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

IMPACT OF DIVIDEND POLICY ON SHARE VALUATION

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ABSTRACT

In financial markets, stock valuation is the method of calculating theoretical values of companies and their stocks. The main use of these methods is to predict future market prices, or more generally, potential market prices, and thus to profit from price movement – stocks that are judged undervalued (with respect to their theoretical value) are bought, while stocks that are judged overvalued are sold, in the expectation that undervalued stocks will, on the whole, rise in value, while overvalued stocks will, on the whole, fall.

KEYWORDS :*Dividend policy, market prices, potential market prices, stocks. Etc.*

INTRODUCTION :

Dividend policy means 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. 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. Dividend is an appropriation or distribution of profit to shareholders. 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.

Each company formulates its own policies as regards dividend. Firms can use internal or external sources to finance their investments. Internal sources include retained earnings and depreciation, while external sources basically refer to new borrowings or the issue of stock. Thus the financing decision involves the appraisal of two choices. The first is the dividend choice – the fraction of retained earnings to be ploughed back and the fraction to be paid out as dividends. The second is the capital structure choice – the fraction of external finance to be borrowed and the fraction to be raised in the form of new equity. Firms are generally free to select the level of dividend they wish to pay to holders of ordinary shares, although factors such as legal requirements, debt covenants and the availability of cash resources impose limitations on this decision. It is thus not surprising that the empirical literature has recorded systematic variations in dividend behavior across firms, countries, time and type of dividend .This mostly is determined by many factors and conditions prevailing during that period.

Shareholders wealth is represented in the market price of the company's common stock, which, in turn, is the function of the company's investment, financing and dividend decisions.

REVIEW OF LITERATURE

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

Corporate dividend policy has long been an issue of interest in the financial literature and, despite the vast research on the topic, it remains an open subject. The earliest major attempt to explain dividend behavior of companies has been credited to Graham and Dodd (1934) who were the major proponents and founders of the school of thought referred to as the traditionalist or rightists who offered the first explanation for the relevance of dividend payment. Later support for the literature of determinants of dividend policy and dynamics was given by Lintner (1956), who conducted a study on American Company and thereafter, the work was refined by Fama and Babiak (1968).

1. 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.

2. Pandy (2001) investigated the dividend payment behavior in Malaysia. The research sample included 248 listed corporations in the period from 1993 to 2000.This sample included building industries, consumer products, industrial products, agricultural products, real estate, and service enterprises. Results showed that dividend payment ratios among different industries are different in Malaysia. Agricultural and consumer product corporations had the highest level of dividend payment, because they had limited investment opportunities and more working capital. The results also indicated that profitability, firms' size and investment opportunities affect dividend payments. These results also suggested that larger and more profitable companies pay higher dividends. However, firms with profitable opportunities pay fewer dividends. The results also suggested that corporations that never pay dividends are more profitable than corporations that only distribute dividends in the first years of their activities. The results suggest that one of the basic characteristic of dividend payers is the firm's size – firms that pay dividends are ten times larger than firms that don't.

MATERIAL AND METHOD

It has been recognized by various research studies that a dividend policy could make significant impact on corporate future value when established and carefully followed. The goal of wealth maximization is widely accepted goal of the business as it reconciles the varied, often conflicting, interest of the stakeholders The dividend policy of a firm becomes the choice of financial strategy when investment decisions are taken as given. It is also imperative to know whether the firm will go for internal or external source of financing for its investment project. There are a number of factors affecting the dividend policy decisions of a firm such as investor's preference, earnings, investment opportunities & Government policies and taxation.

SHARE VALUATION TOOLS

1.Earnings per share (EPS) :-

Earnings are the profits that remain after the payment of preference dividend and are attributable to shareholders. The earnings per share ratio are mainly useful for companies with publicly traded shares.

In the other words EPS ratio majors the earning per share available tp ordinary shareholders. Equity shareholders have the right to all profit left after payment of taxes & preference dividend. This ratio is calculated by dividing the profit available for equity share holders by the no. of equity share issued.

Earnings are expressed per share and are determined as follows:

EPS= (net income- dividend on preference stock)/average outstanding shares

This ratio is quite significant. The EPS affects the market value of share. It is an indicator of the dividend paying capacity of the firm. By comparing the EPS with other firms, management can know whether ordinary share capital is being utilized effectively or not.

2.Price Earnings Ratio (P/E Ratio) :-

This ratio shows how much investors are willing to pay per earning of reported profits.In the other words this ratio is calculated by dividing the market price of a share by earning per share.It can be determined as follows:

PE Ratio = Market Price per share / Earnings per share

3. Return on Assets (ROA):-

With the help of this ratio, overall profitability of all resources can be evaluated. Total assists can also be called gross capital employed. Total assets are equal to the sum of fix assets and current assets. This ratio measures the profitability of the firm as a whole in relation to total assets employed.

It can be determined as follows:

Return on Assets (ROA) = (Net profit after tax / Total Assets) * 100

4.Return on Equity (ROE) :-

The amount of net income as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

This ratio measures the profitability of the firm as a whole in relation to total equity employed.

It can be determined as follows:-

ROE = (Net profit after tax / Total Shareholder's Equity) * 100

Total share equity = Preference share capital + ordinary share capital + share premium + reserve & surplus – accumulated losses.

5. Return on investment (ROI):-

Return on investments is a profitability measure that evaluates the performance of a business by dividing net profit by net worth. Return on investment (ROI) measures the gain or loss generated on an investment relative to the amount of money invested. ROI is usually expressed a percentage and is typically used for personal financial decisions, to compare a company's profitability, or to compare the efficiency of different investments.

ROI = (net profit / Investment) * 100

RESULTS AND CONCLUSION

The Indian information technology (IT) industry plays a significant role in economic growth and development.Information technology industry in India has gained a brand identity as a knowledge economy due to its IT and ITES (The Information Technology-Enabled Services) sector . Indian IT and IT'S industry is divided into four major segments – IT services, business process management (BPM), software products and engineering services, and hardware. The IT services sector accounted for the largest share of the IT and IT'S industry, with a total market size of US$ 56.3 billion during FY13, followed by BPM sector (US$ 20.9 billion), and software products and engineering services (US$ 17.9 billion); the market size for hardware was US$ 13.3 billion during FY12.

The Indian IT-BPM industry is expected to add revenues of US$ 13–14 billion to the existing revenues by FY15, according to National Association of Software and Services Companies (NASSCOM).The industry grew at a compound annual growth rate (CAGR) of 13.1 per cent during FY08–13.Total exports from the IT-BPM sector (excluding hardware) were estimated at US$ 76 billion during FY13, Export of IT services has been the major contributor, accounting for 57.9 per cent of total IT exports (excluding hardware) in FY13. BPM accounted for 23.5 per cent of total IT exports during the same fiscal. The IT outsourcing sector is expected to see exports growing by 13–15 per cent during FY15.

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