

Impact Of Dividend Policy On Shareholders Wealth

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Abstract

The payment made by companies to its shareholders in return of the capital invested by them is defined as dividend. In some cases, companies may distribute stock dividends along with the cash dividends which are usually in the form of stock shares which are issued additionally to the shareholders. They are also known as stock splits. The dividend pay-out by companies is a simple way of communicating financial well-being and shareholders' value to all the stakeholders. The maximum the dividend paid out by the maximum is its shareholders value. Dividend pay-out also denotes the financial stability and profit-making capacity of the shareholders. For the purpose of analysis only four factors are considered, three factors are independent and one is dependent. Dividend per share (DPS), earnings per share (EPS) and legged market price per share of the immediate previous period (MPS_{t-1}), these are the independent factors and current market price is the dependent factors. Dividend policy is measured by dividend per share and shareholders wealth is measured by the current market price of share. In this study, it found that there is a highly impact of dividend policy on the shareholders.

Keywords- Dividend, Investment policy, Shareholders, Stocks, Payout ratio

1.1 Introduction

The Dividend Policy is a financial decision that refers to the proportion of the firm's earnings to be paid out to the shareholders. Here, a firm decides on the portion of revenue that is to be distributed to the shareholders as dividends or to be ploughed back into the firm. The amount of earnings to be retained back within the firm depends upon the availability of

investment opportunities. To evaluate the efficiency of an opportunity, the firm assesses a relationship between the rate of return on investments “ r ” and the cost of capital “ K .” As per the dividend models, some practitioners believe that the shareholders are not concerned with the firm’s dividend policy and can realize cash by selling their shares if required. While the others believed that, dividends are relevant and have a bearing on the share prices of the firm.

MILLER AND MODIGLIANI THEORY ON DIVIDEND POLICY

According to **Miller and Modigliani Hypothesis or MM Approach**, dividend policy has no effect on the price of the shares of the firm and believes that it is the investment policy that increases the firm’s share value. The investors are satisfied with the firms’ retained earnings as long as the returns are more than the **equity capitalization rate “ k_e ”**. What is an equity capitalization rate? The rate at which the earnings, dividends or cash flows are converted into equity or value of the firm is known as equity capitalization rate. If the returns are less than “ k_e ” then, the shareholders would like to receive the earnings in the form of dividends.

WALTER’S MODEL

According to the **Walter’s Model**, given by Prof. James E. Walter, the dividends are relevant and have a bearing on the firm’s share prices. Also, the investment policy cannot be separated from the dividend policy since both are interlinked.

Walter’s Model shows the clear relationship between the return on investments or internal rate of return I and the cost of capital (K). The choice of an appropriate dividend policy affects the overall value of the firm. The efficiency of dividend policy can be shown through a relationship between returns and the cost.

- If $r > K$, the firm should retain the earnings because it possesses better investment opportunities and can gain more than what the shareholder can by re-investing. The firms with more returns than a cost are called the “Growth firms” and have a zero payout ratio.
- If $r < K$, the firm should pay all its earnings to the shareholders in the form of dividends, because they have better investment opportunities than a firm. Here the payout ratio is 100%.

- If $r=K$, the firm's dividend policy has no effect on the firm's value. Here the firm is indifferent towards how much is to be retained and how much is to be distributed among the shareholders. The payout ratio can vary from zero to 100%.

GORDON'S MODEL

The **Gordon's Model**, given by Myron Gordon, also supports the doctrine that dividends are relevant to the share prices of a firm. Here the **Dividend Capitalization Model** is used to study the effects of dividend policy on a stock price of the firm. Gordon's Model assumes that the investors are risk averse i.e. not willing to take risks and prefers certain returns to uncertain returns. Therefore, they put a premium on a certain return and a discount on the uncertain returns. The investors prefer current dividends to avoid risk; here the risk is the possibility of not getting the returns from the investments. But in case, the company retains the earnings; then the investors can expect a dividend in future. But the future dividends are uncertain with respect to the amount as well as the time, i.e. how much and when the dividends will be received. Thus, an investor would discount the future dividends, i.e. puts less importance on it as compared to the current dividends.

According to the Gordon's Model, the market value of the share is equal to the present value of future dividends. It is represented as:

$$P = [E (1-b)] / Ke-br$$

Where, P = price of a share

E = Earnings per share

b = retention ratio

1-b = proportion of earnings distributed as dividends

Ke = capitalization rate

Br = growth rate

SHAREHOLDER WEALTH

Shareholder wealth is defined as the present value of the expected future returns to the owners (that is, shareholders) of the firm. These returns can take the form of periodic dividend payments and/or proceeds from the sale of the stock. Shareholder wealth is measured by the market value (that is, the price that the stock trades in the marketplace) of the firm's common stock.

1.2 REVIEW OF LITERATURE

Most of people selected these variables to check the impact of dividend policy on shareholders wealth like dividend per share, return on equity, and profit after tax & dividend payout ratio and their impact on market price per share. (Ansar et al., (2015); Hunjra et al. (2014); Masum, A. A., (2014); Sharif, I., (2015) &Majanga, B. B., (2015) found that the return on equity shows the negative impact on market price per share and other factors show positive effects on market price and share holders wealth. In some studies, profit after tax, dividend per share and retained earnings considered as a controllable variable and it has insignificant impacts on stock prices.(Sharif, I., (2015).Retained earnings per share, legged price earnings ratio and legged market price is also analyzed by some researchers(Ansar et al., 2015; Kaur, S. &Kaur, P., 2013; Azhagaiah, R. &SabariPriya, N., (2008))and to checked their impact on current market price of shares. In some cases the impact of retained earnings per share on shareholders wealth is negative; it is explored by (Masum, A. A., (2014); Khan, I. K. (2012)). Dividend yield and earnings per share these factors also a lot analyzed by the people and their effects on the stock price. (Hunjra et al., (2014); Czerwonka, L., (2012); Yegon, C., (2014); Matthew et al., (2014); Gul, et al., (2012); Dhungael, A., (2013); Masum, A. A., (2014); Sharif, I., (2015); Majanga, B. B., (2015); Khan, I. K. (2012). In one study the dividend yield had shown the negative relation and impact on shareholders wealth. (Hunjra et al., (2014)).In two papers return on assets also determined by the persons and their impacts on the stock price was positive. (Amidu, M., (2007); Yegon, C., (2014)).There are some factors those are considered in the study and analyzed as a controllable variable, like- policy, and pay, size of firm, leverage and growth in

sale. (Amidu, M., (2007)). Growth in sale has positively related with the share prices and other factors are negatively related with the share prices. In this mostly people used the independent factors like DPS, EPS and legged MPS. That's why, these factors also studied by me in my study.

1.3 Research Methodology

For the purpose of analysis only four factors are considered, three factors are independent and one is dependent. Dividend per share (DPS), earnings per share (EPS) and legged market price per share of the immediate previous period (MPS_{t-1}), these are the independent factors and current market price is the dependent factors. Dividend policy is measured by dividend per share and shareholders wealth is measured by the current market price of share. Here we are going to check the impact of dividend per share, earnings per share and legged market price on the current market price. For the analysis, top 50 companies are selected listed in BSE. Out of the sample of 50 companies only 43 companies has provided the accurate data for 2 financial years from 2015-2016. For the analysis the SPSS software was used and calculated the correlation and regression.

Objectives:-

1. To determine the impact of dividend policy on shareholders' worth.
2. To recommend dividend decision strategies in light of the results.

Operationalization and Hypotheses:-

In this dividend per share and earnings per share are used to measure the dividend policy and current market price of share is used to measure the shareholders wealth but legged market price of share is used as proxy for shareholder wealth. MPS is the dependent variable and other variables are independents.

1. H_0 = There is no significant relation between DPS and MPS.
 H_1 = There is significance relation between DPS and MPS.
2. H_0 = There is no significance relation between EPS and MPS.
 H_1 = There is significance relation between EPS and MPS.
3. H_0 = There is no significance relation between MPS_{t-1} and MPS.

H₁ = There is significance relation between MPS_{t-1} and MPS.

Regression model:-

To determine the impact of dividend policy on shareholders wealth the following regression equation has been used:-

$$MPS = a + b \text{ DPS} + c \text{ EPS} + d (\text{MPS}_{t-1}) + e$$

MPS = Current market price of share

DPS = Dividend per share

EPS = Earnings per share

MPS_{t-1} = Legged market price of share.

1.4 Data Analysis and Interpretation

Table2. Descriptive Statistics

	Mean	Std. Deviation	N
MPS2016	1960.9651	4257.06229	43
DPS2016	15.3784	17.96611	43
EPS2016	67.7781	93.02988	43
MPS2015	2241.2084	4737.91674	43

Descriptive statistics table tells us the mean and standard deviation of the each variable in our data. In this table the average market price per share is 1960.9651. And the standard deviation is 4257.06229. There are total number of companies is 43.

Table 3. Correlations

Correlations					
		MPS2016	DPS2016	EPS2016	MPS2015
Pearson Correlation	MPS2016	1.000	.684	.950	.954
	DPS2016	.684	1.000	.715	.736
	EPS2016	.950	.715	1.000	.884
	MPS2015	.954	.736	.884	1.000
Sig. (1-tailed)	MPS2016	.	.000	.000	.000
	DPS2016	.000	.	.000	.000
	EPS2016	.000	.000	.	.000
	MPS2015	.000	.000	.000	.
N	MPS2016	43	43	43	43
	DPS2016	43	43	43	43
	EPS2016	43	43	43	43
	MPS2015	43	43	43	43

This is a correlation matrix which shows the three things. First, it shows the value of the Pearson correlation coefficient between the every pair of variables, like:- EPS ($R^2 = 0.950$) and legged MPS($R^2 = 0.954$) are highly correlated with the MPS. DPS is not so highly correlated with the MPS that is ($R^2 = 0.684$). Second, one tailed significance of each correlation is displayed like:- correlation above is significant, $p < 0.05$. Finally, the number of cases contributing to each correlation (N= 43) is shown. All the variables are best with outcomes.

Table 4.Variables Entered/Removed

Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	MPS2015, DPS2016, EPS2016 ^b	.	Enter

a. Dependent Variable: MPS2016

b. All requested variables entered.

Since there wasn't any need to carry out the work more exploratory, so entire method was used.

Table 5.Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.984 ^a	.967	.965	796.68109	.967	386.741	3	39	.000	1.510

a. Predictors: (Constant), MPS2015, DPS2016, EPS2016

b. Dependent Variable: MPS2016

This table tells us what the dependent variable (outcome) was and what the predictors were in each of the one model in the columns labeled R are the values of the multiple correlation coefficient between the predictors and the outcome. When lagged MPS, DPS and EPS are used as a predictors. This is the simple correlation between legged MPS, DPS, EPS and MPS

(0.984). the next column give us a value of R^2 , which we already know is a measure of how much of the variability in the outcome is accounted for by the predictors. For the model its value is 0.967 which means that legged MPS, DPS and EPS accounts for 96.5% of the variation in MPS. The adjusted R square gives us some idea of how well our model generalizes and ideally we would like its value to be the same, or very close to, the value of R square. The value of adjusted R square is 0.965. In this the p-value is less than 0.05, that's why results are significant. Durbin Watson tells us about whether the assumption of independent errors is tenable. If it closer to 2 that the value is the ideal, for these data the value is 1.510, which is moderately good.

Table 6: Anova

ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	736395003.538	3	245465001.179	386.741	.000 ^b
	Residual	24753329.628	39	634700.760		
	Total	761148333.166	42			
a. Dependent Variable: MPS2016						
b. Predictors: (Constant), MPS2015, DPS2016, EPS2016						

This table contains analysis of variance that tests whether the model is significantly better at predicting the outcome than using the mean as a 'best guess'. Especially the f-ratio represents the ratio of the improvement in prediction that results from fitting the model, relative to the inaccuracy that still exists in the model. In this, sum of square represents the improvement in the prediction resulting from fitting from a resulting line to the data rather than using the mean as an estimate of the outcome and its value is 736395003.538. We are also told the

residual sum of square that represents the total difference the model and observed data and its value is 24753329.628. in this the degree of freedom is 39 and F-ratio is calculated divided by mean square value to the sum of squares that is 386.7411 that is also good and significance value is also less than 0.05 that is best for the results.

Table 7. Coefficients

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics		
	B	Std. Error	Beta			Tolerance	VIF	
	1	(Constant)	-406.143			175.362		-2.316
	DPS2016	-26.886	10.327	-.113	-2.603	.013	.439	2.278
	EPS2016	23.965	2.887	.524	8.302	.000	.210	4.772
	MPS2015	.516	.059	.574	8.819	.000	.197	5.084

a. Dependent Variable: MPS2016

In this table the p-value is less than 0.05 in each variable, it means all analysis is significant. The b-value of DPS shows the negative relation with the current market price of share and its value is -26.886, EPS and legged market price of share shows positive relation with the current market price and its b-value is 23.965 and .516 respectively. There are no problems of the multi-co linearity because every value of VIF is less than 10 so it is good for the results.

1.6 Conclusion

The results of this overall regression analysis are highly significant because the p-value of ANOVA is less than 0.05. The results of first hypothesis, that is, dividend per share has negative relation with the current market price but its p-value is less than 0.05 that’s why it is significant and its null hypothesis is rejected but in the study of **Ansar et al. (2015)** has positive relation of dividend per share with the market price of share. The results of second and third hypothesis, that are earnings per share and legged market price of share, are also significant because the p-value is less than the 0.05 and has positive relation with the current

market price so these null hypothesis are also rejected. It means there is a highly impact of dividend policy on the shareholders wealth.

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