

# CHAPTER 1

## INTRODUCTION

### 1.1 BACKGROUND

Dividend is a part of company's profit which is distributed among its shareholders. Formulating a proper dividend policy is most important for every business enterprise. The main purpose of dividend policy is to send signals to present investors and attract new investors to the firm. Dividend decision determines the division of profit into two parts that is payment to shareholders and retained earnings. Dividend policy is a crucial one for the firm as it may affect its share price and its performance.

Dividend policy is an vital area in corporate finance and it consider as a tool to signaling the financial performance and growth of the business enterprise to the investors. Dividend policy determines how firm profits are distributed. Profits are either retained in the business or paid as dividend to shareholders.

One of the underlying principle of financial management is that corporate managers make effective framework of dividend decision which increase the value of investors and also the market price of share. Dividends are strongly described as rewards to investors in the form of distribution of profits and as an important determinant of the market value of share (McLaney, 1997).

Dividend policy determines dividend decision of the company that affects dividend payout of the company compared to the retained amount of earnings of the company. The amount of dividend distribution get reduce that will lead to retain more funds for investment in the company. Dividend decision differs from company to company because it differs in sizes, ownership structures, etc. An effective dividend decision is taken on the basis of shareholders return and firm value and also some other important factors that determine dividend policy are investment opportunities, profitability, legal restrictions, liquidity, control, inflation (Weston and Brigham, 1972). The dividend decision is an essence of shareholders earnings and growth of the company (Adelegan, 2008).

## **1.2 DIVIDEND POLICY**

Dividend is the share of firm's earnings that is distributed by the firm to its shareholders and the consideration that shareholders receive the shares from company. Dividend policy defined as the dividend distribution guidelines framed by the board of directors of the company. Dividend policy of the company needs to be systematically framed and implemented that dividend decision signifies the future financial health of the company.

## **1.3 DETERMINANTS OF DIVIDEND POLICY**

In the company, framing an appropriate dividend policy is the most challenging function of the management. The determinants of dividend policy are explained below,

### **a. Stable earnings**

Stability in earnings is one of the key factors in influencing the dividend policy. The stable earnings of a firm performs better and slightly to pay out a higher proportion of its earnings as dividends.

### **b. Liquidity**

The liquidity position of a concern is very important for any concern for its dividend decisions. According to Guthmann and dougall, although it is customary to speak of paying dividends 'out of profits', a cash dividend only be paid from money in the bank. The presence of profit is an accounting phenomenon and a common legal requirement, with the – cash and working capital position is also necessary in order to judge the ability of the corporation to pay a cash dividend. Dividend payment means a cash flow and thus a higher cash position and liquidity of a concern is determined by its investment and financing decisions.

### **c. Past Dividend**

In an already existing firm, the dividend rate is determined on the basis of the dividends disposed in the previous years. To maintain stability is deemed better for any concern in determining the rate of dividend.

#### **d. Growth**

The growth need of the company is another crucial factor in determining the rate of dividend. When a company is in a position to expand its business, it is not easy for the company to declare a higher rate of dividend while for an already expanded company; the rate of dividend can be higher.

#### **e. Legal Restrictions**

The dividend policy of a company is based on the legal provisions and restrictions. According to Indian companies' act 2013, section 123 the dividend should be paid only out of the current profits or past profits after providing for depreciation. In case if there are any accumulated losses in the previous years, those should be set off against current years profit before declaring the dividends.

#### **f. Earnings Per Share**

High dividend payout ratio of a company affects its liquidity position adversely and will lead to issue of new equities in the near future. It might lead to an increase in the number of equities and ultimately reduces the earning per share. If the dividend payout ratio is low, the firm can retain and plough back a higher proportion of its earnings resulting to increase in future earnings and earnings per share.

#### **g. Attitude of the Investors**

Every concern may have a group of powerful shareholders and these shareholders may have a say in the payment of dividend. In case if such shareholders or not of opinion in paying a higher rate of dividend then the firm may declare a low rate of dividend and vice versa.

#### **h. Investment Opportunities**

Investment made in financial instruments such as new shares bonds securities etc., are financial investments. Investments in plant and equipment, land and building etc., are real investments. A concern should find appropriate investment opportunities which are the basis for the earning power and value of the concern.

## **i. Nature and Size of Firm**

Nature and size of firm is another influential factor of dividend policy. Generally, a big organisation will require more funds than that of small organisations. Additionally, some businesses will need a huge amount of investments in fixed assets and low in current assets. While trading and financial firms have a very low investments in fixed assets and huge amount to be invested in working capital. Hence, the dividend policy depends upon the size of the business.

## **1.3 NSE NIFTY INDEX**

The NIFTY fifty is owned and managed by National Stock Exchange index limited. Since April 21<sup>st</sup> on 1996 index has been trading and is well suited for benchmarking, index fund and index based derivatives. The Nifty fifty Index includes major sectors of the Indian economy. It portrays the top 50 equity stocks traded in stock exchange out of a total 1600 stocks. The stocks includes 12 sectors of the economy, information technology, financial services, consumer goods, entertainment and media, metal, pharmaceutical, telecommunication, cement and its products, automobiles, pesticides and fertilizers, energy and other services.

### **Financial Sector**

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firm and new entities entering in the market. The sectors includes commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial supporting entities. The government of india has introduced kinds of reforms to liberalize, regulate and enhance the finance sector.

### **Automobile Sector**

India became fourth largest car manufacturer and seventh largest commercial vehicle manufacturer. Indian automotive industry is expected to reach Rs.16.19 to 18.19 trillion by 2026. The government aims to develop india as a global manufacturing and research and development umbrella. The government of india expects in automobile industry to attract 9-10 billion foreign investment by 2023.

## **Energy Sector**

The energy sector consists of a large group of inter-related companies that cover a wide variety of energy. Energy companies also make substantial spending on research and development. Energy sector consists of a large group of inter-related companies that cover a wide variety of energy. Energy businesses incur large capital expenditures, and they own large amounts of fixed assets.

## **Pharmaceutical Sector**

India is the largest provider of generic drugs globally. Indian pharmaceutical sector supplies over 50 percent of global demand for various vaccines, 40 percent of generic demand in the United States and 25 percent of all medicine in the London. India enjoys an important position in the global pharmaceutical sector. Indian pharmaceutical sector is expected to grow to US Dollar 100 billion, while medical device market is expected to grow US dollar 25 billion by 2025.

## **Information Technology Sector**

The global sourcing market in India continues to grow at a higher pace compared to the IT-BPM industry. India is the leading sourcing destination across the world. India has become the digital capabilities hub of the world with around 75 percent of global digital talent present in the country. Indian IT core competencies and strengths have attracted significant investment from major countries. Leading Indian IT firms like Infosys, Wipro, TCS and Tech Mahindra are diversifying their offerings and showcasing leading ideas in blockchain and artificial intelligence.

## **Metal Sector**

India is the second largest producer of coal. India is the second largest crude producer in the world. Coal share in India's primary energy consumption is expected to be 48 percent in 2040. India's steel consumption rises 7.5 percent year on year. Coal production grew at CAGR 4.6 percent over financial year 2014 to 2020.

#### **1.4 SCOPE OF THE STUDY**

The firm value mainly depends on the amount of dividend paid to the shareholders. It is an important and challenging task of the manager for framing the sound dividend policy. Payment of dividend leads to increase the share price of the company. The company always wants return to pay dividend to the investors. The company wants to survive in the market, it should ensure a stable dividend policy it leads to retain the investors and increase the market value of share.

The research study considers 34 companies from NIFTY 50 index. It consists of financial sector (8 companies), Automobile Sector (5 companies), Energy Sector (8 companies), Pharmaceutical Sector (4 companies), Information Technology Sector (5 companies), and Metal Sector (4 companies). The study covers a period of fifteen years from 2004-05 to 2018-19. The required data collected from Prowess database.

The research study facilitates wide scope to these sectors to take strategic dividend decisions and it leads to provide wider scope of these sectors to increase their efficiency, profitability and market value of the share.

#### **1.5 STATEMENT OF THE PROBLEM**

Dividend decisions signify firm's future growth and financial soundness. Then it is necessary to be thoroughly framed and carried out. Dividend decision is important in each business enterprise for which the reason is to increase shareholders' confidence and company's future prospect. A firm's dividend policy generally affects the growth of the firm, market price of the share and ultimately the value of the firm. The previous literature identifies some studies have concentrated on analysing the determinants of dividend policy, and some showed the relationship of dividend policy and firm's performance. Few other studies analysed the effect of dividend policy on share price. Hence, the study proposes to carry on the research in order to fill the research gap covering the impact of dividend policy on profitability and share price of nifty companies.

## **1.6 INVESTIGATIVE QUESTIONS**

In consideration of above mentioned research problem, the following questions were framed,

- What are the factors determining the dividend policy of the selected companies?
- Whether there exists impact of dividend policy on profitability of the selected companies?
- Does the dividend policy affect market price of share of the selected companies?

## **1.7 RESEARCH OBJECTIVES**

Based on the above research questions, the effect of dividend policy on profitability and share price of NIFTY companies analysed with the following objectives,

- To identify the factors that determines the dividend policy of select nifty companies.
- To examine the impact of dividend policy on profitability of select nifty companies.
- To analyse the impact of dividend policy on share price of select nifty companies.

## **1.8 RESEARCH HYPOTHESES**

The hypotheses framed for the research purpose of the study are as follows,

- The factors determining dividend policy of companies do not vary significantly among different sectors.
- Dividend policy does not have significant effect on profitability of select nifty companies.
- Dividend policy does not have significant effect on share price of select nifty companies.

## **1.9 LIMITATIONS OF THE STUDY**

The study considers following as limitations,

- The data collected for the research study was only from secondary sources.
- All the NIFTY index 50 companies were not included in the study, as they did not achieve the selection criteria.

## **1.10 CHAPTER SCHEME**

The research study is organized under the following five chapters.

### **Chapter I: Introduction**

This chapter presents introduction, scope of the study, statement of the problem, research objectives, research hypotheses and limitations of the study.

### **Chapter II: Review of Literature**

This chapter summarizes the review of various studies conducted in the area of research pertaining to the objectives of the study.

### **Chapter III: Research Methodology**

This chapter illuminates on data collection, period of study, sample selection and statistical tools used for analysis.

### **Chapter IV: Results and Discussion**

This chapter contains the results obtained from the analysis of data and inferences drawn from the results.

### **Chapter V: Summary and Conclusion**

This chapter enlightens the summary of findings and suggestions that are attained from the analysis of data.