Vol 5 Issue 2 Aug 2015
ISSN No :2231-5063

International Multidisciplinary Research Journal

Golden Research Thoughts

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RNI MAHMUL/2011/38595 **ISSN No.2231-5063**

Golden Research Thoughts Journal is a multidisciplinary research journal, published monthly in English, Hindi & Marathi Language. All research papers submitted to the journal will be double - blind peer reviewed referred by members of the editorial board.Readers will include investigator in universities, research institutes government and industry with research interest in the general subjects.

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Golden Research Thoughts
ISSN 2231-5063

Impact Factor : 3.4052(UIF)
Volume - 5 | Issue - 2 | Aug - 2015

STUDY THE DETERMINENT OF DIVIDEND POLICY IN I.T COMPANY IN INDIA

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ABSTRACT

Dividend policy involves extremely important financial decisions which serve as a basis of numerous theories. The term dividend refers to that part of the profits of a company which is distributed amongst its shareholders. It is given to shareholders as a return on their investment in the company. The dividend policy of a company is also based on income-tax position of the shareholders. However, these theories have been developed in different fields, and according to some evidence this policy remains a kind of dilemma in the financial cycles of corporations. This paper seeks to find the determinants of dividend policy of MNC's in India. Thus we deal with them as one of the ten most crucial problems of corporations. The aim of this study is to elaborate a model which would enable us to examine the effects of dividends in relation to Age of corporation, extent of share distribution, trend of profit, Taxation policy, cash balance & financial needs of company.

KEYWORDS :*Determinants, Dividend policy, Corporate Firms, etc.*

INTRODUCTION :

The term dividend refers to that part of the profits of a company which is distributed amongst its shareholders. It is given to shareholders as a return on their investment in the company. Dividend is paid on equity as well as on preference shares. It may, Dividend payment of a company is looked upon differently by different sets of people associated with the company. For the investors, dividends are not merely means of regular earnings but also an important input for determining the worth and credential of the firm. For managers, dividend payment might well determine the level of investment in profitable investment projects. Lenders look at it carefully because they feel that the more the dividend payment, the less will be the amount available for servicing and redemption of their claims. Therefore, be defined as the return that a shareholder gets from the company, out of its profits, on his shareholdings. According to the Institute of Chartered Accountants of India, dividend is "a distribution to shareholders out of profits or reserves available for this purpose."

DIVIDEND POLICY

Dividend policy is the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders. When a company earns profits from operations, management can do one of two things with those profits. It can choose to retain them - essentially reinvesting them into the company with the hope of creating more profits and thus further stock appreciation. It also defines as that decision of the management through which it is determined how much of net profits are to be distributed as dividend among the shareholders and how much to be retained in the business. The term dividend policy refers to the policy concerning quantum of profits to be distributed as dividend. In simple terms dividend policy may be defines as an appropriation or distribution of profit to shareholders. The concept of dividend policy implies that companies through their Board of Directors evolve a pattern of dividend payments which has a bearing on future action. Of course, in practice many companies do not have a dividend policy in this sense. They rather take each dividend decision independent of every other such decision. This is not a sound practice but the financial manager cannot do much about it since he works only in an advisory capacity and the power to recommend/declare dividends vests completely in the Board of Directors of the company. Dividend policy is one of the major decisions in corporate finance. Research on dividend policy was sparked by Miller and Modigliani's (1961) work which concluded that under perfect capital markets dividends are not relevant. Later studies which relaxed the assumption of perfect market and recognized the presence of market imperfections, such as taxes, agency cost, asymmetric information and agency cost revealed that dividend policy is relevant to the firm's value. On annual bases when profits are made, a company has to determine what proportion of the profit that is available should be paid out to shareholders in the form of dividends, and what proportion should be retained for reinvestment. Dividend policy is the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders. When a company earns profits from operations, management can do one of two things with those profits. It can choose to retain them - essentially reinvesting them into the company with the hope of creating more profits and thus further stock appreciation. The alternative is to distribute a portion of the profits to shareholders in the form of dividends.

REVIEW OF LITERATURE

Many people examine and study the determinant of dividend policy in India. And the
Some examples are –

1. COLLINS, SAXENA AND WANSLEY (1996) have studied the role of insiders in Determination of dividend policy of a firm. Study results indicate that payout ratio is negatively related to firm's past and future expected growth rate of earnings, its level of systematic risk and its insider holdings. They also find that regulatory status plays more important role in the determination of strength of association between insider holding and payout ratio in the case of utilities than in the case of financial firms.

2. D'SOUZA (1999) examined the agency cost, Market Risk, Investment Opportunities and Dividend Policy. The results of the study clearly showed that negatively relationship between agency cost and market risk with dividends payout. However the study does not support the negative relationship between dividend payout policies and investment opportunities. The results clearly showed the insignificant relationship between dividend policy and investment opportunities for international firms in sample.

3. GUPTA (1999) shows that regular dividend payments had been the feature in almost all the selected companies though there have been a gradual decline in the proportion of dividend payments to the available earnings for distribution. He also finds that dividend rates are much inflated in comparison to the real effective rates of dividend as represented by dividend yield. In the matter of stability in dividend payments he finds high stability in terms of dividend yields but not so much in terms of dividend rates and dividend payouts.

4. GUGLER (2000) examined the relationship between dividends and the ownership and control structure of the firm. The sample consists of 214 non-financial firms over the period 1991-1999. The study found that state controlled firms engage in dividend smoothing, while family-controlled firms do not. The family-controlled firms choose significantly lower target payout levels. Consistently, state-controlled firms were most reluctant and family-controlled firms were least reluctant to cut dividends when cuts were warranted. The dividend behavior of bank and foreign-controlled firms lied in between state and family-controlled firms. This was consistent with information asymmetries and managerial agency costs. The above results hold for firms with good investment opportunities. The study found that firms with low growth opportunities optimally disgorge cash irrespective of who controls the firm

5. DICKEN ET AL. (2002) examined bank dividend policy and explanatory factors in USA. The study identified factors that explain bank dividend policy. Their model used investment opportunities, capital adequacy, size, signaling, ownership, dividend history, and risk to explain dividend payments. The analysis suggested a negative relationship between dividend payments and investment opportunities, signaling, ownership, and risk and a positive relationship to size and dividend history.

6. KUMAR (2003) in a study of the possible association between ownership structure, corporate governance and firm's dividend payout policy, Kumar observed that a positive association exists between dividends and earnings trend. While debt- to- equity was found to be negatively associated, past investment opportunities where positively associated with dividend payout policy in India.

7. BATHALA AND RAO (2004) infer that firms with high dividend yields have lower costs of capital. They find that large firms are associated with higher dividend yields. Again, dividend yields of financial and public utility companies are found to be larger than that of other types of companies. The factors like current ratio, geometric mean of annual changes in Economic Value Added, insiders' total shareholding as a percentage of total shares outstanding are found not to play any significant role in determining dividend yield of a firm.

8. DONG ET AL. (2005) in a questionnaire survey to a panel of Dutch individual investors tested various theories underlying a firm's dividend payout policy. The theories that they examined from an investor's perspective included signaling, agency costs, dividend irrelevance, transaction costs, uncertainty resolution, free cash flow and taxes. They found that respondents strongly believe that dividend payments send a signal about the profitability of the firm. They concluded that firms are justified to keep up dividend payments in good and bad times given the signaling effect of dividends. Their survey results did support pecking order theory while not support for agency theory.

9. AMIDU AND A BOR (2006) carried out a study on the Determinants of dividend payout ratios in Ghana. The analyses were performed using data derived from the financial statements of firms listed

on the Ghana Stock Exchange during a six-year period. Ordinary Least Squares model was used to estimate the regression equation. The results showed positive relationships between dividend payout ratios and profitability, cash flow, and tax. The results also showed negative associations between dividend payout and risk, institutional holding, growth and market-to-book value. Furthermore, the study founds very strong, significant, and consistent evidences that the safer banks pay more dividends. In the test for the partitioned sample, the tendency of the banks with higher safety and profitability to pay more dividends was observed more strongly and transparently.

10. SHARMA AND SINGH (2006) examined deterministic factors of stock price in Indian corporations. They studied 160 firm samples during 2001-2005. Results indicated that revenue and book value per share and dividends are important and effective factors in determining stock price and that they signaled the financial health of corporations. Therefore, corporations need to adopt an expansible policy in dividend distribution, because high dividend ratio is effective in increasing market value per share.

MATERIAL AND METHOD

Some important determinants that affect dividend policy decision:-

DERTERMINANTS OF DIVIDEND POLICY

Decision regarding the dividend should be made after considering the present financial position of the business as well as all the factors affecting it .Dividend decision should not merely be taken to be a decision of appropriation of profits to the shareholders. There are several complex issues in it. As such the factors influencing the dividend decisions have always been put under scanner by the experts and researchers in the field of financial management. Following are some important determinants that affect dividend policy decision:-

(1) AGE OF CORPORATION:-Newly established enterprises require most of their earning for plant improvement and expansion, while old companies which have attained a longer earning experience, can formulate clear cut dividend policies and may even be liberal in the distribution of dividends.

(2)EXTENT OF SHARE DISTRIBUTION: - A closely held company is likely to get consent of the shareholders for the suspension of dividends or for following a conservative dividend policy. But a company with a large number of shareholders widely scattered would face a great difficulty in securing such assent. Reduction in dividends can be affected but not without the co-operation of shareholders.

(3)TRENDS OF PROFITS: - The past trend of the company's profit should be thoroughly examined to find out the average earning position of the company. The average earnings should be subjected to the trends of general economic conditions. If depression is approaching, only a conservative dividend policy can be regarded as prudent.

(4)TAXATION POLICY: - The dividend policy of a company is also based on income-tax position of the shareholders. If most of the shareholders of a company are in high tax bracket, company should retain most of its profits .As a result, the shareholders will get capital gains only and the tax rate on capital gains is comparatively lower as compared to tax on dividend income. Contrarily, if the shareholders of a company are in lower tax brackets, they will like to get higher dividend as it will meet their expectation for higher income and reduce the uncertainty of income.

(5)CASH BALANCE:-If the working capital of the company is small liberal policy of cash dividend cannot be adopted. Dividend has to take the form of bonus shares issued to the members in lieu of cash payment. Better the cash position of company, better will be its ability to pay dividend.

(6) FINANCIAL NEEDS OF THE COMPANY:-while determining the dividend policy, the board of directors should consider the future financial requirements of the firm. Retained earnings should be used as a source of finance, when profitable opportunities are available to the company .If better profitable opportunities are available to the shareholders, the profit should be distributed to them .In such a case they will get maximum satisfaction from the distribution of dividend .Thus, company can determine its dividend policy on the basis of its financial needs .Generally matured companies keep high payout ratio. The market value of shares of these companies is affected by the changes in dividend. On the other hand, company in a developing stage keeps lower rate of dividend so that it can use more funds for its development.

(7) EARNINGS PER SHARE: - If a company does not retain major parts of its income, it may have to issue more shares to meet its financial needs in future. As a result, the total number of shares issued will increase and in absence of increase in profits, its earnings per share will decrease. On the other hand, by retaining profits, it can earn more for its existing shareholders and thus, earning per share will increase.

RESULTS AND CONCLUSION

This study was conducted to investigate the determinants of dividend policy of financial firms particularly corporate in India. We can conclude that Age of Corporation (old companies which have attained a longer earning experience, can formulate clear cut dividend policies), Extent of share distribution (a company with a large number of shareholders widely scattered would face a great difficulty in securing dividends), Trends of profits & Taxation policy etc are the factors that Effects dividend policy.

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