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DIVIDEND POLICY AND ITS DETERMINANTS IN INDIAN COMPANIES (PUBLIC & PRIVATE)

Km. Deeksha Sharma
UNDER THE GUIDANCE OF Prof. Dr. Saumya Vatsyayan
MASTER OF BUSINESS ADMINISTRATION
School of Business
Galgotias University

Abstract

As time has gone on, investor expectations and attitudes have also changed to reflect the dynamic nature of risk and its variable sources. The process by which investors used to make investment decisions has changed as a result of the general unpredictability of the investment horizon. The corporate entities have been making every effort to achieve the fundamental business objectives while taking into account the type of investors and ensuring dividend policy optimization. Consequently, corporations and the investment community are exploring various dividend criteria and qualities in order to optimize their benefits, both qualitatively and quantitatively. As a result, the stakeholder community's ongoing activities have accelerated the evolution of theoretical and empirical concerns pertaining to dividend policy.Theoretical arguments concerning dividends, which date back to the groundbreaking research of Linter (1954) and Modigliani & Miller (1961), opened the door for a thorough emergence of arguments for and against it, which the esteemed figures in the finance and investing fields progressively came to refer to as the "dividend puzzle." The question of whether or not to pay dividends has taken the form of several theoretical claims that address various aspects to which the community of stakeholders is exposed. As a result, ideas have been categorized according to how relevant or irrelevant the dividend policy is to the community of stakeholders. Prominent scholars have advanced a variety of views about the dividend policy dichotomy. According to the irrelevance proposition, dividend policy only has an impact on the amount of outside funding needed for projects that have a positive net present value, meaning that every dollar delivered to shareholders represents a capital loss. This hypothesis states that the company's unique investment strategy, not the dividend policy that companies adhere to, is the only factor limiting the company's market value. This is so because initiatives in the future are under the purview of investment policy (MM 1961). Therefore, the choice made by the corporation regarding the distribution of cash or non-profit shares would not have an impact on the company's market value, and consequently, the wealth of its owners. According to this concept, managers should prioritize the investment policy more and allow the dividend policy—also referred to as the residual policy—to take precedence over the investment policy.

The study's objectives:-

The current study seeks to accomplish the following goals:

1. Examine the different factors that affect dividend policy.

2. Assess the direction and strength of the factors that affect dividend policy.

3. Examine the effects of dividend announcements on stock price and the frequency of abnormal returns around the announcement day.

4. Examine the effects of dividend payout on stock price and the frequency of

abnormal returns around the payout day.

Introduction

Dividend policy is a critical aspect of corporate financial decision-making, influencing the allocation of profits to shareholders. This study delves into the dividend policies of Indian companies aiming to unravel the determinants that shape these strategies.

The primary objectives are to examine prevailing dividend policies, identify key determinants, and analyze their impact on decision-making within the dynamic Indian corporate landscape.This research aims to contribute valuable insights into the diverse sector influencing dividend policy in Indian companies. By understanding the interplay of these determinants, the study provides practical implications for corporate decision makers, investors, and policy makers.The study scrutinizes a range of determinants, including profitability, cash flow, debt levels, equity life cycle, adherence to industry norms, legal and regulatory factors, investment opportunities, tax considerations, shareholder preferences, and earnings stability.

In Indian companies, dividend policy refers to the decision-making process regarding the distribution of profits to shareholders. Several determinants influence the policy, including;

1. Profitability: Companies with higher profits may have more resources available to distribute as dividends.

2. Cash Flow: Adequate cash flow ensures the ability to sustain dividend payments over time.

3. Debt Levels: High debt levels may limit a company's ability to pay dividends, as debt obligations must be prioritized.

4. Company Life Cycle: Mature companies may prioritize dividend payments, while younger companies may reinvest earnings for growth.

5. Growth Opportunities: Companies with promising growth prospects may retain earnings for investment rather than distributing them as dividends.

The direction and strength of factors affecting dividend policy can vary based on the specific context and characteristics of the companies being studied. However, here are some general insights into how common determinants typically influence dividend policy:

1. Profitability: Profitable companies tend to have higher dividend payouts, as they have the financial resources to distribute dividends to shareholders. The direction of the effect is typically positive, meaning that higher profitability is associated with higher dividend payments. The strength of this relationship depends on the stability and sustainability of the company's earnings.

2. Firm Size: Larger firms may have more stable cash flows and access to capital markets, allowing them to pay higher dividends. The direction of the effect is often positive, indicating that larger firms tend to have higher dividend payouts. The strength of this relationship can vary depending on the industry and market conditions.

3. Growth Opportunities: Companies with greater growth opportunities may prefer to retain earnings for reinvestment in future projects rather than distributing them as dividends. Thus, the direction of the effect is often negative, implying that higher growth opportunities are associated with lower dividend payouts. The strength of this relationship depends on the firm's investment opportunities and risk-return trade-offs.

4. Leverage: Highly leveraged firms may face constraints on their ability to pay dividends due to debt obligations. Therefore, the direction of the effect can be negative, suggesting that higher leverage is associated with lower dividend payouts. The strength of this relationship is influenced by the firm's debt structure, interest coverage ratio, and financial flexibility.

5. Ownership Structure: The ownership structure, including the presence of institutional investors, foreign investors, and promoter groups, can influence dividend policy. For example, firms with concentrated ownership may prioritize the interests of controlling shareholders over dividend payments to minority shareholders. The direction and strength of this relationship depend on the alignment of interests among different shareholder groups and the level of agency conflicts within the firm.

Methodology of the Study

The following equation was used to look at the factors:

$$\mathrm{DIV} = \mathrm{a}_0 + \mathrm{a}_1\mathrm{PROFIT} + \mathrm{a}_2\mathrm{LAG\ DIV} + \mathrm{a}_3\mathrm{GROW} + \mathrm{a}_4\mathrm{BETA} + \mathrm{a}_5\mathrm{IOS} + \mathrm{a}_6\mathrm{LSH} + \mathrm{e}$$

In the formula,

'DIV' represents the total dividend paid by the enterprise in period 't' or paid up capital multiplied by the dividend percentage;
'PROFIT' represents net profit in period 't' after deducting depreciation and taxes;
'GROW' represents the average annual revenue growth rate of companies over the past three years (2009-2011).
'LAG DIV' represents the entire dividend paid by corporations in period 't-1', i.e. the lagged dividend.

The term **'BETA'** refers to the coefficient (β) that represents a company's risk. The beta coefficient is the covariance between a stock return and the market return divided by the variance of the market return.
'IOS' refers to the investment opportunity set in period 't', which is a ratio of a company's market value to its book value to account for financing costs.
'LSH' refers to the total number of shareholders in period 't', taken in natural log. This variable measures ownership dispersion
an error term **('e').**
the following formula is used to get the normal returns ($R_{i,t}$) of the stock prices:

$$R_{i,t} = \log\left(P_{i,t}/P_{i,t-1}\right)$$

where $P_{i,t}$ represents the stock i's daily closing price on day t and $P_{i,t-1}$ represents the stock i's daily closing price on day t-1 before.

The predicted return on a given day is determined by applying the market model in this study, which assumes that securities returns are a linear function of overall market movement. This calculation's formula is as follows:

$$ER_{i,t} = \propto_i + \beta_i R_{mt} + \varepsilon_{i,t}$$

where $R_{i,t}$ is the security's expected daily return on day "t."
β_i = beta factor for security 'i'

∞_i = intercept for security 'i'

The observed daily return for the market index "m" on day "t" is denoted by R_{mt}

A term of error is $\varepsilon_{i,t}$

The following formula was used to determine the company's abnormal returns:

Actual Return - Expected Return = Abnormal Return.
Where:

- Actual Return is the return earned by the security during a specific period.

- Expected Return is the return that would be expected based on the security's risk characteristics and market conditions during the same period.

The regression's 2011 results are displayed in this table.

Equation	Lagged dividend	Profit	Growth	IOS	Beta	LSH	R^2	AdjustedR^2
1	0.864*					0.134*	0.922	0.917
2	0.782*	0.102				0.124	0.924	0.917
3	0.734*	0.148	-0.008	0.07		0.13*	0.928	0.917
4	0.701*	0.176		0.053	-0.045	0.133*	0.93	0.918
5	0.72*	0.158	-0.003		-0.066	0.131*	0.928	0.916
6	0.732*	0.151	-0.008	0.064	-0.009	0.129	0.928	0.914

The results of the regression for the year 2011 are consistent with those of prior years, demonstrating that the lagged dividend is the most important variable and nearly determines the dividend policy. The regression outputs' coefficients demonstrated that, over the three years under consideration, the lagged dividend is the variable that has the most influence on explaining the majority of the variation in the dependent variable. The profit made during the observation period is the second most important factor that influences fluctuations in dividends. Therefore, it can be claimed that the most important factor affecting and significantly impacting the dividend policy in the Indian corporate community is the lagged dividend.

Review Of Literature

The internal benchmark that a business uses to determine how much of its income to distribute to shareholders is called the dividend policy. One of the most important corporate finance decisions that businesses must make is dividend policy. Many research have been conducted since Lintner's (1956) to understand the role that controlled

dividend policy plays in building business value, but dividend policy is still a mystery. The age-old subject of "Whether dividend creates or destroys firm value" has no conclusive answer. Because dividend policy is a two-edged sword, it plays a crucial function in corporate finance. Even if the company's dividend distribution program rewards devoted investors, it also uses up internal money that the business has available. Dividend policy, therefore, has a profound effect on maximizing shareholder value and is entwined with other fundamental finance and investment decisions of a company. The origins of contemporary empirical research on dividend theory are credited to Lintner (1956). According to him, companies stick to established, steady dividend payout percentages, and management steer clear of altering dividends that might be changed back in the near future. As a result, businesses smooth out their payouts, which make them sticky. Numerous empirical investigations have shown that the two key factors that determine the dividends paid out in a given year are the current earnings and the lagged dividends from the previous year. Fama and Babiak (1968), Baker (1999), Dhanani (2005), Brav et al. (2005), Garrett and Priestley (2012), and Gordon (1959) are a few studies that have examined dividend policy from this perspective. This hypothesis states that investors would rather get a guaranteed current cash dividend than an erratic payout in the future. As a result, investors will place a higher value on current dividends than uncertain future capital gains. Miller and Modigliani (1961) were the first to challenge the idea that increasing dividend payments would maximize the value of the company. They came to the conclusion that the value generated by the investment policy was the maximum amount of value that could be produced by a controlled dividend policy. A perfect world would have no frictions such as taxes or bankruptcy costs, making dividend policy meaningless and unrelated to the creation of business value. To simulate the anticipated cash flow from the dividend stream, investors may turn to creating their own dividends. Black (1976) made an effort to comprehend two fundamental issues: "Why do businesses pay dividends at all?" and "What makes dividend-paying stocks more appealing to investors?" He said that companies had no incentive to pay dividends because doing so would destroy value because there was a different tax penalty for dividends than for capital gains.

Dividend Announcement and Reactions in Stock Prices

With value maximization as one of their primary goals, corporate organizations have placed this difficult duty of meeting shareholder expectations on qualified managers. Management representatives dedicated themselves to maximizing shareholders' value through a variety of financing and investment choices. Since the procedures for distributing a company's profits to investors are complex and contentious, managers must make a decision without impairing corporate entities' capacity to generate sustainable profits. Paying cash dividends to shareholders as a return on their investment has been one of the renowned worldwide strategies for allocating a company's profits. Paying cash dividends, on the other hand, limits the managers' ability to invest in fresh,

profitable business ventures. Therefore, the question of whether dividend payments tend to boost stockholder value or get in the way of value maximization still needs to be answered.

The effects of dividend announcements on stock prices and the frequency of abnormal returns around the announcement day are widely studied in finance literature. Here's an examination of these effects:

1. Stock Price Reaction:

- Positive Announcement: A dividend increase or initiation often leads to a positive reaction in stock prices as it signals confidence in the company's financial health and prospects. Investors interpret this as a favorable indication of future earnings and cash flow.

- Negative Announcement: Conversely, a dividend decrease or omission may result in a negative stock price reaction as it could signify financial distress or a shift in corporate strategy. Investors may interpret this as a negative signal about the company's future performance.

2. Frequency of Abnormal Returns:

- Around Announcement Day: Studies have shown that abnormal returns are frequently observed around dividend announcement days. Abnormal returns refer to the difference between actual returns and expected returns based on market trends.

- Event Study Methodology: Researchers often employ event study methodologies to analyze abnormal returns by comparing stock price movements around dividend announcement days with a benchmark or market index. This helps determine the significance and magnitude of abnormal returns associated with dividend announcements.

3. Market Efficiency:

- Semi-strong Form Efficiency: The efficient market hypothesis suggests that stock prices reflect all publicly available information, including dividend announcements, instantaneously. Therefore, abnormal returns should theoretically be minimal or short-lived, assuming semi-strong form efficiency.

- Investor Behavior: However, behavioral biases and market inefficiencies can lead to deviations from rational pricing, resulting in abnormal returns persisting beyond the announcement day.

4. Factors Influencing Abnormal Returns:

- Size of Dividend Change: The magnitude of the dividend change often influences the size of abnormal returns, with larger changes typically associated with more pronounced stock price reactions.

- Company Characteristics: Factors such as company size, industry, growth prospects, and financial stability can also impact the frequency and magnitude of abnormal returns around dividend announcements.

5. Market Reaction Variability:

- **Heterogeneous Responses:** The market reaction to dividend announcements may vary across different companies, industries, and market conditions. Factors such as investor sentiment, macroeconomic trends, and regulatory environment can contribute to this variability.

Here are the latest dividend of various companies Date of Announcement, Dividend (%)

Start Date:- 14/03/2024 End Date:- 23/04/2024

Company Name	Dividend Date	Record Date	Dividend %	Dividend Type
Embassy Office Parks	15-04-2024	06-05-2024	0.0000	Inrerim
Anand Rathi Wealth	12-04-2024	-	180.0000	Final
ICICI Securities	12-04-2024	26-04-2024	0.0000	Inrerim
Tata Consultancy	12-04-2024	-	2800.0000	Final
Vuenow Infratech	9-04-2024	23-04-2024	5.0000	Inrerim
Crisil	8-04-2024	03-05-2024	0.0000	Inrerim
Guj. Toolroom Ld	8-04-2024	20-04-2024	100.0000	Inrerim
Transformers & Recti	8-04-2024	-	20.0000	Final
Aegis Logistics Ltd.	05-04-2024	22-04-2024	125.0000	Inrerim
Aster DM Healthcare	05-04-2024	23-04-2024	1180.0000	Special
India Infra Trust	02-04-2024	17-04-2024	0.0000	ROC
Fortis Malar Hospita	01-04-2024	23-04-2024	400.0000	Inrerim

Dividend Payout on Stock Price

Dividend payouts can influence stock prices and the occurrence of abnormal returns in several ways:

Signaling Effect: Dividends may serve as a signal to investors regarding the health of a company. An increase in dividend payouts may be interpreted as a signal of strong future earnings, thus potentially boosting the stock price. Conversely, a cut in dividends might signal financial distress, possibly leading to a stock price decline.

Clientele Effect: Various investor groups, or "clienteles," could have varying preferences for dividend policy. For example, some investors may prefer high dividend payouts for the income, which can attract them to the stock, potentially increasing its price. Conversely, if a company decreases its dividends, it may lose investors who prefer high dividend-payout stocks, which could depress the stock price.

Tax Preferences: Investors might have different tax preferences related to dividends. For instance, in jurisdictions where dividends are taxed more heavily than capital gains, investors might prefer companies that retain earnings (leading to higher growth and capital gains) over those that pay out dividends, influencing the stock price accordingly.

Regarding the frequency of abnormal returns around the payout day:

Stock Dividend and Split Announcements: Studies have found that stock prices tend to react positively to the announcements of stock dividends and stock splits, showing significantly positive excess returns around the ex-dates of such events, which can be considered abnormal returns (Grinblatt et al., 1984). This reaction could be due to signaling effects, as these corporate actions might be perceived as indications of confidence by the management in the firm's future prospects.

Ex-Dividend Day: The stock price typically drops on or just after the ex-dividend date by approximately the amount of the dividend. While this is a predictable price change, some studies and empirical evidence suggest that there might be abnormal returns associated with dividend payouts, particularly when they differ from market expectations.

Conclusion

In conclusion, the research paper on Dividend Policy and its Determinants in Indian companies reveals that dividend policy is a complex decision influenced by multiple factors including company profitability, growth opportunities, taxation policies, market conditions, and shareholder preferences. The Indian context presents unique challenges and opportunities, given the economic, regulatory, and cultural nuances.

Overall, the direction and strength of factors affecting dividend policy are subject to empirical investigation and may vary across different companies and industries. Empirical research using regression analysis or other statistical methods can help assess the significance and magnitude of these factors in shaping dividend policy decisions.

In conclusion, dividend announcements can have significant effects on stock prices, with abnormal returns frequently observed around the announcement day. The frequency and magnitude of abnormal returns depend on various factors, including the nature of the dividend change, company characteristics, and market conditions.

It is important to note that market efficiency and investor expectations play crucial roles in determining the effect of dividend payouts on stock prices and the frequency of abnormal returns. In efficient markets, all information about dividends should be incorporated into stock prices as soon as it's available, meaning that only unexpected changes in dividend policy would result in abnormal returns.

In conclusion, dividend announcements can have significant effects on stock prices, with abnormal returns frequently observed around the announcement day. The frequency and magnitude of abnormal returns depend on various factors, including the nature of the dividend change, company characteristics, and market conditions.

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