

Dividend Policy

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MEANING OF DIVIDEND

The term dividend refers to that portion of profit which is distributed among the owners/shareholders of the firm.

INTRODUCTION TO DIVIDEND POLICY

The dividend policy of a firm determines what proportion of earnings is paid to shareholders by way of dividends and what proportion is ploughed back in the firm for reinvestment purposes. If a firm's capital budgeting decision is independent of its dividend policy, a higher dividend payment will call for a greater dependence on external financing. Thus, the dividend policy has a bearing on the choice of financing. On the other hand, firm's capital budgeting decision is dependent on its dividend decision; a higher dividend payment will cause shrinkage of its capital budget and vice versa. In such case, the dividend policy has a bearing on the capital budgeting decision.

MEANING OF DIVIDEND POLICY

Dividend policy refers to the policy that the management formulates in regard to earnings for distribution as dividend among shareholders. It is not merely concerned with dividends to be paid in one year, but is concerned with the continuous course of action to be followed over a period of several years.

FACTORS AFFECTING DIVIDEND POLICY

1. Ownership Considerations
2. Firm Oriented Considerations
3. Nature Of Business
4. Attitudes And Objectives Of Management
5. Composition Of Share Holding
6. Investment Opportunities
7. Desire For Financial Solvency And Liquidity
8. Regularity
9. Restrictions By Financial Institutions
10. Inflation
11. Other Factors-
 - Age Of The Company
 - The Demand For Capital Expenditure, Money Supply, Etc.,.
 - Tradition

Goals of Dividend Policy

- Dividend policy should be analysed in terms of its effect on the value of the company
- Investment by the company in new profitable opportunities creates value and when a company foregoes an attractive investment, shareholders incur an opportunity loss
- Dividend, investment and financing decisions are interdependent and there is often a trade-off
- Dividend decisions should not be treated as a short-run residual decision
- A workable compromise is to treat dividends as a long-run residual to avoid undesirable variations in payout. This needs financial planning over a fairly long time horizon
- Dividend policy should be communicated clearly to investors who may then take their decisions in terms of their own preferences and needs
- Erratic and frequent changes in dividends should be avoided

TYPES OF DIVIDEND POLICY

1. On the basis of Company's General Perspective
2. On the basis of a Research Study
3. On the basis of Stability of Dividend

TYPES OF DIVIDEND POLICY

1. *On the Basis of Company's General Perspective*

- Whether dividend should be paid right from the initial year of operations, i.e., **regular dividends**
- Whether equal amount or fixed percentage of dividend be paid every year, irrespective of the quantum of earnings as in case of preference shares, i.e., **stable dividends**
- Whether a fixed percentage of total earnings be paid as dividend which would mean varying amount of dividend per share every year, depending on the quantum of earnings and number of ordinary shares in the year, i.e., a **fixed payout ratio**
- Whether the dividend be paid in cash or in the form of shares of other companies held by it or by converting (accumulated) retained earnings into bonus shares, i.e., **property dividend or bonus share dividend**

TYPES OF DIVIDEND POLICY

2. On the Basis of Research Study

On the basis of the nature of industry such as whether industry belongs to electrical, chemicals, fertilisers, FMCS, automobiles, pharmaceuticals, textiles, a research study classified dividend policy into three types. They are:

- Generous dividend policy
- More or less fixed dividend policy
 - Erratic dividend policy

TYPES OF DIVIDEND POLICY

3. *On the Basis of the Stability of Dividend*

- Stable dividend per share
- Stable percentage of net earnings
- Stable rupee dividend plus extra dividend
- Dividends as a fixed percentage of market value

ADVANTAGES

- The payment of dividends to the shareholders is ensured irrespective of the earnings of the company
- It is beneficial to those investors who expect regularity in income on their investments to meet the expenses

DISADVANTAGES

- Adverse effects on financial stability of the firm cannot be considered easily by changing the stable dividend policy
- If the company fails to pay dividend constantly in any year that shows the weakness of the company in maintaining stability

FORMS OF DIVIDEND

Dividend ordinarily is a distribution of profits earned by a joint stock company among its shareholders. Mostly dividends are paid in cash, but there are also other forms such as script dividends, debenture dividends, stock dividends, and in an unusual circumstances, property dividends. These are briefly described below:

- Scrip Dividend
- Bond Dividend
- Property Dividend
- Cash Dividend
- Debenture Dividend
- Bonus share or Stock dividends
- Cash Dividend
- Share Bonus

REASONS FOR ISSUING BONUS SHARES

- The bonus issue tends to bring the market price per share within a more reasonable range.
- It increases the number of outstanding shares. This promotes more active trading.
- The nominal rate of dividend tends to decline. This may dispel the impression of profiteering.
- Share capital base increases and the company may achieve a more spectacular size in the eyes of the investing company.
- Shareholders regard a bonus issue as a strong indication that the prospects of the company have brightened and they can reasonably look for an increase in total dividend.
- It improves the prospects of raising additional funds.

Merits of Stock Dividend/bonus share

<i>To the company</i>	<i>To the shareholders</i>
(a) Results in more ploughing back of profits.	(a) Not subject to income tax.
(b) Helps in financing for modernisation and expansion programs.	(b) Results in large amount of dividend.
(c) Stabilises future dividends.	(c) Can be realised in case of necessity.
(d) Reduces undercapitalisation.	(d) Association with the company is increased.
(e) Helps in maintenance of liquid position.	(e) Increases demand for shares of investors.
(f) Widens marketability of company's shares with reduction in the market price of shares.	(f) Rise in the wealth of investors.

LIMITATION OF STOCK DIVIDEND

<i>To the company</i>	<i>To the shareholders/investors</i>
(a) Curbs entry of the new shareholders,	(a) Disappoints the investor who expects to receive cash dividend.
(b) Increases the liability of the company of future dividend.	(b) Fall in the market prices of existing shares.
(c) Results in overcapitalisation.	(c) Earning per share will fall as the increase in number of shares.

SHARE SPLIT

- A share split is a method to increase the number of outstanding through a proportional reduction in the par value of the share.
- A share split affects only the par value and the total number of outstanding shares, the shareholders total funds remains unaltered.
- The primary motives to make shares seem more affordable to small investors even though the underlying value of the company has not changed.

REVERSE SPLIT

- Under the situation of falling price of a company's share the company may want to reduce the number of outstanding shares to prop up the market price per share. The reduction of the number of outstanding shares by increasing the per share value is known as reverse split.

STOCK REPURCHASE

It is actually the repurchase of its own share by a company. To return surplus cash to shareholders as an alternative to a higher dividend payment or investing the surplus cash in existing or new operations.

DIVIDEND POLICY OF 5 IT COMPANIES

1. TATA CONSULTANCY SERVICES (TCS)

Dividend Summary

- For the year ending March 2013, Tata Consultancy Services has declared an equity dividend of 2200.00% amounting to Rs 22 per share. At the current share price of Rs 2000.85 this results in a dividend yield of 1.1%.

2. WIPRO

Dividend Summary

- For the year ending March 2013, Wipro has declared an equity dividend of 350.00% amounting to Rs 7 per share. At the current share price of Rs 477.95 this results in a dividend yield of 1.46%.

3. INFOSYS

Dividend Summary

- For the year ending March 2013, Infosys has declared an equity dividend of 840.00% amounting to Rs 42 per share. At the current share price of Rs 3347.60 this results in a dividend yield of 1.25%.

4. HCL TECHNOLOGIES

Dividend Summary

- For the year ending June 2012, HCL Technologies has declared an equity dividend of 600.00% amounting to Rs 12 per share. At the current share price of Rs 1050.25 this results in a dividend yield of 1.14%.

5. LARSEN & TOUBRO INFOTECH

Dividend Summary

- For the year ending March 2013, Larsen and Toubro has declared an equity dividend of 925.00% amounting to Rs 18.5 per share. At the current share price of Rs 964.15 this results in a dividend yield of 1.92%.

THANK YOU!