

# **DIVIDEND POLICY**

Dr. P. D. Das, CIME, BBSR

By

**Dr. P.D.Das**

CIME, Bhubaneswar

# Provisions in companies act 1956

## Section 205

- Dividends for any financial year shall be declared or paid only out of the profits of the company for that year arrived at after providing for depreciation of that year.
- The board of directors can pay interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within 5 days from the declaration of such dividend.
- Dividends shall be declared or paid for any financial year only after transfer of profits of that year to reserves, not exceeding 10 percent as may be prescribed by rules.
- Dividends shall be payable in cash
- Dividends can also be paid by cheque or warrant.
- A company which fails to comply with the provision of section 80 A relating to redemption of irredeemable preference shares, shall not declare and pay dividend on its equity share, so long as failure continues.

# Companies (Transfer of Profits to Reserves) 1975

A company must transfer certain percentage of profits of current year to reserves, before declaring a dividend. A company may transfer higher amount to reserves than prescribed.

If dividend is proposed upto 10%

nil

If dividend is proposed upto 10.01% to 12.5%

2.5% of profit

If dividend is proposed upto 12.51% to 15%

5% of profits

If dividend is proposed upto 15.01% to 20.00%

7.5% of profits

If dividend is proposed over 20%

10% of profits.

# Stock exchange requirement as to dividends

Since dividend declaration is a price sensitive information, companies listed on any stock exchange must follow requirements of stock exchange which are as follows.

- Communicate to stock exchange the date of board meeting where dividend is to be proposed by the board, atleast 7 days in advance.
- Inform date of record date to stock exchange atleast 42 days in advance(30 days for dematerialised share).
- Dividend should be recommended atleast five days before the record date.

# Stock exchange requirement as to dividends

- As soon as board meeting is over, stock exchange on which shares are listed should be informed by letter or telegram, the dividend proposed. Other financial figures are also required to be sent.
- Date from which dividend will be payable should be informed to stock exchange atleast 21 days in advance.
- Dividend warrants shall be payable at par at such centres as may be agreed to between exchange and the company.

# Important considerations in dividend policy

- Transaction costs
- Shareholder's Income tax
- Dividend clientele
- Dividend payout ratio
- Dividend signaling hypothesis
- Divisible profits
- Liquidity
- Rate of expansion of business
- Rate of return
- Stability of earnings
- contractual constraints
- cost of external financing
- degree of control
- Access to capital market
- General state of economy.

# Types of Dividend Policy

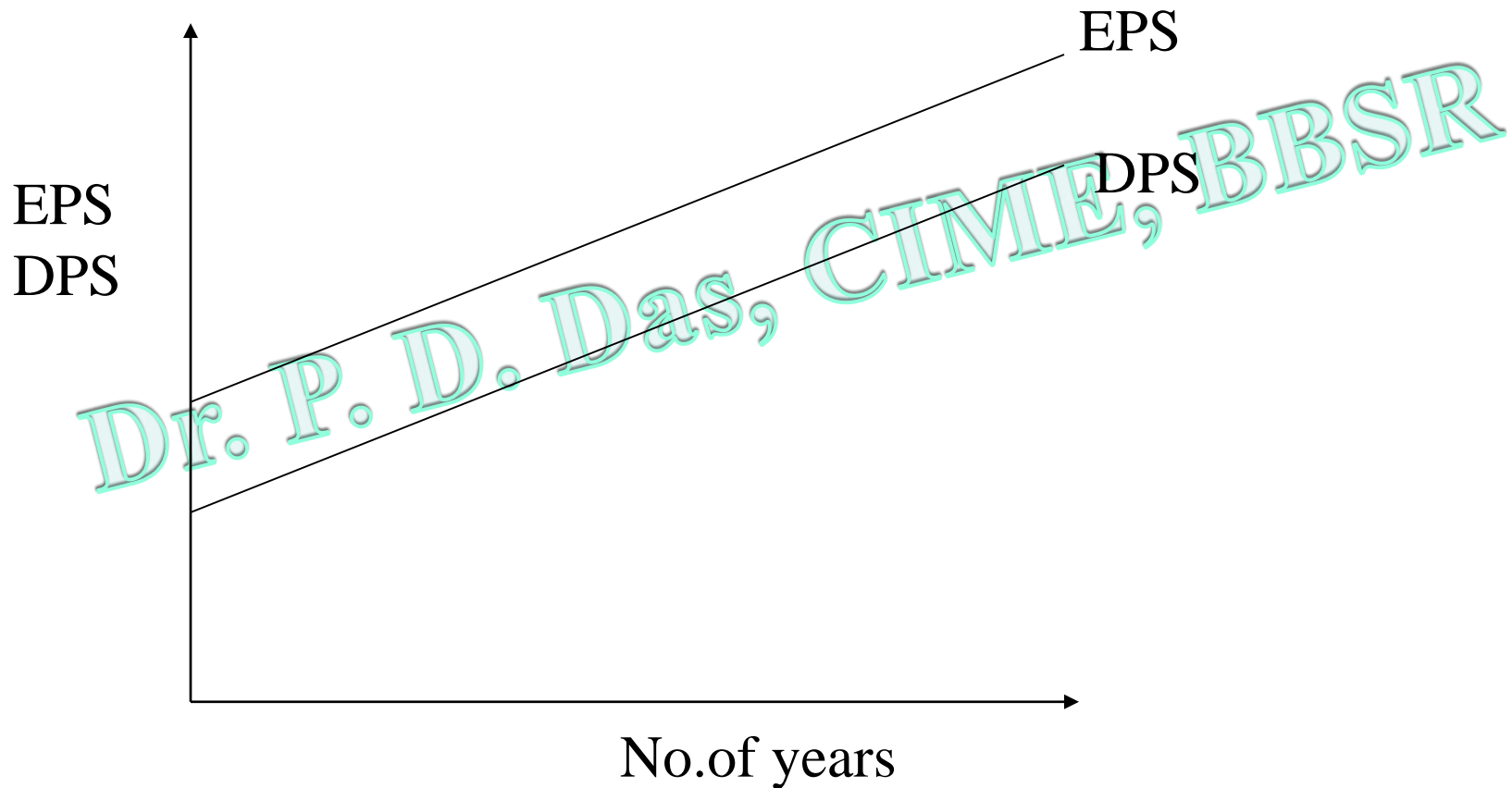
- 1) Constant payout ratio policy
- 2) Constant dividend rate policy
- 3) Multiple Dividend increase policy
- 4) Regular dividend plus extra dividend policy
- 5) Uniform cash dividend plus bonus shares policy

# 1. Constant Payout ratio

- This method is known as constant payout ratio.
- This concept of stability of dividends means ‘always paying a fixed percentage of the net earnings every year.
- If the earnings vary, the amount dividend varies from year to year.
- The dividend policy is entirely based on company’s ability to pay under this policy.
- The company follows a regular practice of retained earnings.
- Very few firms select this method.



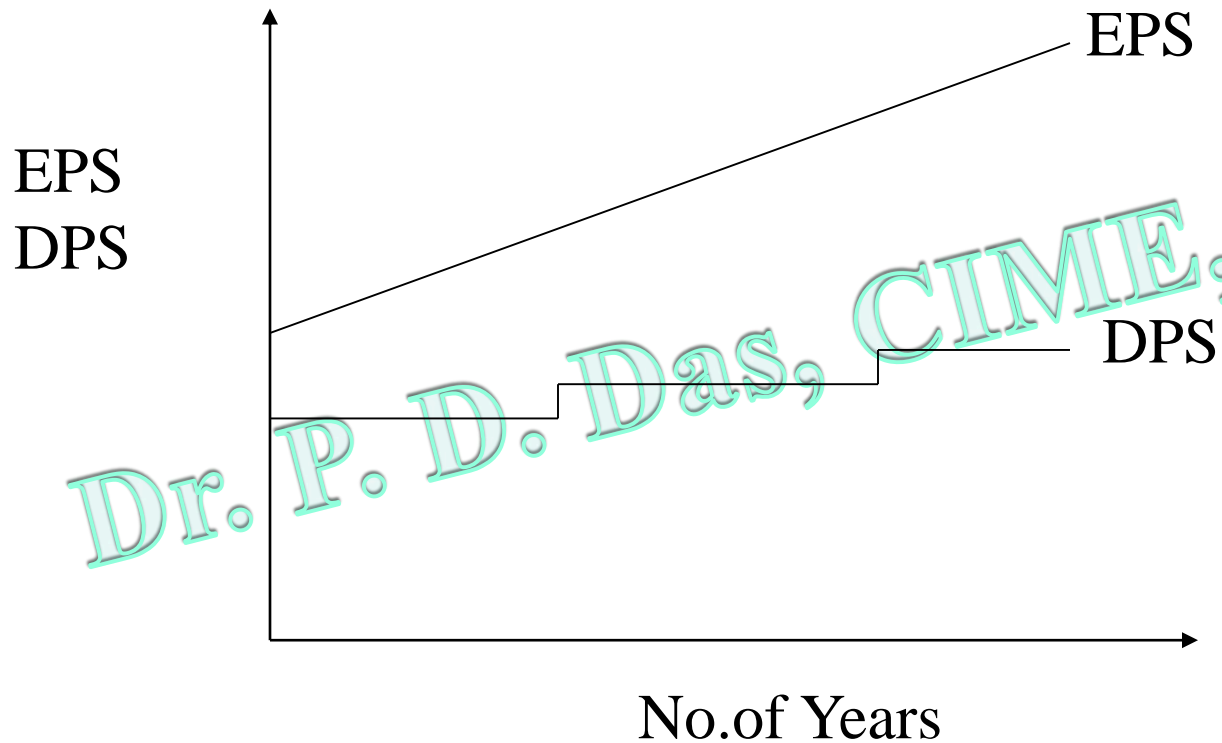
# Constant payout



## 2. Constant Dividend per share

- It the most popular method.
- This possible only when the earnings of the company is far or more stable.
- Firms are generally very careful to set the dividend at a sustainable level and raise it only when the firm can sustain a higher level.
- Occasionally firm cut dividends

# Constant Dividend



### **3. Multiple Dividend Increase policy**

- Some firms follow a policy of very frequent and very small dividend increases to give the illusion of movement and growth.
- The obvious hope behind such a policy is that market rewards consistent increases.

## **4. Regular Dividend plus extra dividend policy**

- Some firms consciously divide their announced dividends into two portions a regular dividend and an extra dividend.
- The regular dividend is the dividend that will continue at the announced level.
- The extra dividend payment will be made when circumstances permit.

## **5. Uniform Cash Dividend plus Bonus shares policy**

- This policy is usually adopted in case of companies which have fluctuating earnings.
- Under this method, a minimum rate of dividend per share is paid in cash plus bonus shares are issued from accumulated reserves.
- But the issue of bonus shares is not bound on annual basis. It depends upon the amount kept in reserves over a period say 3 to 5 years.

# FORMS OF DIVIDENDS

- Cash Dividends
- Bonus Shares (Stock Dividend)

Dr. P. D. Das, CIMIE, BBSR

# Advantages of Bonus Shares

- **To shareholders:**

- Tax benefit
- Indication of higher future profits
- Future dividends may increase
- Psychological value

- **To company:**

- Conservation of cash
- Only means to pay dividend under financial difficulty and contractual restrictions
- More attractive share price



# Limitations of Bonus Shares

- Shareholders' wealth remains unaffected
- Costly to administer
- Problem of adjusting EPS and P/E ratio

Dr. P. D. Das, CIVIL, BBSR

# Conditions for the Issue of Bonus Shares

- Residual reserve criterion
- Profitability criterion

Dr. P. D. Das, CIMA, BBSR

# Share split

- A share split is a method to increase the number of outstanding shares through a proportional reduction in the par value of the share. A share split affects only the par value and the number of outstanding shares; the shareholders' total funds remain unaltered.

# Example

- The following is the capital structure of Walchand Sons & Company:

	<i>Rs</i>
Paid-up share capital (1 crore Rs 10 par)	10
Share premium	15
Reserves and surplus	8
Total net worth	<u>33</u>

- Walchand Company split their shares two-for-one. The capitalization of the company after the split is as follows:

	<i>Rs</i>
Paid-up share capital (2 crore Rs 5 par)	10
Share premium	15
Reserves and surplus	8
Total net worth	<u>33</u>

# Illustration

Tourist Resorts limited is a listed company paying dividends every year. Its last 5 year profit and dividend track record is given below.

Rs lakhs			
Year	Paid Up Capital	Profits	Dividend Paid
1999	500	125	75
2000	500	132	82.5
2001	650	195	117
2002	800	265	160
2003	800	280	168

Analyse the company's dividend policy.

# Solution

Year	No.of Shares outstandi ng	Profits (Rs lakhs)	EPS (in Rs)	DPS (In Rs)	Dividend Payout ratio	Dividend rate
1999	50,00,000	125	2.5	1.5	60%	15%
2000	50,00,000	132	2.64	1.65	62.5	16.5
2001	65,00,000	195	3.0	1.8	60	18
2002	80,00,000	265	3.3	2.00	60.6	20
2003	80,00,000	280	3.5	2.10	60	21

Constant payout policy

**END OF SESSION**

for any query,  
please contact @

Dr. P. D. Das, CIMIE, BBSR  
pddas1@gmail.com , # 9438485460