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DETERMINATION OF DIVIDEND POLICY OF PUBLIC LISTED COMPANIES

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ABSTRACT

Explaining why companies pay dividend and some do not pay dividends is still problematic to explain and therefore dividend policy remains controversial. The overall objective of a company's dividend policy is 'maximising shareholders' wealth' since it is the aim of every investor to get a return from his investment. A well regulated stock market is a devising force for overall economic development and should has a spin-off effect on the dividend policy of public sector undertakings. This article narrates Public sector undertakings (PSUs) dividends in financial year 2017.

KEYWORDS

dividend policy, maximising shareholders' wealth, public sector undertaking.

INTRODUCTION

The primary concern of any dividend policy is to determine the dividend payout and retention. Ronald C. Lease et.al (2000) described it as the practice adopted by managers in making dividend payout decisions. The dividend policy frames out the guidelines about how much amount of cash is to be distributed to the shareholders and what is to be retained by the company for further investment. The overall objective of a company's dividend policy is 'maximising shareholders' wealth' since it is the aim of every investor to get a return from his investment. A well regulated stock market is a devising force for overall economic development and should has a spin-off effect on the dividend policy of public sector undertakings. Therefore, dividend policy is a fundamental corporate finance issue due to its significance impact on investment and financing decisions.

If a company decides not to pay or pay fewer dividends, the company will have more retained earnings thus reducing its reliance on external sources of finance on the other hand, if the company pays higher dividend it will result in less internal earnings, thus increasing the company's dependence on other sources of finance like debt financing. This implies that the decision of the company to raise funds for its functioning is directly linked with the dividend policy. In other words, as the dividend policy influences the capital structure of a company, it will also have an influence on the investment decision and cost of capital of the company.

LITERATURE REVIEW

Dividend policy has been analyzed for many decades, but no universally accepted explanation for companies observed dividend behavior has been established. Brealey & Myers (2005) described dividend policy as one of the top ten most difficult unsolved problems in financial economics. Al-makawi (2007) asserted that dividend payment affects the value of the firm hence dividend relevant theory.

Explaining why companies pay dividend and some do not pay dividends is still problematic to explain and therefore dividend policy remains controversial. Some researchers like Amidu and Abor (2006) believe that setting dividend policy involves judgmental decision making and that there has been emerging concern that there is no single explanation of dividend.

The leverage shows total debt as a percentage of the shareholders' fund and it also measures the extent to which a firm is financed by external funds (Al-Najjar & Hussainey 2009). A mounting number of studies have found that the level of financial leverage negatively affects dividend policy (Gugler and Yurtoglu, 2003; Al-Malkawi, 2005)

DETERMINANTS OF DIVIDEND POLICY:

An appropriate dividend policy should be capable of answering the following questions.

- How much dividend should a company distribute to its shareholders?
- What will be the impact of the dividend policy or share price of the company?
- What will be the impact of the dividend policy or the retained earnings of the company?
- What will happen if the amount of dividend changes from year to year?
- How will the dividend policy impact the composition of capital structure of the company?
- What will be the tax implications of a dividend policy?

Some of the determinants of dividend policy are discussed below:

1. *Dividend payout ratio:*

Dividend payout ratio is calculated by dividing the dividend per share by earnings per share. It indicates the proportion of earnings distributed as dividend. Lower dividend payout ratio implies that the company follows a conservative dividend policy. However, higher dividend payout ratio shows liberal dividend policy.

2. *Stability of dividend:*

In general, the shareholders of a company prefer a stable dividend policy as they expect that a certain minimum percentage of dividends should be paid regularly to them. Therefore, dividend policy should devise after taking into account, the expectations of the shareholders.

3. *Liquidity:*

The liquidity position of a company plays a major role in determining a dividend policy. Payment of dividends requires availability of liquid cash with the company. The company's future investment opportunity should also be taken into consideration.

4. *Divisible profits:*

Dividends could be declared only out of divisible profits (ie) the profits which are legally available for distribution as dividend to the shareholders. In certain cases, dividends can be distributed out of capital profits if it is capable of being realized in cash and if it is permitted by the Articles of Association of the company.

5. *Legal constraints:*

All the requirements of the companies Act and the SEBI guidelines must be kept in mind before declaring dividend.

6. *Shareholders preferences:*

Tax statuses of the shareholders, availability of investment opportunities in the present and the future, ownership compositions and dilutions, etc., are the different factors should be taken into consideration while framing a dividend policy.

7. *Capital Market conditions and Inflation:*

A company having a wide and an easy access to the capital market will follow a liberal dividend policy in composition with others. During times of inflation, a good company tries to satisfy its shareholders by paying higher dividends.

PUBLIC SECTOR UNDERTAKINGS (PSUS) DIVIDENDS IN FINANCIAL YEAR 2017

Listed public sector undertakings have not only been key contributors to government revenues by way of dividends but, also in many cases, yielded attractive dividend for investors. However as result of "Demonetization", the trend has been very different this time. Many PSU's, under immense pressure to pay a large dividend fund Government spending, are seeking exemption from making huge payouts as that may affect their capital structure plans. Every state run firm must pay a minimum dividend of 30% of its net profit or 5% of net worth, whichever is higher subject to the maximum dividend permitted under the law. A state company is expected to pay the maximum dividend possible until it can justify that the funds retained were being optimally leveraged to ensure higher investment, according to the guideline.

DETERMINANTS OF DIVIDEND PAYOUT OF PSUs

(i) Profitability:

"Signalling theory" assets that a company will generally ensure that an increase in its dividends will occur only when such an increase is sure to be associated with a higher level of future cash flows. Investors in such a company will take careful note of the firm's credibility to measure the likelihood that the future cash flow will be high. A company may maintain a good level of credibility by avoiding any unexpected changes in dividend payments. Thus this theory predicts a positive correlation between dividend and corporate income. The main argument of this theory is that the managers of the profitable companies tend to pay more dividends to prove their ability to maintain a healthy financial position in the future.

(ii) Size:

Many empirical studies have considered size as one of the most important determinants of a firm's dividend payout policy. Large firms are highly diversified and have huge cash flows. So they will be more willing to pay higher dividends. Thus, size of a company affects the dividend in a positive significant way.

(iii) Leverage:

There is a positive correlation between leverage and dividend decisions since high leverage firms tend to keep paying dividends despite the compulsion to service their loans. However, there is a contradictory argument that highly levered companies try their level best to maintain the internal cash flow in order to meet the company's financial obligations and protect the creditors, instead of paying the existing cash to shareholders. Therefore, a negative relationship is expected between leverage and dividend decisions.

(iv) Growth prospects:

The growth prospects of a company in future affect the dividend policy. If the growth opportunities are good, the company uses the internal funding sources to finance investments. The company either pays low dividends or avoid payment of dividends to avoid the need for costly external financing. On the other hand, the companies with fewer investment opportunities and slow growth tend to pay higher cash dividends.

CONCLUSION

Thus it is quite evident that the dividend policy of the public listed companies is determined by various important factors, in addition to the market conditions, Government regulations, rate of inflation etc.

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