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A Study on Divdend Policy

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Abstract- The term dividend refers to that part of the profits of a company which is distributed amongst its shareholders. It may therefore be defined as the return that a shareholder gets from the company, out of its profits, on his share holdings. "According to the Institute of Charted Accounts of India" dividend is a "Distribution to shareholder out of profits or reserves available for this purpose" The Dividend policy has the effect of dividing its net earnings into two Parts: Retained earnings and dividends. The retained earnings provide funds to finance the long¬-term growth. It is the most significant source of financing a firm's investment in practice. A firm, which intends to pay dividends and also needs funds to finance its investment opportunities, will have to use external sources of finance. Dividend policy of the firm. Thus has its effect on both the long-term financing and the wealth of shareholders. The Moderate view, which asserts that because of the information value of dividends, some dividends should be pa-id as it may have favorable effect on the value of the share.

Keywords- Divdend Policy, capital structure, stock price, shareholder

I. INTRODUCTION

The theory of empirical evidence about the dividend policy does not matter if we assume a real world with perfect capital markets and no taxes. The second theory of dividend policy is that there will definitely be low and high payout clients because of the differential personal taxes. The majority of the holders of this view also show that balance, there will be pre-ponderous low payout clients because of low capital gain taxes[1]. The third view argues that there does exist an optimum dividend policy. An optimum dividend policy is justified in terms of the information in agency costs.

The Dividend Decision is a decision made by the directors of a company. It relates to the amount and timing of any cash payments made to the company's stockholders. The decision is an important one for the firm as it may influence its capital structure and stock price. In addition, the decision may determine the amount of taxation that stockholders pay[2].

There are four main factors that may influence a firm's dividend decision:

- Free-cash flow
- Dividend clienteles
- Information signaling
- Stability of earnings

Dividend decision, one of the important aspects of company's financial policy, is not an independent decision[3]. Rather, it is a decision that is taken after considering the various related aspects and factors. There are various factors influencing a firm's dividend policy.

For example, some studies suggest that dividend policy plays an important role in determining firm capital structure and agency costs. Many studies have provided arguments that link agency costs with the other financial activities of a firm.

Dividend

Meaning

Dividend is that part of the profits of a company which is distributed amongst its shareholders.

Definition

According to ICAI, "Dividend is a distribution to shareholders out of profits or reserves available for this purpose.

Nature of Dividend Decision

The dividend decision of the firm is crucial for the finance manager because it determines:

- The amount of profit to be distributed among the shareholders, and
- The amount of profit to be retained in the firm[4].

There is a reciprocal relationship between cash dividends and retained earnings. While taking the dividend decision the management take into account the effect of the decision on the maximization of shareholders' wealth.

Maximizing the market value of shares is the objective.

Dividend payout or retention is guided by this objective.

Dividend Policy

Factors Affecting Dividend Policy

- External Factors
- Internal Factors

External Factors Affecting Dividend Policy

General State of Economy

- In case of uncertain economic and business conditions, the management may like to retain whole or large part of earnings to build up reserves to absorb future shocks.
- In the period of depression the management may also retain a large part of its earnings to preserve the firm's liquidity position.
- In periods of prosperity the management may not be liberal in dividend payments because of availability of larger profitable investment opportunities.
- In periods of inflation, the management may retain large portion of earnings to finance replacement of obsolete machines.

State of Capital Market

- Favorable Market: liberal dividend policy.
- Unfavorable market: Conservative dividend policy.

Legal Restrictions

Contractual Restrictions

Lenders sometimes may put restrictions on the dividend payments to protect their interests (especially when the firm is experiencing liquidity problems)

Example

A loan agreement that the firm shall not declare any dividend so long as the liquidity ratio is less than 1:1. The firm will not pay dividend more than 20% so long as it does not clear the loan.

Internal Factors Affecting Dividend Decisions

Desire of the Shareholders

Though the directors decide the rate of dividend, it is always at the interest of the shareholders.

Shareholders expect two types of returns:
Capital Gains: i.e., an increase in the market value of shares.

The term Dividend refers to that part of the profits of a company which is distributed amongst its shareholders[5]. It may therefore be defined as the return that a shareholder gets from the company, out of its profits, on his share holdings. “According to the Institute of Charted Accounts of India” dividend is a “Distribution to shareholder out of profits or reserves available for this purpose”

The Dividend policy has the effect of dividing its net earnings into two Parts: Retained earnings and dividends. The retained earnings provide funds two finance the long-term growth. It is the most significant source of financing a firm’s investment in practice. A firm, which intends to pay dividends and also needs funds to finance its investment opportunities, will have to use external sources of finance. Dividend policy of the firm. Thus has its effect on both the long-term financing and the wealth of shareholders. The moderate view, which asserts that because of the information value of dividends, some dividends should be paid as it may have favorable affect on the value of the share.

The theory of empirical evidence about the dividend policy does not matter if we assume a real world with perfect capital markets and no taxes. The second theory of dividend policy is that there will definitely be low and high payout clients because of the differential personal taxes. The majority of the holders of this view also show that balance, there will be preponderous low payout clients because of low capital gain taxes. The third view argues that there does exist an optimum dividend policy. An optimum dividend policy is justified in terms of the information in agency costs.

II. DIVIDEND PRACTICES AND MODELS A CONCEPTUAL FRAME WORKS

Dividend refers to that portion of a firm's net earnings, which are paid out to the shareholders. Our focus here is on dividends paid to the ordinary shareholders because holders of preference shares are entitled to a stipulated rate of dividend. Moreover, the discussion is relevant to widely held public limited companies, as the dividend issue does not pose a major problem[6] for closely held private limited companies, since dividends are destroyed out of the profits, the alternative to the payment of dividends is the retention of earning profits. The retained earning constitutes an accessible important source and financing the investment requirements of firms. There is, thus a type of inverse relationship between retained earnings and cash dividends: larger retentions, lesser dividends smaller retentions, larger dividends. Thus, the alternative uses of the not earnings-dividends and retained earnings are competitive and conflicting.

1. Residual Dividend Policy

is used by companies, which finance new projects through equity that is internally generated. In this policy, the dividend payments are made from the equity that remains after all the project capital needs are met. This equity is also known as residual equity. It is advisable that those companies, which follow the policy of residual dividend, should maintain a balanced debt/equity ratio. If a certain amount of money is left after all forms of business expenses then the corporate houses distribute that money among its shareholders as dividends[7].

2. Calculation of Residual Dividend Policy

Let's suppose that a company named CBC has recently earned $1,000 and has a strict policy to maintain a debt/equity ratio of 0.5 (one part debt to every two parts of equity). Now, suppose this company has a project with a capital requirement of $900. In order to maintain the debt/equity ratio of 0.5, CBC would have to pay for one-third of this project by using debt ($300) and two-thirds ($600) by using equity. In other words, the company would have to borrow $300 and use $600 of its equity to maintain the 0.5 ratio, leaving a residual amount of $400 ($1,000 - $600) for dividends. On the other hand[8], if the project had a capital requirement of $1,500, the debt requirement would be $500 and the equity requirement would be $1,000, leaving zero ($1,000 - $1,000) for dividends. If any project required an equity portion that was greater than the company's available levels, the company would issue new stock

3. Arguments against Dividends

First, some financial analysts feel that the consideration of a dividend policy is irrelevant because investors have the ability to create "homemade" dividends. These analysts claim that this income is achieved by individuals adjusting their personal portfolios to reflect their own preferences. For example, investors looking for a steady stream of income are more likely to invest in bonds (in which interest payments don't change), rather than a dividend-paying stock (in which value can fluctuate). Because their interest payments won't change, those who own bonds don't care about a particular company's dividend policy.

4. Arguments for Dividends

In opposition to these two arguments is the idea that a high dividend payout is important for investors because dividends provide certainty about the company's financial well-being; dividends are also attractive for investors looking to secure current income. In addition, there are many examples of how the decrease and increase of a dividend distribution can affect the price of a security. Companies that have a long-standing history of stable dividend payouts would be negatively affected by lowering or omitting dividend distributions; these companies would be positively affected by increasing dividend payouts or making additional payouts of the same dividends. Furthermore, companies without a dividend history are generally viewed favorably when they declare new dividends[9].

The residual dividend policy is more suitable for the government concerns because they mainly aim for creation of value and maximization of wealth and therefore they have to make use of every value added investment opportunity that comes on their way. A little change in the basic postulates of the policy usually occurs when it is applied to the government sector because it takes into its purview the government's liking for dividends rather than capital gains.

III. IRRELEVANCE OF DIVIDEDS

Modigliani and Miller Model

The crux of the argument supporting the irrelevance of dividends to Valuation is that the dividend policy of a firm is a part of its financing decision. As a part of the financing decision, the dividend policy of the firm is a residual decision and dividends are passive residuals

1. Crux of the Argument

The crux of the MM position on the irrelevance of dividend is the arbitrage argument. The arbitrage process, involves a swathing and balancing operation. In other words, arbitrage refers to entering simultaneously y into two transactions here are the acts of paying out dividends and raising external funds either through the sale of new shares or raising additional loans-to finance investment programmes. Assume that a firm has some investment opportunity. Given its investment decision, the firm has two alternatives: (i) it can passiceretain is earnings to finance the investment programmed; (ii) or distribute the earnings to he shareholders as dividend and raise an equal amount externally through the sale of new shares/bonds for the purpose.

IV. CRITIQUE

Modigliani and Miller argue that the dividend decision of the firm is irrelevant in the sense that the vale the firm is independent of it. The crux of their argument is that the investors are indifferent between dividend and retention of earnings. This is mainly because of the balancing natures internal financing (retained earnings) and external financing (raising of funds externally) consequent upon distribution earnings to finance investment program’s. Whether the mm hypotheses provides a satisfactory framework for the theoretical relationship between dividend decision and valuation will depend, in the ultimate analysis on whether external and internal financing really balance each other.

This in turn, depends upon the critical assumptions stipulated by them. Their conclusions, it may be noted, under the restrictive assumptions, a logically consistent and intuitively appealing. But these assumptions are unrealistic and untenable in practice As a result, the conclusion that dividend payment and other methods of financing exactly offset each other and, hence, the irrelevance of dividends is not a practical proposition’ it is merely of theoretical relevance.

The validity of the MM Approach is open to question on two Coutts:

- Imperfection of capital market, and
- Resolution of uncertainty

Market Imperfection

Modigliani and Miller assume that capital markets are perfect. This implies that there are no taxes; flotation costs do not exist and there is absence of transaction costs. These assumptions ate untenable in actual situations.

1. Tax Effect

An assumption of the mm hypothesis is that there are no taxes. It implies that retention of earnings (internal financing) and payment of dividends (external financing) are, from the viewpoint of law treatment, on an equal footing the investors would find both forms of financing equally desirable. The tax liability of the investors, broadly speaking, is of two types: (i) tax on dividend income, and (ii0 capital gains. While the first type of tax is payable by the investors when the firm pays dividends, the capital gains tax is related to retention of earnings. From an operational viewpoint, capital gains tax is (i) lower thebe the tax or dividend income and (ii) it becomes payable only sheen shares are actually sold[10],

2. Flotation Costs

Another assumption of a perfect capital market underlying the MM Hypothesis is dividend irrelevance is the absence of flotation costs. The term 'flotation cost' refers to the cost involved in raising capital from the market for instance, underwriting commission, brokerage and other expenses. The presence of flotation costs affects the balancing nature of internal (retained earnings) and external (dividend payments) financing. The MM position, it may be recalled, agues that given the investment decision of the firm, external funds would have to be raised, equal to the amount of dividend, through the sale of new share to finance the investment programmed. The two methods of financing are not perfect substitutes because of flotation costs.

3. Transaction and Inconvenience Costs

Yet another assumption, which is open to question, is that there are no transaction costs in the capital market. Transaction costs refer to costs associated with the sale of securities by the shareholder-investors. The no-transaction costs postulate implies that if dividends are not paid (or earnings are retained), the investors desirous of current income to meet consumption needs can sell a part of their holdings without incurring any cost, like brokerage and so on. This is obviously an unrealistic assumption. Since the sale of securities involves cost, to get current inome equivalent to the dividend, if paid, the investors would have to sell securities in excess of the income that they will receive. Apat from the transaction cost, the sale of securities, as an alternative to current income, is inconvenient to the investors. Moreover, uncertainty is associate with the sale of securities. For all these reasons an investor cannot be expected, as MM assume, to be indifferent between dividend and retained earnings. The investors interested in current income would certainly prefer dividend payment to plugging back of profits by the firm.

4. Institutional Restrictions

The dividend alternative is also supported by legal restrictions as to the type of ordinary shares in which certain investors can invest for instance, the Life Insurance Corporation of India is permitted in terms of clauses I(a) to I(g) of section 27-A of the Insurance Act, 1938, to invest in only such equity shares on which a dividend of not less than 4 per cent including bonus has been paid for 5 years out of 7 years immediately preceding. To be eligible for institutional investment, the companies should pay dividends. These legal impediments therefore, favor dividends to retention of earning. A variation of the legal requirement to pay dividends is to be found in the case of the Unit Trust of India (UTI). The UTI is required in terms of the stipulations governing its operation, to distribute at least 90 percent of its net income to unit holder. It cannot invest more than 5 per cent of its inventible fund under the unit schemes 1964 and 1971, in the shares of new industrial undertakings. The point is that the eligible securities for investment by the UTI are assumed to be those that are on the dividend payment list.

V. RELEVANCE OF DIVIDENDS

In sharp contrast to the MM position, there are some theories that consider dividend decisions to be an active variable in determining the value of a firm. The dividend decision is, therefore, relevant. We critically examine below two theories representing this notion:

- Walter's Model
- Gordon's Model

1. Walter's Model

Proposition Walter's models support the doctrine that dividends are relevant. The investment policy of a firm cannot be separated from its dividends policy and both are, according to Walter, interlinked. The choice of an appropriate dividend policy affects the value of an enterprise. The key argument in support of the relevance proposition of Walter's model is the relationship between the return on a firm's investment or its internal rate of return (r) and its cost of capital or the required rate of return (Ke) The firm would have an optimum dividend policy, which will be determined y the relationship of r and k. In other words, if the return on investments exceeds the cost of capital, the firm should refrain the earnings, whereas it should distribute the earnings to the shareholders in case the required rate of return exceeds the expected retune on the firm's investments. The rationale is that if r > ke, the firm is able to earn more than what the shareholders could by reinvesting, if the earnings are paid to them. The implication of r < ke is that shareholders can earn a higher return by investing elsewhere.

Limitations

The Walter's model, one of the earliest theoretical models, explains the relationship between dividend policy and value of the firm under certain simplified assumptions. Some of the assumptions do not stand critical evaluation. IN the first place, the Walter's model assumes that exclusively retained earnings finance the firm's investment; no external financing is used. The model would be only applicable to all- equity firms. Secondly, the model assumes that r is constant. This is not a realistic assumption because when the firm makes increased investments, r also changes. Finally as regards the assumption of constant risk complexion of firm has a direct bearing on it. By assuming a constant Ke. Walter's model ignores the effect of risk on the value of the firm.

2. Gprdon's Model

Another theory, which contends that dividends are relevant, is Gordon's model. This model, which opines that dividend policy of a firm affects its value, is based on the following assumptions:

Assumptions

The firm is an all-equity firm. No external financing is used and exclusively retained earnings finance investment program's.

- r and ke are constant.
- The firm has perpetual life.
- The retention ratio, once decided upon, is constant. Thus, the growth rate, (g=br) is also constant.
- Kc>br.

Postpones dividends. The discount rate would vary, as shown if figure with the retention rate or level of retained earnings. The term retention ratio means the percentage of earnings retained. It is the invers of D/P ratio. The omission of dividends, or payment of low dividends, would lower the value of the shares.

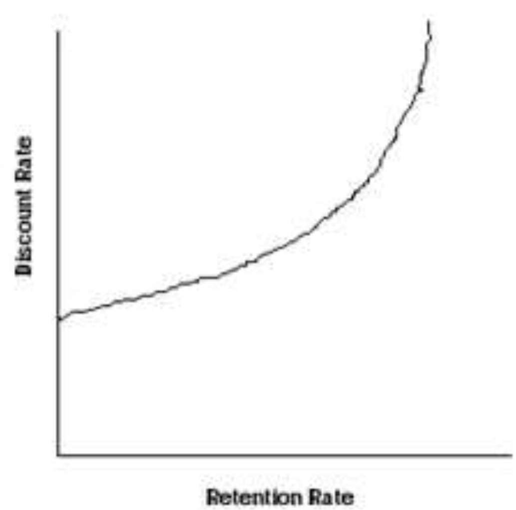

Figure 1: graph of Gprdons model discount rate Vs Retention Rate

Dividend Capitalization Model: According to Gordon, the market valued of a share is equal to the present value of future streams of dividends. A simplified version of Gordon's model can be symbolically 18 expressed as

$$\frac{E(1-b)}{Kc-br}$$

Where

p = price of a share

E= Earnings per share

b= Retention ratio or percentage of earnings retained.
1-b=D/P ratio, i.e. percentage of earnings distributes as dividends
Kc= Capitalization rate/cost of capital
Br=g=Growth rate= rate of return on investment of an all-equity firm

VI. DATA ANALYSIS AND INTERPRETATION

1. Dividend Policies in Ultratechcement Industry

The various modes of dividend theories, which have been discussed earlier, the sample of the UltraTech's cement industry selected. And analyzed to empirical evidence for the two theories supporting the relevance of dividend policies Walter's model and Gordon's model.

We shall classify the UltraTech cements industry into these six categories basing on the explain the Dividend per share, Earning per share, Return per share, Price Earning, Profit after Tax, UltraTech. These are explaining based on last six financial years' data.

Since 2018-19 to 2022-23 collected the data in UltraTech cement industries.

Comparison of Dividend per Share of the UltraTech Cements

Table 1: year wise dividend pershare

Year	Dividend Pershare
2018-19	2.50
2019-20	3.00
2020-21	4.00
2021-22	2.25
2022-23	3.25

Dividend Per Share

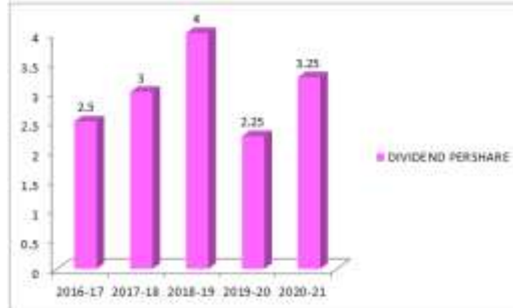

Figure 2: Dividend per share related map

Interpretation

The dividend Per Share of UltraTech Cement ltd., is Rs 2.50 in the year of 2018-19. The dividend per share for the next two financial years is 3.00 and 4.00 respectively.

When it is compared with the year 2018-19 the dividend per share in the year 2018-19it is increased at the rate of 20% and 30% in the year of 2019-2020.

Comparison of Earning Per Share of the Firm for the Last Five Years

Table 2: year wise earning per share

Year	Earning Per Share
2018-19	58.08
2019-20	83.80
2020-21	82.80
2021-22	51.88
2022-23	-45.95

Earning Pershare

Figure 3: Earning share values year wise

Interpretation

The Earning per share of the firm is moderate in the year 2018-19. The Earning per share fluctuated slightly during the financial years2018-19, 2019-20and 2020-21.

However, there is massive decrease reported (about 200% of 2018-19 in the year 2022-22).

Comparison of Profit after Tax of the Ultra tech Cements

Table 3:year wise pattern ultratech in Rs.

Year	Pat In (Rs)
2018-19	265.68
2019-20	383.35
2020-21	378.74
2021-22	237.34
2022-23	210.21

Profit After Tax

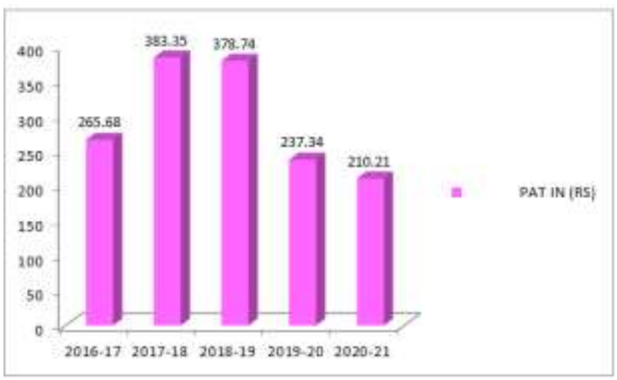

Figure 4: Graph against profit after tax

VII. CONCLUSION

Efficient market with no taxes and no transaction costs the free cash flow model of the dividend decision would prevail and firms would simply pay as a dividend any excess cash available. The observed behaviours of firm differs markedly from such a pattern Most firms pay a dividend that is relatively constant over time. This pattern of behavior is likely explained by the existence of clienteles for certain dividend policies and the information effects of announcements of changes to dividends. The dividend decision is usually taken by considering at least the three questions of how much excess cash is available. What do our investors prefer? And what will be the effect on our stock price of announcing the amount of the dividend. The result or most firms tends to be a payment that steadily increases over time, as opposed to varying wildly with year-to-year changes in free cash flow. Investors in aggregate cannot be shown to uniformly prefer either high or low dividends. Individual investors however, have strong dividend preferences and will tend to invest in companies whose dividend policies match their preferences. Regardless of the payout ratio, investors prefer a stable, predictable dividend policy.

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