SOS POLITICAL SCIENCE AND PUBLIC ADMINISTRATION

MBA FA 202

SUBJECT NAME: FUNDAMENTALS OF FINANCIAL MANAGEMENT

UNIT-V

TOPIC NAME: PETTERNS OF DIVIIDENT POLICY

DIVIDEND POLICY

Definition: A dividend policy can be defined as the dividend distribution guidelines provided by the board of directors of a company. It sets the parameter for delivering returns to the equity shareholders, on the capital invested by them in the business. While taking such decisions, the company has to maintain a proper balance between its debt and equity composition. A dividend is nothing but the return declared to the equity shareholders through the distribution of a portion of profits earned by the organization.

The important aspect of dividend policy is to determine the amount of earnings to be distributed to shareholders and the amount to be retained in the firm. Retained earnings are the most significant internal sources of financing the growth of the firm. On the other hand, dividends may be considered desirable from the shareholders' point of view as they tend to increase their current return. Dividends, however, constitute the use of the firm's funds. Dividend policy involves the balancing of the shareholders' desire for current dividends and the firms' needs for funds for growth.

Despite the suggestion that dividend policy is irrelevant, it is income for shareholders. Company leaders are often the largest shareholders and have the most to gain from a generous dividend policy.

Dividends are often part of a company's strategy. However, they are under no obligation to repay shareholders using dividends. Even though investors know companies are not required to pay dividends, many consider it a bellwether of that specific company's financial health.

CONTENT: DIVIDEND POLICY

1. What is a Dividend?
2. Factors
3. Types
    - Stable Dividend
    - Regular Dividend
    - Irregular Dividend
    - No Dividend

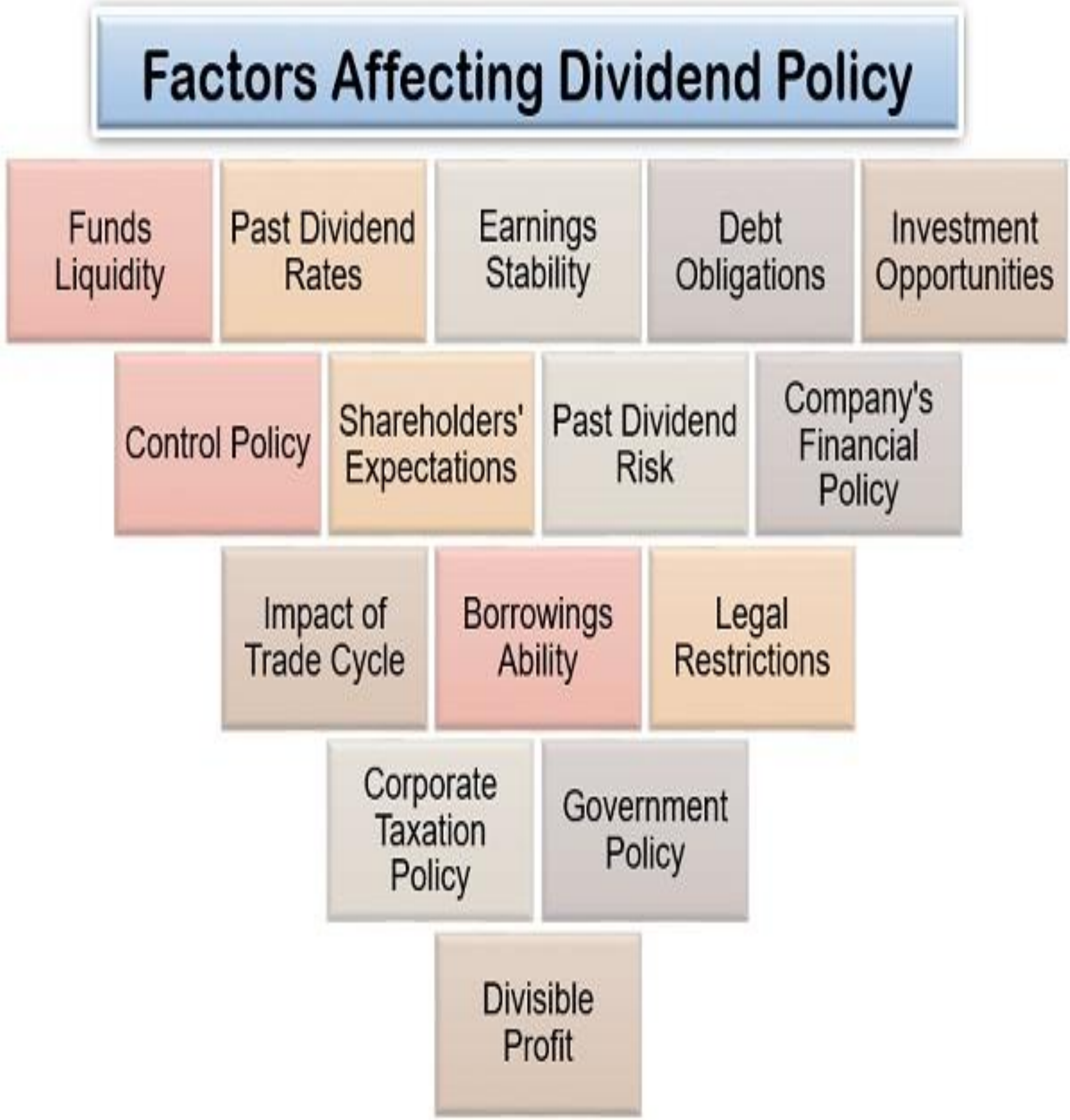
Essentials

Importance

Example

FACTORS AFFECTING DIVIDEND POLICY

Many a time we wonder how a company frames its dividend policy. These dividend decisions of an organization are dependent upon the following determinants



Funds Liquidity: It should be framed in consideration of retaining adequate working capital and surplus funds for the uninterrupted business functioning.

Past Dividend Rates: There should be a steady rate of return on dividends to maintain stability; therefore previous year's allowed return is given due consideration.

Earnings Stability: When the earnings of the company are stable and show profitability, the company should provide dividends accordingly.

Debt Obligations: The organization which has leveraged funds through debts need to pay interest on borrowed funds. Therefore, such companies cannot pay a fair dividend to its shareholders.

Investment Opportunities: One of the significant factors of dividend policy decision making is determining the future investment needs and maintaining sufficient surplus funds for any further project.

Control Policy: When the company does not want to increase the shareholders' control over the organization, it tries to portray the investment to be unattractive, by giving out fewer dividends.

Shareholders' Expectations: The investment objectives and intentions of the shareholders determine their dividend expectations. Some shareholders consider dividends as a regular income, while the others seek for capital gain or value appraisal.

Nature and Size of Organization: Huge entities have a high capital requirement for expansion, diversification or other projects. Also, some business may require enormous funds for working capital and other entities require the same for fixed assets. All this impacts the dividend policy of the company.

Company's Financial Policy: If the company's financial policy is to raise funds through equity, it will pay higher dividends. On the contrary, if it functions more on leveraged funds, the dividend payouts will always be minimal.

Impact of Trade Cycle: During inflation or when the organization lacks adequate funds for business expansion, the company is unable to provide handsome dividends.

Borrowings Ability: The Company's with high goodwill has excellent credibility in the capital as well as financial markets. With a better borrowing capability, the organization can give decent dividends to the shareholders.

Legal Restrictions: In India, the Companies Act 1956 legally abides the organizations to pay dividends to the shareholders; thus, resulting in higher goodwill.

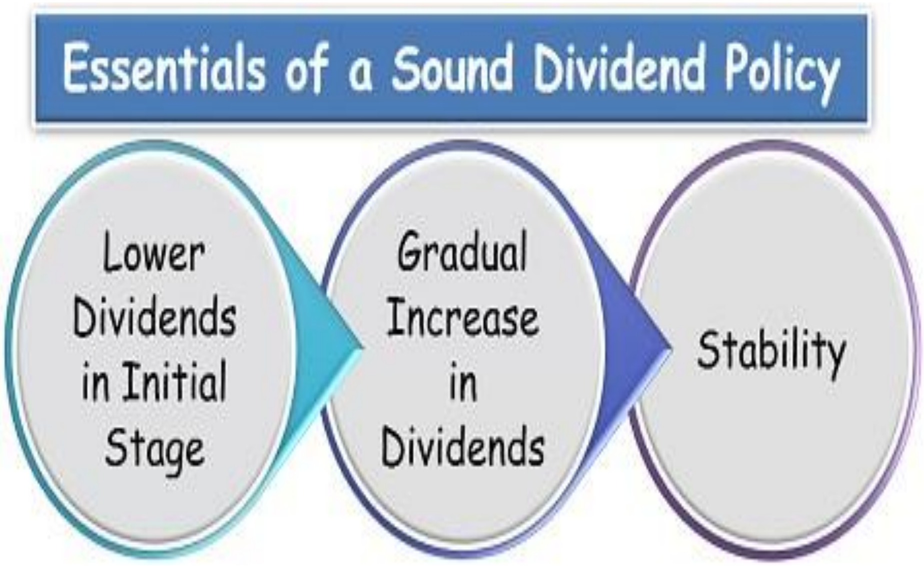
Corporate Taxation Policy: If the organization has to pay substantial corporate tax or dividend tax, it would be left with little profit to pay out as dividends.

Government Policy: If the government intervenes a particular industry and restricts the issue of shares or debentures, the company's growth and dividend policy also gets affected.

Divisible Profit: The last but a crucial factor is the company's profitability itself. If the organization fails to generate enough profit, it won't be able to give out decent dividends to the shareholders.

ESSENTIALS OF A SOUND DIVIDEND POLICY

A company's dividend decisions and policy signify its future and financial well-being. Therefore, it needs to be systematically framed and implemented. Let us see the three essential steps to take flawless dividend decisions:



1. **Lower Dividends in Initial Stage**: When the company is at the beginning stage and earns little profit, it should still provide dividends to the shareholders, though less.

2. **Gradual Increase in Dividends**: As the company prosper and grow, the dividend should be kept on increasing proportionately, to build shareholders' confidence.

3. **Stability**: It is one of the crucial features of a superior dividend policy. When the company can survive in the market, it should ensure a stable rate of return in the form of dividends to its shareholders. This leads to retention of shareholders and gains investors' interest, all resulting in the enhancement of shares market value. Stable dividend policy is the easiest and most

commonly used. The goal of the policy is steady and predictable dividend payouts each year, which is what most investors seek. Whether earnings are up or down, investors receive a dividend. The goal is to align the dividend policy with the long-term growth of the company rather than with quarterly earnings volatility. This approach gives the shareholder more certainty concerning the amount and timing of the dividend.