuan			
Year	cash inflow from operating activities	cash out of operating activities	net cash flow from operating activities
2013	4,656,134,660.62	3,993,170,593.49	662,964,067.13
2014	5,356,766,173.40	4,398,448,636.14	958,317,537.26
2015	5,531,876,125.77	4,993,069,642.20	538,806,483.57
2016	6,303,288,945.31	5,506,987,983.17	796,300,962.14
2017	10,238,781,256.60	8,265,221,789.12	1,973,559,467.48

### **2.2.2 External financing**

External funds mainly include debt financing and equity financing. Debt financing is mainly obtained through long-term and short-term borrowings and issuance of creditor's rights. Equity financing is the method of attracting existing shareholders and potential shareholders to invest by issuing additional shares of the company's outstanding shares. According to the data of Han's Laser 2013-2017 balance sheet, its asset-liability ratio has remained within the range of 40% to 50% all year round. Overall, the capital structure is stable, and the share of equity is slightly higher than that of debt. This shows that the main source of external funding for Han's Laser is equity financing, which is to obtain funds through shareholder investment. As the shareholder goes bankrupt and settles after the creditor, and the creditor's interest is paid before the tax payment, the shareholder has a higher financial risk than the creditor and the required rate of return is higher than the creditor. For Han's Laser, although the asset-liability ratio remains at the normal range of 40% to 50%, its use of less debt financing will lead to the increase of the company's capital cost, and it is impossible to use the tax shield effect to reduce the company's capital cost. The funds reduced the overall profitability.

## **3. Pecking Order Theory and its Influence on Han's Laser Dividend Policy**

The pecking order theory means that when the company decides to carry out a new project, it will give priority to the use of internal surpluses, secondly it will choose bond financing, and finally it will consider using equity financing.

In order to analyze the impact of the financing order theory on the Han's Laser dividend policy, we must first analyze the changes in its funding methods in recent years.

**Table 3. Han's Laser Financing Scale for 2013-2017**

Unit: yuan				
Year	Internal finance	proportion	External finance	proportion
2013	662,964,067.13	20.99%	2,495,695,886.97	79.01%
2014	958,317,537.26	25.53%	2,795,377,293.74	74.47%
2015	538,806,483.57	16.18%	2,792,203,734.31	83.82%
2016	796,300,962.14	23.04%	2,660,153,774.56	76.96%
2017	1,973,559,467.48	37.57%	3,279,339,025.00	62.43%

As can be seen from Table 3, the main source of financing for Han's Laser is external funds, accounting for much more than internal funds over the years. However, in recent years, its internal and external financing structure has been continuously improved, and the proportion of internal financing has increased. As of 2017, it has accounted for 37.57% and external funding has decreased. External financing is characterized by a large scale of financing and will provide a large amount of cash flow for the enterprise in a short period of time. However, because its capital is derived from creditors or shareholders, companies need to bear higher capital costs and also have certain financial risks. The company's management should balance its capital costs and financial risks to ensure that the company's capital structure is at its best.

Next, we will further analyze the impact of the Pecking Order Theory on Han's Laser dividend policy.

According to the theory of financing order, Han's Laser should use more internal funds to reduce the proportion of external funds. Under the guidance of this theory, in the early stage, the main reason why Han's Laser mainly used external funds was that the amount of external financing was large and the funds were obtained quickly, which would help the company quickly obtain the necessary funds for investment. At this time, Han's Laser invested more funds in the company's fixed assets, construction in progress and other inward investments to improve the company's overall production and operation capabilities. The fixed dividend distribution policy is conducive to stabilizing the company's stock at this time, and the same amount of cash flow will benefit the company's forecasted net profit retention. With the improvement of investment, the company's operating performance has increased year by year. The advantages of internal financing in the Pecking Order Theory have been gradually highlighted. The company has chosen to improve its capital structure while using more internal funds, because of dividend payout ratio=1-internal retention rate, The use of a fixed dividend distribution policy while increasing net profits allows the amount of dividend distribution to be fixed at a certain value. The retention rate of corporate net profit increases, ensuring that more profit after tax is transferred to retained earnings, which is conducive to providing funds required for investment.

#### **4. Evaluation and Suggestion of Han's Laser Dividend Policy**

According to the above analysis, the Han's Laser dividend policy is a fixed dividend policy. This kind of dividend policy has certain advantages. Mainly: (1) Deliver stable information to the company's investors; (2) investors have a certain expectation of dividend returns, which will help stabilize stock prices. (3) When the company's net profit increased, the internal retention ratio was increased, which provided the source of funds for the internal source financing of the company.

With the continuous expansion of the company's scale, from the growth type approach to mature companies, this dividend policy also has some problems:

(1) For small and medium shareholders who use dividends as their main source of income, if the company's operating conditions improve, for example, the company's overall performance significantly increases in 2017, the revenue they received don't increase in the same proportion, and they choose to withdraw funds and invest in other companies to earn higher dividend returns.

(2) For management, the current overall operating conditions of the company are good, and the pressure for payment of fixed dividends is small. However, when the business conditions are poor and net profits decline, the payment of fixed dividends will bring greater pressure to the company.

Much worse, it will give investors in the company a signal of poor corporate management if the fixed dividend changes suddenly, leading to fluctuating of stock price.

In summary, the impact of the Pecking Order Theory on Han's Laser is obvious. The management of Han's laser tends to gradually improve the source of funding for the company, relying more on the company's internal resources and reducing the proportion of external funds. When increasing the proportion of internal sources of funds, we will choose a fixed dividend policy so as to obtain more internal funds when the net profit rises. In response to this, the proposal for Han's Laser dividend distribution policy is: It can be considered that when the investment scale is gradually stabilized, the company's dividend distribution policy will be appropriately changed, and the fixed dividend policy will be changed to a stable growth dividend policy. This stable growth dividend policy will, according to the Pecking Order Theory, satisfy the need of large shareholders for further investment in profit retention; at the same time, as the growth rate of dividend payment makes the annual earnings of small and medium shareholders increase steadily rather than fixed, it meets the needs of them for the growth of dividend return and net profit growth.

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