DIVIDEND DECISION-MAKING AND ANALYSIS: EXPLORING THE CHOICES

[#1]**O.RUPA ALEKYA REDDY,** *PG Student,*
[#2]**PARSA KISHORE,** *PG Student,*
Department of Master of Business Administration,
SAI SPURTHI INSTITUTE OF TECHNOLOGY, SATHUPALLI, KHAMMAM, TELANGANA.

ABSTRACT:
The timeliness and size of dividend distributions to shareholders are highly valued in corporate finance. These sorts of choices have the potential to drastically impact a company's bottom line, stock price, and public image. This summary provides a concise overview of what needs to be taken into account before declaring a dividend. Maximizing shareholder wealth through stable dividends and cash flow is the stated goal of dividend policy. Concepts and theories such as the agency theory, the signaling hypothesis, and the dividend irrelevance theory are discussed. Regular dividends, special dividends, and share repurchases are all backed by theory that has been established by these investigations.

1. INTRODUCTION

DIVIDEND

Financial experts in India define a dividend as "a distribution to shareholders out of profits or reserves available for this purpose." Therefore, "dividend" must imply "profit distributed to owners/shareholders" after taxes for the purposes of this article. So, dividends are the money that is given to stockholders. It's a way to show gratitude to the people who have invested in the company with their own money. Stockholders are compensated for their investment in a company through dividends. Companies frequently use dividends as a means of returning capital to its owners.

DIVIDEND POLICY

The dividend policy of a firm specifies the proportion of net income that will be distributed to shareholders as cash dividends, as opposed to being retained and invested. Management's established pattern of deciding how much and how often shareholders will receive dividend payments is known as the dividend policy. To repeat, the company's dividend policy defines the parameters for dividend payments. It's the trade-off between dividend payments and investments back into the company. Choosing a dividend policy that is good for shareholders requires thinking about the firm's purpose. The dividend policy of a company is indicative of its fiscal health. Dividends and retained earnings are crucial for a robust capital market because they affect a company's ability to invest in growth, diversification, and mergers.

A corporation is owned by its shareholders, but its day-to-day activities are managed by the Board of Directors. The company's profits are subject to the Board of Directors' discretionary decision to either be dispersed to shareholders or invested in new business opportunities. Shareholders and the board do not see eye to eye on this issue. Investors tend to lack patience. However, there are many considerations that board members must weigh before deciding on a divided policy. The vast majority of corporations have dividend policies. Companies typically keep a certain percentage of their net income for operations and provide the rest to stockholders. Before choosing on a dividend plan that can be maintained over the long term, many aspects should be considered.

2. TYPES OF DIVIDENDS

There are numerous dividend structures, each of

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which corresponds to a certain dividend kind. There are several options for disbursing dividends.

- Cash dividend
- Bonus Shares referred to as stock dividend
- Property dividend interim dividend, annual dividend.
- Special- dividend, extra dividend etc.
- Regular Cash dividend
- Scrip dividend
- Liquidating dividend
- Property dividend

Cash dividend:

Companies typically pay out dividends monetarily. Dividends given in cash require sufficient funds in the business's bank account. It may be required to take out a loan if there is not enough cash on hand. Companies that plan to continue paying dividends on a consistent basis should include the associated costs in their cash flow forecasts for the upcoming fiscal year. Dividend payment forecasting can be challenging in the presence of policy uncertainty. When a dividend is paid out in cash, the company's available cash is reduced. When a company pays out dividends in the form of cash, it reduces its total assets and net worth. When a cash dividend is paid out, the price of a share of stock often falls by that amount.

Bonus Shares:

The term "bonus share issue" refers to the practice of giving out free shares to current investors. In India, bonus shares are issued in addition to, rather than in place of, cash dividends. This means that Indian corporations can pay both dividends and bonus shares to their shareholders. A corporation can raise the number of shares outstanding by the issuance of bonus shares. Each existing shareholder receives the same number of bonus shares. There is consequently no risk of having to change management teams. After the bonus shares are declared, the company's paid-up Share Capital will rise while its reserves and surplus retained earnings fall. No change has occurred to the company's paid-in-capital, reserve, or surplus values as a result of the bonus issue. A bonus issue is a way for a company to reinvest its extra cash flow. Paid-in capital is simply calculated as the sum of the surplus and reserves. Stockholders benefit in the following ways from the bonus shares:

Tax benefit:

Bonus shares are advantageous to investors since they incur a lower tax rate than regular dividends.

Indication of higher future profits:

Investors will view a company favorably if it issues bonus stock.

Future dividends may increase:

After the bonus issue is declared, the total cash dividend paid to shareholders stands to grow if the company maintains its current dividend payment policy.

Psychological Value:

There may be a psychological benefit for shareholders to hear about the bonus issue being announced. The investor's initial capital is protected against loss while selling bonus shares. It's often seen as a symbol of the company's success as a whole.

Special dividend :

On rare occasions, the company will provide a special dividend payment. When unexpected profits are realized, companies frequently issue special dividends.

Extra- dividend:

In case there was any confusion, a "extra dividend" is a one-time payment made in addition to the normal dividends paid by the company. Rather from making smaller dividend payments on a consistent basis, companies whose income is subject to fluctuations would rather make larger payments when profits allow it.

Annual dividend:

The term "annual dividend" is used to refer to dividends paid by a firm once every year.

Interim dividend:

Any period during the year is suitable for a corporation to declare an interim dividend.

Regular cash dividends:

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Payment schedule options include monthly, semiannual, and annual intervals.

Scrip dividends:

These investments provide the possibility of a dividend payment in the future rather than immediately. Scrip is a stockholder's promissory note.

Liquidating dividends:

In the event of a company's dissolution, special dividends may be paid out to owners in the form of cash or other assets on a pro rata basis.

Property dividends:

These distributions will not come directly from the company's financial reserves. Free services or stock in a wholly owned subsidiary may be offered to investors.

3. DIVIDEND DECISION

The dividend payment schedule is set by the Board of Directors. The dilemma facing the corporation is whether to return the money to shareholders in the form of dividends or to reinvest it in an effort to expand. When weighing the pros and downsides of reinvesting income vs paying cash dividends, management must make a decision.

When deciding on a dividend policy, two things should always be kept in mind:

- Maximizing owners' wealth
- Providing sufficient financing

Finding the right balance between reinvesting in the firm and distributing dividends to shareholders is essential for effective profit management.

Here are two things to keep in mind while designing a sound dividend policy framework:

Funds Convertible to Common Equity Ratio = Net Amount After All Expenses.

How many profitable opportunities does the organization have access to (Return on Equity greater than Return on Investment)?

Dividend Decision Matrix

Factors	FCFE > Dividends	FCFE <Dividends
ROE > Cost of Equity	Good Projects Cash flow surplus No Change	Good Projects Decrease Dividends Invest in Projects
ROE < Cost of Equity	Poor Projects Cash flow surplus Increase Dividends Reduce Investment	Poor Projects Cash flow Deficit Decrease Dividends Reduce Investment

Free cash flow to equity (FCFE) is a similar concept to return on equity (ROE).

TYPES OF DIVIDEND POLICY

In the 1950s, Lintner polled managers to uncover what factors went into their dividend decisions. Most respondents said they were told a certain percentage of their income would be covered. Half or more of a company's annual profits may be distributed as dividends, however this is unusual. Lintner consulted with CEOs to learn that businesses determine dividend payout percentage targets and make modest adjustments to dividend payments to fulfill those targets. If this is the case, dividends may be adjusted based on the company's profit situation. However, this autonomy can also result in dividend policy differences among companies. Dividend options for corporations are as follows:

Generous or liberal dividend policy:

The dividends of such companies tend to rise with time.

Stable dividend policy:

Companies can employ a stable dividend payment ratio by doing the following. This technique will ensure a constant dividend payout ratio relative to earnings. Depending on the state of the company's finances, dividends may be increased or decreased. An inflation-adjusted dividend payment is assured by the policy's "stable rupee" language.

Low regular dividend plus extra dividend policy:

The concept calls for a small dividend to be paid out each year, with higher payouts in years of financial success. A corporation may decide to pay a "extra dividend" to its shareholders if its profits for a certain time are very high. The dividend's ultimate value is unknown, but you may expect to receive payments on a regular schedule.

Residual dividend policy:

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If the company's earnings are greater than the amount needed to finance reasonably new capital expenditures, the excess will be paid out to shareholders in the form of dividends. Depending on the state of the company, dividends could increase or decrease.

Multiple dividend increase policy:

There are several businesses that raise their dividend payments on at least an annual basis. The expectation is that this will be seen as positive news by investors.

Uniform cash dividend plus bonus policy:

The plan stipulates a fixed dividend payout of cash per share at a minimum and bonus stock at a maximum. The annuality of stock bonus payments varies. Depending on how much money the corporation has set up for such payouts, incentive payments in our case could be spread out over a period of three to five years.

STABLE DIVIDEND POLICY: A POLICY OF DIVIDEND SMOOTHING

Lintner (1956) found that managers and enterprises care more about dividend stability than they do about profit stability. However, dividends are more reliable than profits because their size only changes slightly over time and rarely decreases. The primary objective of a corporation is to accumulate cash reserves so that it may continue operations indefinitely, and the secondary objective is to distribute earnings equitably to its shareholders. Dividends per share (DPS) increase when EPS decrease and vice versa. Dividend growth has lagged behind profit growth in order to "smooth out" or "stabilize" dividend payments over time. The corporation may choose to implement any of the following long-term dividend plans:

- Stable dividend payout ratio
- Stable dividends per share
- A regular plus extra dividend policy

Dividend payout Ratio:

it is calculated by dividing the total dividend to equity shareholders by the net income available to them for that period as follows:

= Total dividend paid/ Net income after tax

OR

= Annual dividend paid per share/ EPS

OR

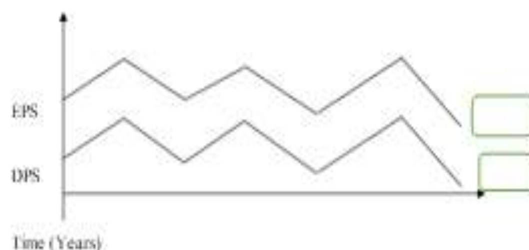
= 1- Retention Ratio

Where retention ratio = Retained Earnings/ Net income

Retention Ratio + Dividend payout Ratio = 1 (which means whatever amount is not paid by dividend is retained by the company to reinvest)

Stable dividend payout ratio

As per this policy the **percentage** of dividends paid out of earnings remains **constant**.



Stable dividends per share

A fixed annual dividend per share will be paid out by the corporation in accordance with this policy. Companies typically raise their dividend payout if they have reached a certain level of sustainable profit.

A regular plus extra dividend policy

Annually, per this plan, you will get a dividend payment that is at least $X or is otherwise computed. A "additional" or "extra" dividend may be distributed by the corporation if annual profits are higher than expected.

Rationale for stable dividend policy:

Dividend payments are a standard practice at many companies. If a business anticipates a temporary drop in earnings or requires a substantial amount of money for investment and wants to repay the loan once its financial condition improves, the dividend might be paid with borrowed cash. Therefore, dividends should be distributed on a consistent basis:

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If dividends are cut, it might be disastrous for stockholders who rely on them for survival. Dividends are crucial to the financial security of many stockholders, especially those in retirement.
Studies have shown that reduced uncertainty leads to lower capital costs and higher stock values, thus providing investors with stability like a reliable dividend policy can help everyone sleep better at night.
Companies having a history of consistent dividend payments are preferred by institutional investors.
Financial backers are more likely to invest in businesses that provide dividends on a consistent basis.
One disadvantage of this approach is that it may reduce organizational flexibility. Companies that have built their reputations on consistently paying dividends may see their share prices plummet and their financial soundness called into question if the company ever deviates from that policy.

4. THEORIES OF DIVIDEND

- Walter's model
- Gordon's model
- Modigliani and Miller's hypothesis

Walter's model:
Stock price fluctuations, according to Professor James E. Walter, are proportional to a company's dividend policy. His method relies on the connection between a company's r and k, or internal rate of return and cost of capital, to determine the dividend distribution that maximizes shareholder wealth.
The following are some of the pillars upon which Walter's model rests:
When the cost of capital (k) is equal to the internal rate of return (r), the firm will use its retained earnings to finance all investment and will either pay out all dividends or reinvest all profits.
All dividends and profits will continue at their current levels indefinitely. Even though EPS and DPS both have the potential to change, the model treats any given EPS/DPS combination as static.
The company might survive indefinitely.
Shares of stock can be valued at their current market price (P) by applying Walter's formula:

$$P = D/K + r(E-D)/K/K$$

The above formula states that the current share price equals the present value of an infinite stream of constant dividends (D/K) plus the present value of an endless stream of stream gains.

$$[r\,(E-D)/K/K]$$

Gordon's Model:
Myron Gordon created a widely used model that relates stock price to dividend payouts.
Assumptions:
The following are the presumptions upon which Gordon's model rests.
All of the stock in the company is owned by the workers.
There is currently no other way to acquire funds.
The ROI has been stable for the company for the past several years.
The best course of action for the company would be to maintain a constant discount rate (K).
The company has infinite potential to generate profits.
In this jurisdiction, businesses are not subject to taxation.
Once the retention rate (b) is determined, it won't change. This means that the formula g = br won't change as time goes on.
If K > br = g is not correct, then the stock price cannot be calculated with any accuracy.
Gordon's dividend capitalization model states that the value of a share is equivalent to the present value of a perpetual stream of dividends (Pq) that the share would receive. Thus:

$$P_0 = \frac{E_1\,(1-b)}{K-br}$$

In order to determine the initial share price (P0) of an all-equity corporation, the firm's current earnings (E,), dividend payout policy (b), internal profitability (r), and cost of capital (k) are all inputs into a formula.
Modigliani and Miller's hypothesis:

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If dividends have no impact on stock price, according to Modigliani and Miller (M-M), they should be disregarded. They state that the company's worth is directly related to the rate of return produced by the investment strategy. Accordingly, whether gains be kept or paid as dividends makes little difference when appraising an investment. M - M bases its idea of insignificance on these presumptions.

The public can invest in the company through the stock market.

There are zero taxes.

The company's approach to the marketplace is cautious.

In the dark, there is no threat. Accurate price and payout forecasting is possible using a single discount rate across all securities and time periods. Because of this, we can conclude that r = K = Kt always.

The discount rate, r, will be the same for every stock under the M-M assumptions. Only if the share price changes will the rate of return on shares (dividends plus capital gains) be equal to the discount rate.

To calculate ROI in a single year, use the following formula.

$$r = \frac{D + (P_1 + P_0)}{P_0} = \frac{\text{Dividends} + \text{Capital gains (on loss)}}{\text{Purchase price}}$$

At time 0, both the market price, or P0, and the dividend, denoted by D, are zero dollars.

The M - M hypothesis predicts that the r values of all stocks will converge to a single value over time. Investors will dump present shares and buy those of other companies if they don't see the profits they want.

Thus, the low-return shares' price would fall while the high-return shares' price would rise. Iterate until there is no longer any noticeable shift in yields. According to the M-M assumption, all businesses should be given the same discount rate because they are all exposed to the same level of risk.

The pricing structure of M-M can be deduced from this basic concept.

$$P_0 = \frac{D_1 + P_1}{(1+r)} \qquad P_0 = \frac{D_1 + P_1}{(1+k)} \qquad r = k$$

We can estimate the company's worth in the absence of fresh funding by considering (a), (b), and the current number of shares outstanding (n).

$$V = nP_0 = \frac{N(D_1 + P_1)}{(1+k)}$$

Value at time 0 for P is the sum of the company's entire assets less the proceeds from issuing m additional shares at time 1.

$$nP_0 = \frac{ND_1 + (n+m)p_1 - mp_1}{(1+k)}$$

In contrast to the Walter and Gordon models, the aforementioned M-M value equation permits the issue of additional shares. In order to get the most out of its investments, a corporation should use capitalization techniques like dividend payments. The M - M model keeps dividend and investment strategies separate, while the Waiter and Gordon models combine both.

5. CONCLUSION

Since the introduction of the dividend irrelevance hypothesis by M&M (1961), a great deal of theoretical and empirical research has been published on dividend policy. Despite decades of research, scholarly disagreements persist, even when considering the same evidence. According to M&M, dividends shouldn't have any effect on a company's value in a liquid market. Due to the market's many flaws (taxes, transaction costs, information asymmetry, agency difficulties, etc.), various theories of dividend policy have been established. The report started out with a brief overview of dividends and how they have been paid out by various companies over the years. The dividend policy is thought to be influenced by the company's past and future. Both the M&M example and the major argument for the dividend's insignificance were presented in the paper. The study continued by responding to the most common arguments against the claim of irrelevance. Before presenting the most

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compelling empirical evidence against them, the writers of this paper attempt to set out the theoretical foundations of many dividend policy ideas.

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