A STUDY ON DIVIDEND POLICIES OF INDIAN COMPANIES

Pothuganti Srinivas
MBA, M.Com, AP-SET-2013, NET-2017, Department of Commerce
Osmania University, Hyderabad, Telangana State, India.

Abstract

Under current Indian law, individual shareholders do not pay any tax on dividend incomes, while they are taxed for realised capital gains. Instead of the investors, companies have to pay tax on the distributed incomes. This raises the effective corporate tax rates for the dividend paying companies. This study is on the overview of the dividend policy of Indian corporate firms or companies, their announcements, Objectives, and the factors affecting the Dividend policy and at last the determinants of dividend policy.

Keywords: *Dividend policy, Types, Objectives, and Determinants.*

INTRODUCTION

Dividend policy is an important element in financial management. This policy is associated with financial policies about paying cash dividend present or paying an increased dividend at a later stage. The term dividend denotes to that portion of profit which is distributed among the proprietors/shareholders of the firm. Whether to issue dividends and what amount, is determined primarily on the basis of the company's unappropriated profit (excess cash) and influenced by the company's long term generating revenues.

A company cannot announce dividend unless there is:

1) Sufficient profits.
2) Board of Directors recommendation.
3) An acceptance of the shareholders in the annual general meeting.

YPES OF DIVIDEND

1. **Cash** – this is the payment of actual cash from the company directly to the shareholders and is the most common type of payment. The payment is usually made electronically (wire transfer), but may also be paid by check or cash.
2. **Stock** – stock dividends are paid out to shareholders by issuing new shares in the company. These are paid out pro rata, based on the number of shares the investor owns.
3. **Assets** – a company is not limited to paying distributions to its shareholders in the form of cash or shares. A company may also pay out other assets such as investment securities, physical assets, real estate, and others.
4. **Special** – a special dividend is one that's paid outside of a company regular policy (i.e., quarterly, annual, etc.). It is usually the result of an excess cash build up.
5. **Common** – this refers to the class of shareholders (i.e., common shareholders), not what's actually being received as payment.
6. **Preferred** – this also refers to the class of shareholder receiving the payment.
7. **Other** – other, less common, types of financial assets can be paid out such as options, warrants, shares in a new spin-out company, etc.

DETERMINANTS OF DIVIDEND

Type of industry, Age of corporation, Extent of share distribution, Need for additional capital, Business cycles, Changes in Government policies, Trend of profits, Taxation policy, Future Requirements, Cash Balance.

FACTORS AFFECTING DIVIDEND POLICY

Banks play important role in bridging the gap between the end users and operates in unpredictable social environment with changing economical norms depending upon pace of growth and development. Factors like external and internal economic condition, age of banks, capital market status, and government policies related to universal competition, taxation policy, past dividend rates, liquidity position of the banks, regularity and stability in dividend payment, strength to borrow funds can affects dividend policies of the banks to a large extent. These factors cannot be eliminated but can be minimized through judicious and efficient utilization of all available resources.

DIVIDEND POLICY IN INDIA

- ✓ Most of the corporates have a policy of dividend for long run pay-out ratio.
- ✓ Dividend changes follow shift in the long term sustainable earning.
- ✓ Dividend policy as a residual decision after meeting the desired investment needs is endorsed by about 50% of the sample corporates. The corporates which are creating shareholder value significantly rescind dividend increase in the event of growth opportunities available to them. Large firms are considerably less willing to rescind dividend increases.
- ✓ Dividend policy provides a signalling mechanism of the future prospects of corporate and to that exact affects in market share.
- ✓ Investors have different relative risk perceptions of dividend income and capital gains and are not indifferent between receiving dividend income and capital gains. Management should be responsive to the shareholders preferences regarding dividend and the share buyback program should not replace the dividend payment of corporates.
- ✓ Dividend payments provide a bonding mechanism so as to encourage manager to act in the best interest of shareholders.
- ✓ The corporate enterprises of India seem to have a tendency to pay comparatively less dividends. In fact, large number of them hardly pay any dividend. The foreign controlled companies seem to follow a policy of larger distribution of profits relative to the domestic companies. Retained earnings are significant source of corporate finance.
- ✓ Majority of Indian corporates follow a stable dividend policy in the sense that they pay either constant dividend per share in the following year with fluctuating EPS or increased dividend with increase in EPS.
- ✓ Firms which are creating shareholder values are significantly more willing to rescind dividend increase in the event of growth opportunity available to them. Big firms are significantly less willing to rescind dividend increase than small firms.

TYPES OF DIVIDEND POLICIES:

1. **Stable Dividend Policy**: Stability of dividend means similarity or no change in dividend payments over the years. It can be supposed that when a company pays dividend at a fixed rate and follows it for future years to come regardless of fluctuations in the level of earnings, it is said to be a stable dividend policy. Therefore, stability of dividends denotes to regular payment of dividend at a fixed rate. Stable dividend policy upsurges reliability of the management in the market and shareholders also desire such stock giving minimum return at regular interval leads to increase in market price of shares. Those companies whose earnings are stable follow this policy. The stability of dividend is defined in two different ways that includes constant/fixed dividend per share and constant pay-out ratio.

    a. Constant amount per share: In this policy, company pays fixed amount of dividend per share regularly, every year regardless of the earnings of the company. But it does not indicate that management has static nature and will adopt the policy for years to come. If the company's levels of earnings are augmented progressively and same level is to be maintained in the future then the dividend per share is increased correspondingly. This policy puts equity shares at par with preference shares which yields fixed dividend per share every year. Normally, this policy is chosen by those persons and institutions that depend upon the dividend income to meet their living and operating expenses.
    b. Constant pay-out ratio: In this policy, a fixed percentage of net earnings are paid as dividend every year, that is, constant pay-out ratio.

2. **Policy of No Immediate Dividend**: This policy is devised as normally, management follows a policy of paying no immediate dividend in the inception because it requires funds for growth and development or they may be experiencing serious financial difficulties and may be incapable to pay dividend. In this case, the firm can decrease adverse effects on the stock price by carefully clarifying the reason for the removal of the dividend. After the, no dividend policy, it is sensible that the company should either issue bonus shares from its reserves or company's shares should be split into shares of small amount so that later on rate of dividend is maintained at a realistic rate.
3. **Policy of Irregular Dividend**: When the firm does not pay-out fixed dividend frequently, it is irregular dividend policy. It changes from year to year according to change in earnings level. This policy is based on the management conviction that dividends should be paid only when the earnings and liquid position of the firm warrant it. Firms having unbalanced earnings, particularly engaged in luxury goods adopt this policy.
4. **Policy of Regular Dividend plus Extra Dividend**: This policy is suitable for a firm with recurring earnings and restricted opportunities for growth. In a good earnings year, the firm would announce an extra dividend. The designation 'extra' is used in

connection with the payment to tell the shareholders that this is extra and which might not be continued in future. When the earnings of the company have permanently increased, the extra dividend should be compounded with regular normal dividend and consequently, rate of normal dividend should be high.

5. **Policy of Regular Dividend plus Stock Dividend**: In this policy, company pays stock dividend along with the regular dividend. Consequently, the dividend is split into two parts. This policy is espoused when the company has earned huge profit and wants to give shareholders a share in the additional profit but wants to retain cash for development. It is not suitable to follow this policy for a long time, as the number of shares increases and the earning per shares reduces, which led to reduction in share price.

CONCLUSION

Dividend policy is an important factor in the valuation of the company. Moreover, the signals interpreted by the investors from the various changes in the dividend payments also affect the stock price of the company. It is important for the analyst to know the impact of various dividend policies and the share repurchases on the stock and its valuation. A dividend policy serves the purpose of guiding the company on how and when to pay dividends to its investors. This is important because studies show that stakeholders are more likely to invest more in a company that pays dividends to its investors since paying dividends is viewed as a sign of the company's good health. Such a company also attracts potential investments, generates additional funds and increases stakeholder wealth. However, it is important to note that a business needs to choose the most suitable approach for the firm in regards to its financial status in the past and the expected earnings in the future as well as the internal needs of the company. The residual approach is most suitable for enterprises that need additional capital. The company's priority is to reinvest the earnings into the business, a remainder of which will be distributed in the form of dividends to the stakeholders. A firm that makes enough earnings to pay its stakeholders at a low rate could adopt the stable approach. The firm is required to pay its stakeholders dividends at fixed rates, which is usually low. The hybrid approach pays low fixed rate dividends to its stakeholders and extra earnings after the business' needs have been met. This assures that the stakeholders receive dividends regardless of how the company is performing. Several theories have been developed by economists on the relevance of dividend policies to the stakeholder. These theories include the optimal dividend theory, tax-preference dividend theory, dividend irrelevance theory and dividend relevance theory.

REFERENCES

1. *Black, (1976), Black, F. (1976). "The Dividend Puzzle," Journal of Portfolio Management, 5-8.*
2. *N. Bhattacharyya, (2007) "Dividend policy: a review", Managerial Finance.*
3. *Amitabh Gupta, C. B. (2010, August). The Determinants of Corporate Dividend Policy. Decision, Vol. 37(No.2), pp63to77.*
4. *Yarram S.R (2002). Dividend policy of Indian corporate firms: An analysis of trends and determinants.*

5. *Gugler, K. (2003). Corporate Governance, Dividend Payout Policy, and the interrelationship between dividend, R&D and Capital Investment, Journal of Banking and Finance (27), pp.1197-1321.*
6. *Gupta, Amitabh; Banga, Charu. 2010. Decision (0304-0941). Vol. 37 Issue 2. 63-77.*
7. *Linter J. (1962) Dividends, Earnings, Leverages, Stock Prices and the supply of Capital to Corporations'. Review, Economic Stat. 44(3): 234-269*
8. *Kevin, S. (1992), "Dividend Policy: an Analysis of Some Determinants", Finance India, Vol. VI, No. 2, June, pp. 253-259.*
9. *Mishra, C. and V. Narender (1996), "Dividend Policies of SoEs in India – An Analysis", Finance India, Vol. X, No. 3, September, pp. 633-645*
10. *Asif, Rasool and Kamal (2011).Impact of Financial Leverage on Dividend Policy: Empirical Evidence from Karachi Stock Exchange-Listed Companies. African Journal of Business Management,*
11. *www.civilserviceindia.com.*
12. *Mahapatra, R.P. and P.K. Sahu (1993), "A Note on Determinants of Corporate Dividend Behaviour in India – An Econometric Analysis", Decision, Vol. 20, No. 1, January-March, pp. 1- 22*