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Address:-Ashok Yakkaldevi 258/34, Raviwar Peth, Solapur - 413 005 Maharashtra, India
Cell : 9595 359 435, Ph No: 02172372010 Email: ayisrj@yahoo.in Website: www.isrj.org

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THE IMPACT OF DIVIDEND POLICY ON STOCK PRICE - A CASE STUDY OF SELECT COMPANIES.

K. Ramu
Lecturer, Sandeepani Degree College, Kamareddy , Telangana State.

ABSTRACT

The main purpose of this study is to examine the impact of dividend policy on share price with a focus on select companies. One of the significant of financial decision is the allocation of earnings per share to two sections of dividend and retained earnings. Since the primary objective of financial management of firms, i.e. the dividend policy is one of the most important issues in financial management this is the main optioned decision which the managers will face.

KEYWORDS: *Dividend Policy , extensive literatures, theories, and models .*

INTRODUCTION :

The manager has to decide how much of the corporate income should be divided and how much, retained earnings should be reinvested in the firm. Dividend decision is the one of the important decisions of the corporate firm has been still a most debated issue across the world. There are many extensive literatures, theories, and models for facilitating dividend decisions. Although there have been a host of research efforts by different scholars in strongly deciding what appears to be optional dividend policy for firms, there is no universally accepted theory through out the literature explaining the dividend payout and retention choice of firms. But in the last decades, several theories have emerged explaining firms' dividend policy and the resultant effects on their market values. These theories include the dividend irrelevance theory which assets dividend do not really matter because they do not affect the firm value (Modigliani-miller 1961); the dividend relevance theory which assets dividend policy affect the value of a firm. The choice if dividend policies almost always affects the value of the firm (Walter, 1963). The dividend policy does affect value of a share even when rate of return equal to cost of capital (Gordon, 1962).

LITERATURE REVIEW

Dividend policy has been subject of investigation and debate for almost 50years, most of it conducted in the United Kingdom. Before regression analysis was applied by john Lintner in 1956 to the behavior of a small group of industrial companies, dividends were good and should be maximized by firms wherever possible. Lintner, who showed that firms adopted and tended to adhere to optimal long-term dividend pay-out ratios which were relatively stable, suggested that managers would only raise a firm's dividend it they were confident that the firm's future earnings could be maintained at a consistently higher level in the future. An implication of this was that the announcement of a dividend increase might convey useful information about future earnings.

Initial forays into explaining corporate dividend policy are divided as to their prediction of dividend payments effects on share prices. Three streams of thinking seem to be offered: one is explaining dividends as attractive and positive influence on stock price, the second argues that stock prices are negatively correlated with dividend payout levels, and a third avenue of empiricists maintain that the firm's dividend policy is irrelevant in stock price valuation. In this chapter a brief overview various theoretical modeling and empirical investigations by financial economists is given.

The dividend irrelevance theory of Modigliani and miller (1961) proposed the absence of any significant impact of the dividend policy on the value of shares because it's impact is offset exactly by other means of financing and is thus irrelevant. This theory was formulated by assuming perfect market conditions, which didn't take into account the imperfection like taxes, transaction cost or asymmetric information. Consequently, dividend policies have little impact on the market value of the firms. In a perfectly competitive market situation both the company, through its profit retention, and the shareholders, through their dividends, might invest in the same assets, and hence, who's making the investment does not matter for the economic as a whole. However, since the capital market is neither perfect nor complete the dividend irrelevance proposition needs to be applied carefully focusing on effects of taxes, information content, agency cost and other relevant affecting variables.

The Gordon model (1959) stock valuation model states the fair value of a stock should equal to the stock-dividend per share and the difference between the discount rate and the long-term dividend growth rate. The model assumes that the firm's dividend will grow at a constant rate and that the discount rate stays the same forever. The theory suggests if there will be an increase in dividend rate there will be simultaneously an increase in stock value of the firm.

Fama and Babiak (1968) analyzing the Lintner model on the dividend policy maintained that firms will try to increase the dividend only when the dividends can be sustained in future. Black (1976) finds no convincing explanation of why companies pay dividends to their shareholders.

However, in a related study, Booth and Cleary (2001) in their study concluded that a firm's dividend policy is affected by profitability, size, debt, risk, tangibility and growth.

Kania and Bacon (2005) examined the impact of profitability, growth, risk, liquidity and expansion on the dividend decision/policy of a corporation by analyzing the financial data of over 10,000 publicity traded firms. The study concluded that the dividend payout ratio is significantly affected by the profitability, growth, risk and liquidity.

Anil and Kapoor (2008) in their paper examined the determinants of dividend payout ratio of the Indian information technology sector. For the pooled data for seven years, they observed that cash flows, corporate tax, sales growth and market-to-book value ratio do not explain the dividend payment pattern that existed in the information technology industry. However, liquidity and beta (year to year variability in earnings) were found to be noteworthy determinants.

Given the above background, the study makes an attempt to examine the effect of dividends and retention earnings on the stock price behavior in Indian corporate sector in a partial macro economic frame work.

OBJECTIVES OF THE STUDY

The principal objective of the study is to evaluate the effect of dividend policy on share price of some selected listed companies in India. To accomplish this objectives following specific objectives have covered.

- To find the relation between the shares market price and the dividend policy of the Indian firms.
- To measure the impact of the firm's dividend policy on its shares market price.
- To find the impact of dividend announcement on shareholder's wealth.
- To investigate the association between various ownership groups and dividend payout policies of Indian corporate firms.
- To analyze the influence of firms' characteristics like profitability, growth, risk, cash flows, agency cost and on dividend payment pattern i.e. to identify various determinates of dividend payout.

• To evaluate the dependency of dividend per share and retained earnings on share price.

METHODOLOGY OF THE STUDY:

- This study is based on the primary and secondary data. This study covers four companies -Wipro technologies, Infosys Ltd, Dr. Reddys laboratories and Bajaj auto Ltd from each company for the period of 2010 to 2014. The convenience sampling technique is to be used for the collection of primary data. The data will be analyzed by using the different types of statistical techniques like percentages, averages growth rates, chi-square test and t-test etc..
- The study based on secondary data and annual report of each company collected as a source of secondary data.

LIMITATION OF THE STUDY:

This study focused basically the relationship pattern of NPV and dividend policy and show the importance of dividend policy in share price that intern effect the wealth maximization goal of a firm. The study used only data for five years and selected Wipro technologies, Infosys LTD, Dr.reddys laboratories Ltd, Bajaj auto Ltd. This study covers few listed companies based on which data; it reveals that dividend policy significantly effects on stock holders return. Above mentioned study does not cover analyze the MPPS on other factors in listed companies which creates an opportunity to deal with through investigation.

Volume - 6 | Issue - 11 | December - 2016

SCOPE OF THE STUDY

This study basically attempts to examine some of the features that determine the behavior of firms' dividend payouts ratio in India. To accomplish this objective, the annual reports for the period 2013-2014 were analyzed. And it is restricted only of irrelevance theory Modigliani-Miller model, relevance theory Garden model and also some of the leading theories have been discussed on dividend policy same only last one year data of a company had been taken. The study can be further extended for long tenure, various sectors, and economic cycles and for irrelevance theories also.

INDUSTRY PROFILE

Bombay stock exchange is a leading stock market in India since its inception. It was established in 1875 in Mumbai, Maharashtra in India. BSE is the 10th largest stock exchange in the world by market capitalization. Over the last 137 years, BSE has facilitated the growth of the Indian corporate sector by providing it an efficient capital-raising platform.

The S&P BSE SENSEX is the index of Bombay stock exchange. It also called the BSE 30 or simply the SENSEX, it is the index companies of 30 reputed companies in India on the base of a free-float market weighted stock.

The 30component companies which are some of the largest and most actively traded stocks are benchmark of various industrial sectors of the Indian economy.

The S&P SENSEX is key index of Bombay stock exchange.

FOLLOWING COMPANIES ARE SELECTED FOR THE STUDY;

- Wipro Technologies,
- Infosys Ltd,
- Dr. Reddy's laboratories Ltd,
- Bajaj auto Ltd.

Wipro Technologies

S.NO	Firm Name	Value/NPV	Dividend	Date	Next Dividend Date	NPV	Change in NPV
1	Wipro	426		4/1/2010	27/01/2011	437	11
2	Wipro	437	100	27/01/2011	29/06/2011	429	-8
3	Wipro	429	200	29/06/2011	24/01/2012	402	-27
4	Wipro	402	100	24/01/2012	28/06/2012	398	-4
5	Wipro	398	200	28/06/2012	23/01/2013	387	-11
6	Wipro	387	100	23/01/2013	27/06/2013	326	-61
7	Wipro	326	250	27/06/2013	22/01/2014	553	227
8	Wipro	553	150	22/01/2014	21/07/2014	526	-27
9	Wipro	526	250	21/07/2014	22/01/2015	576	50
10	Wipro	576	250	22/01/2015	29/06/2015	555	-21

If we do analysis of NPV of stock over different time periods during which dividend is declared by the firm it is noticed that even after the declaration of dividend there is no sign of any growth at all in stock price not even minute growth. But the periods between 27/6/2013 and 22/1/2014 and between 21/7/2014 and 22/1/2015 are rare exemptions from the analysis of the remaining periods. During the former period mentioned above there is substantial growth of stock price by almost 70% where as during the latter period it is an average growth of measly 10%. Hence I strongly feel that the dividend policy of the firm does not have any strong impact on share price.

Volume - 6 | Issue - 11 | December - 2016

Infosys Ltd

S.NO	Firm Name	Value/NPV	Dividend	Date	Next Dividend Date	NPV	Change in NPV
1	Infosys	654		4/1/2010	21/10/2010	789	135
2	Infosys	789	800	21/10/2010	26/05/2011	709	-80
3	Infosys	709	400	26/05/2011	20/10/2011	667	-42
4	Infosys	667	300	20/10/2011	25/04/2012	597	-70
5	Infosys	597	640	25/04/2012	18/10/2012	592	-5
6	Infosys	592	300	18/10/2012	30/05/2013	583	-9
7	Infosys	583	540	30/05/2013	17/10/2013	833	250
8	Infosys	833	400	17/10/2013	29/05/2014	798	-35
9	Infosys	798	860	29/05/2014	16/10/2014	966	168
10	Infosys	966	600	16/10/2014	15/06/2015	1011	45

When we analyze the NPV of stock over different time periods during which dividend is declared by the firm there is no positive sign of any growth at all in stock price from the period 21/10/2010 and 26/05/2011 to 18/10/2012 and 30/05/2013 inspite the declaration of dividend. But surprisingly there is substantial growth in stock price after the above mentioned periods in almost every period except during 17/10/2013 and 29/05/2014 period where there is minus growth. Hence I have come to conclusion that there has been fluctuating growth of stock price and the dividend policy of the firm has the mixed impact on share price.

D.R Reddys Laboratories Ltd

S.NO	Firm Name	Value/NPV	Dividend	Date	Next Dividend Date	NPV	Change in NPV
1	Dr.Reddys'	1283		4/1/2010	30/6/2011	1514	231
2	Dr.Reddys'	1514	225	30/6/2011	28/06/2012	1628	114
3	Dr.Reddys'	1628	275	28/06/2012	12/7/2013	2278	650
4	Dr.Reddys'	2278	300	12/7/2013	11/7/2014	2678	400
5	Dr.Reddys'	2678	360	11/7/2014	2/7/2015	3568	890

If we do analysis of NPV of stock over different time periods during which dividend is declared by the firm it is noticed that after the declaration of dividend there has been tremendous and unachievable growth in stock price except in two periods 30/06/2011 and 28/06/2012. So I note with conviction that the dividend policy of the firm has strong impact on the share price.

Bajaj Auto Ltd

S.NO	FIRM NAME	VALUE/NPV	DIVIDEND	DATE	NEXT DIVIDEND DATE	NPV	CHANGE IN NPV
1	Bajaj auto	**1005**		1/4/2010	8/7/2010	1241	236
2	Bajaj auto	**1241**	400	8/7/2010	29/6/2011	1424	183
3	Bajaj auto	**1424**	400	29/6/2011	5/7/2012	1486	62
4	Bajaj auto	**1486**	450	5/7/2012	4/7/2013	1898	412
5	Bajaj auto	**1898**	450	4/7/2013	3/7/2014	2289	391
6	Bajaj auto	**2289**	500	3/7/2014	2/7/2015	2575	286

If we do analysis of NPV of stock over different times periods during which dividend is declared by the firm it is noticed that after the declaration of dividend there has been tremendous and unachievable growth in stock price except in two periods 29/6/2011 and 5/7/2012. So I note with conviction that the dividend policy of the firm has strong impact on the share price

CONCLUSION:

This study has investigated the relationship between issue of the dividend and impact on NPV. It is hypothesized that there is no constant effect of dividend policy on the share price. This study has shown that there is no positive relationship between the NPV and DIVIDED in some situations. But most probably in some situations there is a Dividend impact on the NPV. So there is a positive relationship between DIVIDEND and NPV in some situations. The study has proved that there is no significant effect of dividend policy and NPV which support the irrelevance theory of the dividend policy.

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K. Ramu
Lecturer, Sandeepani Degree College, Kamareddy , Telangana State.