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THE RELIABILITY OF DIVIDEND DISCOUNT MODEL IN VALUATION OF BANK STOCKS AT THE BOMBAY STOCK EXCHANGE

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ABSTRACT

Valuation of common stock is a very complex process. There are several factors that contribute to the variations of stock returns and it is one of the most researched areas by financial researchers. The study was conducted to establish the reliability of the dividend discount model which is based on the discounted cash flow techniques on the valuation of bank stocks at BSE. Hence, this study attempted to focus on the accuracy of Dividend discount valuation model which contains dividend as value relevant variable. The study has selected 14 banks' scrip which are included in BSE Bankex that are listed in Bombay Stock Exchange. Taking reliable data from the Prowess, a CMIE data base, It is found that dividends are not related to Bank stock prices. It is also found that the dividend discount model cannot be relied on by investors in the valuation of majority of the bank stocks at the BSE due to the higher prediction errors. The results are attributed to among other factors like inappropriate discounting factors, information differentials and measurement and evaluation problems.

KEYWORDS

Dividends, Stock Returns, Bank Stocks, Bombay Stock Exchange.

INTRODUCTION

DIVIDEND DISCOUNT MODEL

The Dividend Discount Model (DDM) is the simplest tool for valuing equity. Whilst some analysts view the DDM as out-dated and inadequate there are still a lot of companies where the DDM still is viewed as a convenient instrument for estimating value (Damodaran, 2002). The dividend discount model estimates the equity value based on the idea that the value of the equity equals all future dividends discounted back to today, using an appropriate cost of capital as discount rate. The cost of capital used in each calculation is reflecting the integrated risk in that particular cash flow (Frykman & Tolleryd, 2003). Author Roberg G. Hagstrom describes, in his book "The Warren Buffett way" (2005), how one of the world's greatest investors believes that the dividend discount model (created over sixty years ago by John Burr Williams) is the best system for determining the intrinsic value of a company.

IMPORTANCE OF DIVIDEND DISCOUNT MODEL FOR VALUING BANK STOCKS

THE GENERAL MODEL

When an individual buys stock, there are two types of cash flows that he or she can expect to receive – namely the dividend that the stock will pay during the time it is owned and the expected price at which the stock can be sold. The general equation for stock value can be expressed as:

$$V = \text{Value of stock} = \text{DPS}(1) / \text{Ke} - g$$

In order to obtain the numerator, expected dividends per share, assumptions regarding future payout ratios and growth rates have to be made. The denominator, the cost of equity or required rate of return, is determined by its riskiness and is measured differently in different models (the market beta in capital asset pricing model (CAPM) and the factor betas in the arbitrage and multifactor models). Since the model just presented cannot be applied on "real" dividend projections, due to the assumption of an infinite timeline, numerous varieties of the dividend discount model have been established which are constructed around different assumptions about future growth. (Damodaran, 2002)

GORDON GROWTH MODEL

The Gordon Growth Model is used mainly to value firms that are in stable growth with dividends growing at a rate that can be maintained for all eternity. Since the model assumes that the firm's growth rate in dividends is expected to last forever, the term stable growth is widely discussed and questioned. One of the aspects of the Gordon growth model and its "stable growth" is that other performance measures, such as earnings, also can be projected to have the same annual growth rate as dividends. Hence, if a company's earnings are growing faster than its dividend payout in the long run, the company's payout ratio will slowly approach zero, and that is not a feature of a company in a steady state of growth. Furthermore, a firm in a "steady state" cannot have a growth rate that exceeds the growth rate of the economy in which the firm operates. (Damodaran, 2002). It is clear that the growth rate plays a crucial role in the model, and if used wrong, the resulting value will be incorrect or misleading. Given the equation, one can see that if a firm's growth rate goes towards the cost of equity the value per share will approach infinity, and if the growth rate in fact surpasses the cost of equity the resulting value per share instantly turns negative.

DIVIDEND DISCOUNT MODEL IN VALUATION OF BANK STOCK

The dividend discount model can be a worthwhile tool for equity valuation. Financial theory states that the value of a stock is the worth all of the future cash flows expected to be generated by the firm discounted by an appropriate risk-adjusted rate. We can use dividends as a measure of the cash flows returned to the shareholder. Gordon growth model is best suited for firms growing at a rate comparable to or lower than the nominal growth in the economy and which have well established dividend payout policies that they intend to continue into the future. The dividend payout of the firm has to be consistent with the assumption of stability, since stable firms generally pay substantial dividends¹. In particular, this model will under estimate the value of the stock in firms that consistently pay out less than they can afford and accumulate cash in the process. In general, to value a stock using the dividend discount model, we need estimates of the cost of equity, the expected payout ratios and the expected growth rate in earnings per share over time based on the Dividend discount valuation Model.

A. COST OF EQUITY

Cost of equity for a financial service firm has to reflect the portion of the risk in the equity that cannot be diversified away by the marginal investor in the stock. This risk is estimated using a beta (in the capital asset pricing model) or betas (in a multi-factor or arbitrage pricing model).

B. PAYOUT RATIOS

The expected dividend per share in a future period can be written as the product of the expected earnings per share in that period and the expected payout ratio. There are two advantages of deriving dividends from expected earnings. The first is that it allows us to focus on expected growth in earnings, which is both more reasonable and more accessible than growth in dividends. The second is that the payout ratio can be changed over time, to reflect changes in growth and investment opportunities. The payout ratio for a bank, as it is for any other firm, is the dividend divided by the earnings. This said, financial service firms have conventionally paid out more in dividends than other firms in the market. The dividend payout ratios and dividend yields for banks, insurance companies, investment banks and investment firms are much higher than similar statistics for the rest of the market.

An obvious response would be that they operate in much more mature businesses than firms in sectors such as telecommunications and software, but this is only part of the story. Even if we control for differences in expected growth rates, financial service firms pay out far more in dividends than other firms for two reasons. One is that banks and insurance companies need to invest far less in capital expenditures, at least as defined by accountants, than other firms. This, in turn, means that far more of the net income of these firms can be paid out as dividends than for a manufacturing firm. A second factor is history. Banks and insurance companies have developed a reputation as reliable payers of high dividends. Over time, they have attracted investors who like dividends, making it difficult for them to change dividend policy.

C. EXPECTED GROWTH

If dividends are based upon earnings, the expected growth rate that will determine value is the expected growth rate in earnings. For financial service firms, as with other firms, earnings growth can be estimated in one of three ways: · Historical growth in earnings: Many banks and insurance companies have very long histories and estimating historical growth is usually feasible. Furthermore, the correlation between past earnings growth and expected future growth is much higher for financial service firms than it is for other firms. Analysts estimate expected growth rates in earnings for many publicly traded firms, though the extent of coverage varies widely. Many large banks and insurance companies are widely followed, allowing us to get these estimates of future growth. We suggested that the expected growth in earnings per share can be written as a function of the retention ratio and the return on equity:

Expected Growth in EPS = Retention ratio * Return on equity

This equation allows us to estimate the expected growth rate for firms with stable returns on equity. If we consider stock buybacks in addition to dividends when looking at payout, the retention ratio should be defined consistently as well.

REVIEW OF LITERATURE

Valuation of common stock is very important yet a very complex process. **Tobias Olweny (2011)** conducted the study in Nairobi stock exchange to establish the reliability of the dividend discount model (which is based on the discounted cash flow techniques) on the valuation of common stocks. Study concluded that the dividend discount model was not reliable in the valuation of common stocks at the Nairobi Stock Exchange. **Imbarine Bujang (2007)** tests the Gordon's Model developed by Gordon (1956) and the Earnings Multiplier approach developed by Basu (1977) to appraise the stock value of selected components stocks of Bursa Malaysia. Both valuation models show practical usefulness depending upon economic conditions and concluded that both models are relevant in appraising stock value though Gordon's model. **Anne Vila Wetherill (2000)** examines the usefulness of summary statistics, such as the price-earnings ratio and the dividend yield, that are commonly used in valuing equity markets. But these measures are very sensitive to assumptions made about the (unobservable) equity risk premium. **Thomas H. Payne (1999)** paper demonstrates that the valuation measure derived from using the DDM is very sensitive to the relationship between the required return on investment (Ks) and the assumed growth rate (g) in earnings and dividends. **John D. Stowe, CFA(1997)** argued that incorporating repurchases into a discounted cash flow framework leads to higher equity valuations and expected return estimates and, further, that traditional dividend discount models (DDMs) may be obsolete. **Stephen R. Foerster** studied in his paper about "Dividends and Stock Valuation: A Study From the Nineteenth to the Twenty-First Century" investigate and provide a new perspective for how changing economic conditions have impacted the relationship between the actual and intrinsic values of firms in the S&P Composite Index. Based on the dividend discount model, we find that stocks were undervalued, on average, by approximately 26% over the entire sample. **Mohammad Ali Tareq** paper titled 'Is Residual Income Model (RIM) REALLY Superior to Dividend Discount Model (DDM)?' examine the applications of RIM and DDM Model and finds that RIM have triggered arguments on the superiority over DDM. In theory, both models give the same value estimates; empirically, these value estimates changes with the changes in the assumption sets. In this paper, we show that both models provide the same values estimates when the terminal value can be forecasted. **Gülnur Muradoglu**, Warwick Business school (1999) article continues our coverage of the building blocks of cost of capital, as part of our focus on shareholder value and company valuations. The dividend discount model is simple and intuitive, but the accuracy of results depends entirely on the accuracy of the forecasts about future dividends. **Larry Gorman** studied in "An Internally Consistent Approach To Common Stock Valuation" about the deeper fundamental understanding of how stock valuation relates to (i) operational efficiency, (ii) dividend policy, and (iii) the economic environment in which the firm competes. **Janette Rutterford(1997)** studied in his paper compares developments in the UK and the US, in particular the relative slowness of the UK market to adopt US-pioneered techniques such as the P/E ratio, the concept of value versus growth stocks, and using intrinsic value to determine whether shares are cheap or dear. The article concludes with a discussion of the relatively slow introduction of the dividend discount model and of discounted cash flow as equity valuation tools on both sides of the Atlantic. **David B. Moore (2009)** tells that the best approach to valuing bank stocks – or any other type of stock for that matter – is to employ multiple valuation techniques that encompass both sound financial theory as well as current market realities.

OBJECTIVES OF THE STUDY

Objectives of the study include the following:

1. To know the reliability of dividend discount model on the valuation of bank stocks at BSE.
2. To know the prediction accuracy of Dividend Discount Model for valuing bank stocks.

RESEARCH METHODOLOGY**A. DATA**

The sample period for the study extends from March 2000-01- March 2010-11 for the 14 bank stocks included in BSE Bankex. Data required was collected in form of secondary data, and in particular the market prices of the stock, annual dividend per share and dividend yield. Annual dividends per share, market price of each bank stock and dividend yield on yearly basis were obtained from CMIE (PROWESS) Database.

Secondary data was used in the study. The following data were collected:

1. Market prices of the stock.
2. Annual dividend per share
3. Dividend yield.

B. METHODOLOGY

The results were summarized using descriptive statistics such as mean, standard deviation and MAPE. Each price obtained was compared to the actual price from 2000-01 to 2010-11. This was done by finding the difference between the actual and predicted prices then testing whether the difference between the two are significant. The following hypothesis was tested:

In order to examine the impact of dividend on selected bank stocks, Hypothesis developed is as follows:

Ho: There is no significant difference between the actual share prices and the predicted share prices using dividend discount model.

Ha: There is a significant difference between the actual and the predicted share price using dividend discount model. The t- test was used as the appropriate test statistic.

EMPIRICAL ANALYSIS

The historical relationship between the Dividend yield and stock return

Having set out the accounting framework for these equity valuation measures this section focuses on the historical relationship between equity valuation ratios and stock returns. As shown in the table 1.1, 1.2 ,1.3 valuation ratios have in the past tended to fluctuate within a fairly narrow and stable range. Whenever these valuation ratios have moved towards the bounds of this range, some form of adjustment has followed that restored the ratio towards its historical average. This adjustment process is referred to as mean reversion. In the case of the dividend yield it could in principle be brought about by either a change in stock returns or in dividends.

TABLE 1.1: CORRELATION CO EFFICIENT BETWEEN DIVIDEND YIELD AND STOCK RETURN FOR BANKSTOCKS

Year	HDFC		ICICI		SBI		AXIS BANK		KOTAK	
	Dividend yield	Stock Returns	Dividend yield	Stock Return						
2001-02	1.08	.73	2.08	-8.95	2.77	12.88	3.65	50.86	30.43	111.85
2002-03	1.38	2.71	1.39	3.26	3.48	16.72	5.23	-8.16	2.49	17.60
2003-04	1.89	50.46	8.49	80.02	4.21	84.20	7.42	163.98	2.61	97.01
2004-05	1.26	33.77	3.45	30.02	2.40	13.22	1.92	51.74	0.35	7.52
2005-06	1.23	33.64	2.62	37.93	2.23	47.70	1.84	44.89	0.23	2.58
2006-07	0.97	31.03	1.98	38.05	1.46	10.23	1.37	38.94	0.29	57.66
2007-08	1.08	31.67	1.48	-1.03	2.04	52.87	1.38	65.63	0.34	34.29
2008-09	0.89	-30.99	1.45	-66.78	2.03	-28.01	1.53	-38.78	0.13	-56.18
2009-10	1.45	73.92	3.97	115.10	3.10	75.05	3.46	110.18	0.57	113.67
2010-11	0.99	19.64	1.75	12.98	1.46	28.43	1.60	16.69	0.08	-41.92
Coefficient of correlation	.5938		.6554		.5131		.5526		.4875	

TABLE 1.2: CORRELATION CO EFFICIENT BETWEEN STOCK RETURNS AND DIVIDEND YIELD FOR BANKSTOCKS

Year	BANK OF BARODA		PNB		INDUS IND BANK		YES BANK		CANARA BANK	
	Dividend Yield	Stock Returns	Dividend Yield	Stock Returns	Dividend Yield	Stock Return	Dividend Yield	Stock Return	Dividend Yield	Stock Return
2001-02	6.56	-9.77	*	*	3.29	23.08	*	*	*	*
2002-03	11.81	61.63	9.61	97.64	14.83	-30.63	*	*	*	*
2003-04	9.50	118.15	5.10	148.20	29.33	95.61	*	*	7.26	81.08
2004-05	2.11	-6.09	1.45	29.62	5.30	22.02	*	*	3.23	41.15
2005-06	2.57	7.13	1.63	19.25	0.71	-8.14	*	*	3.77	24.74
2006-07	2.96	-5.92	1.94	5.21	0.00	-10.69	0	26.89	2.87	-32.74
2007-08	4.50	39.34	4.23	12.81	1.68	77.72	0	25.00	4.63	15.22
2008-09	4.90	-8.16	4.51	-13.85	1.59	-72.18	0	-103.0	5.51	-28.93
2009-10	6.00	105.02	6.91	89.97	9.31	179.39	3.51	185.1	8.22	89.77
2010-11	3.54	38.07	2.85	17.88	1.79	43.87	1.14	22.75	3.52	39.44
Coefficient of Correlation	.6123		.6139		.3600		.8498		.6295	

TABLE 1.3: CORRELATION CO EFFICIENT BETWEEN STOCK RETURNS AND DIVIDEND YIELD FOR BANKSTOCKS

Year	FEDERAL BANK		BANK OF INDIA		UBOI		IDBI	
	Dividend Yield	Stock Returns	Dividend Yield	Stock Returns	Dividend Yield	Stock Return	Dividend Yield	Stock Return
2001-02	27.60	115.90	8.05	95.23	*	*	9.64	-45.17
2002-03	4.20	-26.87	13.45	30.13	*	*	34.22	-27.85
2003-04	6.19	168.99	8.93	53.21	12.14	88.60	32.18	157.36
2004-05	1.40	-65.95	3.86	64.99	6.43	101.72	3.62	60.72
2005-06	3.54	20.74	3.30	29.78	2.99	-2.55	1.71	-15.00
2006-07	2.15	3.22	2.53	28.63	3.69	-24.08	2.34	1.77
2007-08	1.37	14.48	2.79	53.19	6.40	36.58	2.62	28.40
2008-09	2.94	-34.47	3.70	-5.84	4.13	17.53	3.05	-59.77
2009-10	3.93	66.07	3.71	49.98	4.92	75.20	7.74	108.04
2010-11	2.76	47.24	2.39	47.21	2.12	16.81	3.52	21.75
Coefficient of Correlation	.5331		.1594		.6910		.3057	

From the above analysis we can see the moderate positive relation between dividend yield and stock returns for most of the bank Stocks included in BSE bankex. Most of the bank stocks returns were not highly influenced by dividends. But the above results also proved that there is a positive relationship between dividend yield and yearly stock returns from 2001-02 to 2010-11. Result also shows that high Dividend yield stocks like PNB, Federal bank provided fair returns when the dividend yield ratio kept at high level.

Co efficient of correlation between dividend yield and stock returns for most of the bank stocks kept at average level in the above stocks. Co efficient of correlation between stock returns and dividend yield for 3 banks PNB, Federal Bank , Canara are more than .50 This tells that returns from these stocks are increasing when the dividend yield is increasing. But for most of the other bank stocks, Dividends are not influenced in the returns for bank stocks .

VALUATION ACCURACY OF DIVIDEND DISCOUNT MODE

In order to test the dividend discount model, we first estimated the required rate of return of each company as shown in table 2.0 using Capital asset pricing model. The rates of returns were then used to calculate their present values, for each bank. Table 3.0 shows the actual, predicted and difference for each of the eighteen companies. The results were tested for significance by hypothesis testing on the difference for each company. Table 4.0 shows the valuation errors for 14 bank stocks included in BSE Bankex. Table 5.0 shows a summary including mean, t-statistic and decision rule. All the fourteen companies had their shares

“predicted” but only four had positive results (about 28 percent), while the rest were negative (72 percent). We therefore reject our null hypothesis and conclude that dividend discount model is not a good predictor of share prices at the Bombay Stock Exchange for bank stocks. The model cannot be relied on by Banking companies listed in the Bombay Stock Exchange to predict their share prices: The results may be attributed to: i) Inefficient market (BSE). ii) Inappropriate discounting factors. iii) Information differentials. iv) Measurement and evaluation problems, among others. As suggested earlier in this report the BSE could be inefficient, but the model can be used where all securities in an equivalent class are priced to offer the same expected returns (where the market is efficient). Some managers believe that the market is highly inefficient and that any valuation method (including the dividend discount model) that is based on rationality of market participants will prove ineffective (Sharpe *et al* 1999). The study assumed that the Bombay Stock Exchange is an efficient market. Although there is active trading in the BSE, improved liquidity, and investor protection regulations; its state of efficiency is still inconclusive. Inappropriate discounting factors used may have contributed to the results above, since the discounting factors (rates of return) for each company was obtained through CAPM..

TABLE 2.0: COST OF EQUITY FOR BANK STOCKS

Name of Bank stocks	Average Cost of Equity (CAPM Rate)
1. HDFC Bank	15.46
2. ICICI Bank	20.11
3. State Bank Of India	19.40
4. Axis Bank	15.22
5. Kotak Mahindra Bank	16.04
6. Bank Of Baroda	21.60
7. Punjab National bank	22.67
8. Indus ind Bank	17.52
9. Yes Bank	13.65
10. Canara Bank	26.62
11. Federal Bank	18.10
12. Bank Of India	22.78
13. Union Bank Of India	29.29
14. IDBI	19.26

TABLE 3.0 PREDICTED BANK STOCK PRICES USING DIVIDEND DISCOUNT MODEL

Name of Bank		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
HDFC	Actual	230	235.15	233.75	378.35	544.25	773.5	949.4	1319.5	967.8	1932.5
	Predicted	-346.5	-455.8	-620.1	-666.5	-934.7	-1049	-1440	-1638	-1960	-2686
	Difference	576.5	690.95	853.85	1044.8	1478.9	1822.5	2389.4	2957.9	2927.8	4618.5
ICICI	Actual	165.4	124	133.9	295.9	393	589.2	853.1	770.1	332.6	952.7
	Predicted	31.8	15.9	105.8	94.2	95.09	107.69	117.01	103.3	122.0	154.1
	Difference	133.5	108.0	28.87	201.62	297.9	481.5	736.0	666.7	210.5	798.5
SBI	Actual	247.6	219.8	269.9	605.7	656.9	968.0	992.9	1598.8	1066.5	2079
	Predicted	49.4	145.2	219.4	280.6	282.2	272.7	390.6	824.3	837.9	770.6
	Difference	198.2	74.56	50.49	325.0	374.7	695.2	602.2	774.4	228.6	1308.3
AXIS	Actual	37	39.9	40.1	146.7	242.0	356.3	490.1	781.1	414.5	1169.1
	Predicted	-130.8	-202.2	-267	-305	-382	-459	-683	-1145	-1356	-1592
	Difference	167.8	242.1	307.1	451.7	624.0	815.3	1173.1	1926.1	1770.5	2761.1
KOTAK	Actual	8	142.6	157.9	404.1	340.5	278	479.6	628.5	282.9	749.0
	Predicted	36.6	53.4	62.2	21.1	11.94	12.04	24.31	12.39	24.46	8.83
	Difference	-28.68	89.19	95.75	382.95	328.56	265.96	455.34	616.16	258.49	740.22
BOB	Actual	69.6	47.9	85.9	242.7	218.0	230.3	215.4	283.9	234.5	639.2
	Predicted	40.7	50.4	72.7	45.7	49.9	60.8	86.4	123.9	129.1	202.7
	Difference	28.9	-2.53	13.16	196.95	168.13	169.46	128.98	159.93	105.41	436.46
PNB	Actual	*	37.4	101.8	333.9	393.3	471.2	471.6	508.1	410.9	1013.4
	Predicted	*	95.3	137.8	128.0	169.7	243.0	529.5	608.7	753.5	766.8
	Difference	*	-57.94	-35.99	205.86	223.59	228.17	-57.88	-100.5	-342.6	246.5
INDUSIND	Actual	20.1	16.7	15.6	40.3	50.0	46.8	41.9	78.7	32.3	170.6
	Predicted	7.3	27.5	51.0	23.7	3.9	*	7.83	13.8	33.7	33.8
	Difference	12.75	-10.82	-35.36	16.57	46.09	46.85	34.12	64.81	-1.41	136.7
YES	Actual	*	*	*	*	*	100.4	140.7	168.7	49.9	254.8
	Predicted	*	*	*	*	*	*	*	*	*	29.7
	Difference	*	*	*	*	*	*	*	*	*	225.07
CANARA	Actual	*	*	71.2	144.6	200.4	266.9	194.7	225.2	165.9	410.3
	Predicted	*	*	71.0	64.2	103.8	105.4	123.9	170.3	187.4	198.2
	Difference	*	*	.19	80.36	96.51	161.4	70.77	54.83	-21.51	212.06
FEDERAL	Actual	15.3	104.5	92.6	372.1	154.5	201.6	215.5	216.3	138.1	166.9
	Predicted	124.1	128.4	167.9	152.7	160.4	126.7	86.2	186.3	159.0	215.7
	Difference	-108.7	-23.94	-75.36	219.3	-5.87	74.87	129.31	29.91	-20.99	51.16
BOI	Actual	17.9	25.1	37.9	58.9	103.5	132	167.8	252.9	219.9	340.7
	Predicted	25.3	59.2	59.3	39.8	59.9	58.6	81.9	164.1	143.1	142.6
	Difference	-7.4	-34.13	-21.45	19.05	43.51	73.38	85.83	88.73	76.75	198.12
UBOI	Actual	*	*	25.15	52.7	113.0	121.8	103.9	141	142.7	292.9
	Predicted	*	*	25.32	28.12	28.08	37.3	55.1	48.3	58.3	51.5
	Difference	*	*	-.17	24.58	84.97	84.54	48.78	92.69	84.45	241.37
IDBI	Actual	30.7	16.3	16.5	58.1	91.1	78.3	77.5	89.0	45.4	115
	Predicted	25.06	47.39	45.1	17.8	13.1	15.5	17.1	23.0	29.7	34.2
	Difference	5.64	-31.04	-28.56	40.27	77.97	62.77	60.36	66.05	15.64	80.73

TABLE 4.0: VALUATION ERRORS FOR BANK STOCKS

Year	HDFC	ICICI	SBI	AXIS	KOTAK	BOB	PNB
	Prediction errors						
2001-02	-166.38	416.94	401.25	-128.29	-78.19	70.92	*
2002-03	-151.59	676.94	51.34	-119.73	166.84	-5.01	-60.77
2003-04	-137.70	27.47	23.01	-115.04	153.94	18.09	-26.11
2004-05	-156.77	213.85	115.83	-148.11	1810.64	430.49	160.78
2005-06	-158.23	313.29	132.76	-163.36	2751.76	336.80	131.75
2006-07	-173.74	447.17	254.90	-177.64	2208.97	278.53	93.89
2007-08	-165.93	629.08	154.19	-171.76	1873.06	149.25	-10.93
2008-09	-180.58	645.43	93.95	-168.22	4973.04	129.01	-16.52
2009-10	-149.38	172.47	27.29	-130.57	1056.79	81.62	-45.47
2010-11	-171.95	517.87	169.76	-173.44	8383.01	215.23	32.16
MAPE	-161.22*	406.32	142.43	-149.62*	2329.98	170.49	28.75

TABLE 4.1: VALUATION ERRORS FOR BANK STOCKS

Year	INDUSIND	YES	CANARA	FEDERAL	BOI	UBOI	IDBI
	Prediction errors						
2001-02	173.47	*	*	-87.63	-29.19	*	22.51
2002-03	-39.32	*	*	-18.64	-57.62	*	-65.50
2003-04	-69.32	*	.27	-44.87	-36.14	-0.67	-63.31
2004-05	69.83	*	125.09	143.63	47.80	87.41	225.86
2005-06	1163.89	*	92.90	-3.66	72.53	302.60	591.58
2006-07	0	0	153.20	59.06	125.18	226.59	404.19
2007-08	435.76	0	57.10	149.94	104.71	88.50	351.13
2008-09	466.59	0	32.18	16.05	54.05	191.87	287.17
2009-10	-4.18	0	-11.48	-13.19	53.62	144.85	52.55
2010-11	403.99	755.78	106.94	23.71	138.90	467.95	235.57
MAPE	260.07	755.78	69.53	22.44	47.38	188.64	204.17

TABLE 5.0: AN ANALYSIS OF THE DIFFERENCES BETWEEN ACTUAL AND PREDICTED PRICES BY THE DIVIDEND DISCOUNT MODEL

Name of Bank	Mean	SD	T Comp	Null Hypothesis
HDFC	1936.13	1291.63	4.740	Reject H ₀
ICICI	366.34	282.43	4.101	Reject H ₀
SBI	463.20	388.47	3.771	Reject H ₀
AXIS BANK	1023.9	869.23	3.724	Reject H ₀
KOTAK MAHINDRA BANK	320.39	240.02	4.221	Reject H ₀
BANK OF BARODA	140.48	126.16	3.521	Reject H ₀
PUNJAB NATIONAL BANK	34.35	203.13	.507	Accept H ₀
INDUS IND BANK	31.03	47.80	2.053	Accept H ₀
YES BANK	136.96	66.52	4.603	Reject H ₀
CANARA BANK	81.83	77.19	2.998	Reject H ₀
FEDERAL BANK	26.96	97.32	.8762	Accept H ₀
BANK OF INDIA	52.33	68.64	2.406	Accept H ₀
UNION BANK OF INDIA	82.65	72.39	3.229	Reject H ₀
IDBI	34.98	42.13	2.625	Reject H ₀

SUMMARY AND CONCLUSION

The main objective of the study was to know the reliability of the dividend discount model on the valuation of bank stocks at the Bombay Stock Exchange. In order to achieve this, share prices were predicted using the dividend discount model and then compared with the actual prices. The differences between the two were obtained. T-tests were carried out on the differences to establish whether the two prices were significantly different from each other. Of the fourteen companies studied, only four companies showed that the differences were significant. We can therefore; conclude that the dividend discount model cannot be relied on by companies in the valuation of their bank stocks at the BSE. The results are attributed to among other factors, the inefficient market (NSE), inappropriate discounting factors, information differentials and measurement and evaluation problems.

Dividend discount model has the highest prediction errors across India for bank stocks. So We conclude that DDM performed well only for few bank stocks like PNB, Federal Bank, Bank of India with consistent Yield record. So the study proven that Dividend discount Model is not very informative for the estimations of equity market value for bank stocks.

This DDM method yields the following findings

1. There was moderate positive relation exists between dividend yield and returns for the selected bank stocks included in BSE bankex.
2. Dividend discount model works only for bank stocks like PNB, Federal Bank and Bank of India and Indusind Bank with consistent Dividend Yield record in the past.
3. On an overall basis, Dividend discount model does not hold good for bank stocks due to inappropriate discounting factors.

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