

A Study Of Dividend Policy And Its Effect On Market Value Of Shares Of Selected Banks In India

¹ Dr. Vinay Kandpal, ² Prof P C Kavidayal

Assistant Professor, Department of Accounting & Finance, University of Petroleum & Energy Studies, Bidholi, Dehradun

Head, Department of Management of Studies, Bhimtal, Kumaun University, Nainital

Abstract: *Dividend policy is a strategy used by a company to determine the amount and timing of dividend payments. The dividend policy framed by an organization is one of the crucial issues in corporate finance since it may have an impact on the firm's value and shareholder wealth. The research study is an attempt to analyze the effect of dividend policy on shareholder wealth of thirty selected Indian banks listed and traded in Bombay Stock Exchange (BSE). For the purpose of study the financial data from the period 2003-04 to 2012-13 of selected Indian banks (15 Public and 15 Private) would be used. The data would be analyzed using statistical tools like multiple regression technique, t test, the coefficient of determination (R²) and F-Value. The results of the data analysis might reveal that there is a significant effect of dividend policy on the share price of selected Indian Banks. The study is limited to a time period of 10 years and only selected Indian Banks. The result might change if the time period and number of banks are extended.*

Keywords: *Dividend, shareholder wealth, Finance, BSE*

I. Introduction

Financial management is mainly concerned with the raising of funds minimizing the cost of capital and allocating the funds in long term investment which involve Capital budgeting decision. The next important decision is deciding how much profit to retain and how much to distribute as dividend i.e. dividend decision. The dividend is planned and declared by the Board of Directors. Dividend policy refers to the proportion of earning distributed as dividend and the rest kept for further investment i.e. retained earnings. Dividend policy is a strategy used by a company to determine the amount and timing of dividend payments. The dividend policy framed by an organization is one of the crucial issues in corporate finance since it may have an impact on the firm's value and shareholder wealth. From the viewpoint of financial management, the key objective is to determine the dividend policy that will maximize the market price of the shares of the firm. Dividend policy remains one of the most debatable matters in corporate finance. Financial economists have engaged in designing and investigate corporate dividend policy. Dividend policy is two types one is managed second residual. In residual dividend policy, dividend is paid cash left after the firm makes attractive investments using net present value basis. The manager must apply managed dividend policy if investors are satisfied and it reflects in share price. The best dividend policy is the one which guide to maximize of shareholder wealth and increase the company's stock price. In India the company declaring the dividend has to pay dividend distribution tax and dividend income is exempt from tax for the recipients or the shareholders. A dividend is the minimum return to the investors in order to compensate for the money invested and the risk taken by investing in the organization. An organization pays dividend to reward existing shareholders and to encourage potential investors to buy new issues of shares at higher prices. A dividend policy of a corporation may range from a decision regarding dividend action in a complex formal statement approved by the board of directors and reviewed on a regular basis.

II. Literature Review

There are a number of research paper written in dividend policies earlier, which analyze the relationship between dividend policy and share prices. Dividend policy has been an area of interest for researchers in finance since the establishment of Joint Stock Companies. Linter (1956) through a research work comes to a conclusion that shareholders prefer the smooth flow of dividend income. The Gordon model (1959) concluded that dividend rate and share price of the firm are related, i.e. with an increase in dividend rate the share price increases and vice versa. Graham et.al. (1962) concluded that dividends is the only purpose of the firm's existence. Miller and Modigliani (1961) come to a conclusion that the payment of dividends has no effect on the value of the firm and is therefore irrelevant.

Baker, Farrelly and Edelman (1985) in a research work surveyed 318 New York stock exchange firms and concluded that the major determinants of dividend payments are anticipated level of future earnings and pattern of past dividends. Pradhan (2003) after studying Nepalese firms concluded that payment of dividend have a significant relationship with share prices. Nepalese shareholders prefer dividend income than long term

capital gains. Nishat & Irfan (2003) after analyzing 160 companies listed at Karachi Stock Exchange for the period of 1981-2000 concluded that dividend yield and payout ratio was positively correlated to the share price. Mancinelli and Ozkan (2006) studied ownership structure of companies and dividend policy of 139 firms listed in Italian exchange. He comes to a conclusion that the dividend payout ratio is negatively related with the voting rights of the largest shareholders. A study by Akbar and Baig (2010) on a sample of 79 companies listed at Karachi Stock Exchange for the period of 2004 to 2007 showed that announcement of dividends either cash dividend or stock dividend or both had positive impact on share prices. According to Hussainey et al. (2011), company with higher payout ratio or dividend yield, will result in less volatile stock price. Dividend payout ratio is the main determinant of the volatility of stock price. The larger the size of the company, the stock price will be less volatile. Well, if the company incurs high leverage, there is a higher probability that stock price be more volatile.

In Indian context a few numbers of studies have analyzed the dividend behavior of corporate firms and focused on Indian cotton textile Industry and Manufacturing sector. Very few studies have analyzed the dividend behavior of Indian banks and their impact on wealth maximization or the market value of shares. The study may prove to be useful for policy makers keeping in view the analysis, results and discussions presented.

Objective of Study: The major objective of this research is to critically analyze the possible effect of dividend policy on shareholder wealth of thirty selected Indian banks listed and traded in Bombay Stock Exchange (BSE).

Hypotheses of the Study: This study focuses on examining the effect of dividend policy on share price in selected banks in India. As per the objectives of the study the null and alternative hypotheses framed are as follows:

H₀: There is no significant effect of dividend policy on share price

H₁: Dividend policy has a significant effect on share price

III. Research Methodology

The research study is an attempt to analyze the effect of dividend policy on shareholders wealth of thirty selected Indian banks listed and traded in Bombay Stock Exchange (BSE). This study is based on the secondary data. For the purpose of study the financial data from the period 2003-04 to 2012-13 of selected Indian banks (15 Public and 15 Private) would be used. The data would be analyzed using statistical tools like multiple regression technique, t test, the coefficient of determination (R²) and F-Value. The data has been sourced from Prowess database of Centre for Monitoring Indian Economy (CMIE). In this study market price is taken as dependent variable. Dividend payout ratio, Return on Net worth, Debt Equity ratio and total assets are used as independent variables.

Results And Analysis

Companies	Share price & Dividend Payout Ratio	Share Price & Return on Net worth	Share price & Debt Equ	Share price & Total Assets
ICICI Bank	-0.84831715	-0.528347541	-0.559915499	0.754085503
HDFC Bank	-0.107789096	-0.56121509	-0.671169696	0.975254273
Axis Bank	-0.800544697	-0.511848881	-0.811621882	0.898169909
Kotak Mahindra Bank	-0.866177336	0.228098881	-0.470511347	0.965520283
Yes Bank	0.956295991	0.650406094	0.633442644	0.94241508
IndusInd Bank	-0.393037335	0.012815748	-0.961640443	0.974706635
Jammu & Kashmir Bank	-0.307641653	0.424257291	0.383911798	0.86967514
Federal Bank	0.725028414	-0.556146778	-0.674421409	0.938193475
ING Vysa Bank	0.41496596	0.522010103	0.753132236	0.854236436
Karur Vysa Bank	0.52135276	0.058410863	0.850510481	0.94678279
South Indian Bank	0.33252047	0.421106741	-0.054964035	0.928323548
Karnataka Bank	0.118927174	-0.171513878	-0.258822454	0.016752589
City Union Bank	-0.552492735	-0.278251639	-0.135151911	0.964495341
DCB Bank		0.234631203	0.154542261	0.010500039
Dhanlaxmi Bank	0.059529805	0.018457033	-0.317535979	0.567540052
State Bank of India	0.911719528	-0.758873107	-0.494504066	0.85024123
Punjab National Bank	0.057252873	-0.018415908	-0.222933767	0.745698101
Bank of Baroda	-0.623938572	0.557252357	0.318493288	0.824474497
Canara Bank	-0.576768103	-0.105322357	0.124177054	0.735740457
Bank of India	-0.189187297	-0.328139852	-0.350007738	0.839224806
Union Bank of India	-0.198762146	-0.488964581	-0.281697772	0.780750428
Syndicate Bank	-0.089715712	-0.757393998	-0.86546758	0.738397873
IDBI	0.073065509	0.58775146	0.694792192	0.483789354
Dena Bank	0.748182242	0.034556458	-0.696711499	0.849347344
Allahabad Bank	0.296417356	-0.221301725	0.068140794	0.716274439
Central Bank of India	-0.273351411	0.368477117	0.004230344	0.023128928
Andhra Bank	-0.542771502	-0.134363796	-0.130913613	0.546311025
Oriental Bank of Commerce	-0.061498089	0.377827458	0.152461488	0.152314735
Corporation Bank	0.077241009	0.319363184	0.427077861	0.507835936
Indian Bank	0.420007951	-0.53894528	-0.595955439	0.787122453

Table 1

Results from Correlation Matrix

Table 1 explains the correlation among variables that can have impact on share price of an organization. The result of correlation matrix was obtained for 15 private sector banks in India. In case of ICICI bank share price is positively correlated with Total assets (0.75) and shows negative correlation with dividend payout ratio (-0.84), return on net worth (-0.52) and debt equity ratio (-0.55). It means that with an increase in total assets there is an increase in share price and vice versa. In Case of HDFC share price is positively correlated with total assets (0.97) whereas it shows negative correlation with dividend payout ratio (-0.10), return on net worth (-0.56) and debt equity ratio (-0.67). Results from Axis bank show positive correlation of share price and total assets. On the other hand there was a negative correlation of share price with net worth, debt equity ratio and dividend payout ratio. There was a negative correlation of share price and dividend payout ratio (-0.86) in case of the Kotak Mahindra bank. The result of Yes Bank shows that share price is positively correlated with a dividend payout ratio (0.95), return on net worth (0.65), debt equity ratio (0.63) and total assets (0.94). The result of IndusInd bank shows that share price is negatively correlated with a dividend payout ratio (-0.39) and a debt equity ratio (-0.96) whereas share price is positively correlated with total assets (0.97) and return on net worth (0.012). In case of Jammu & Kashmir Bank Ltd share price has negative correlation with a dividend payout ratio (-0.30). On the other hand share price shows positive correlation with return on net worth (0.42), debt equity ratio (0.38) and total assets (0.86). Positive correlation was found between dividend payout ratio (0.72), total assets (0.93) and share price of Federal Bank. In case of ING Vysa Bank share price have positive correlation with a dividend payout ratio (0.41), return on net worth (0.52), debt equity ratio (0.75) and total assets (0.85). In case of Private sector banks like Karur Vysa Bank and South Indian Bank share price has positive correlation with a dividend payout ratio. DCB Bank was found to have no dividend payout ratio as a major portion of profit is retained for further investment purpose.

The result of correlation matrix in table 1 was also obtained for 15 public sector banks in India. In case of SBI share price and dividend payout ratio (0.91) is positively correlated whereas share price is negatively correlated with a debt equity ratio (-0.49) and return on net worth (-0.75). The share price of public sector banks like PNB, IDBI, Indian bank, Corporation bank, Allahabad Bank and Dena Bank are positively correlated with a dividend payout ratio whereas the results obtained from other public sector banks shows negative correlation.

Regression Analysis: As shown in table 2, High R square value in Private sector banks like ICICI , HDFC, Axis bank, Kotak Mahindra, IndusInd, Karur Vysa , ING Vysa bank shows that the independent variables like Return on net worth, dividend payout ratio, debt equity ratio and total assets explain a major portion of the share price. The R square value of some banks like Karnataka bank and Dhanlaxmi bank was quite low.

In case of Public sector banks R square value was high in case of SBI, PNB, BOB, Union bank of India and Syndicate bank to name a few whereas it was low in case of Central Bank of India and Oriental Bank of Commerce.

While analyzing Significance F value of banks it was found that F value was statistically significant for majority of banks like ICICI, HDFC, Axis bank, Kotak Mahindra, Yes Bank, IndusInd bank among private sector banks. In case of public sector only few banks like SBI, Syndicate bank, Bank of India and Bank of Baroda Significance F value was statistically significant as $F < 0.05$. Thus Null hypotheses was rejected and alternative hypotheses was accepted.

Companies	R Square	Significance F value
ICICI Bank	0.89151714	0.012515351
HDFC Bank	0.96127266	0.001004452
Axis Bank	0.86368104	0.021675451
Kotak Mahindra Bank	0.94353333	0.002544889
Yes Bank	0.93729581	0.011302364
IndusInd Bank	0.9787984	0.000225612
Jammu & Kashmir Bank	0.79249043	0.058477693
Federal Bank	0.91771765	0.006397776
ING Vysa Bank	0.81434548	0.045086457
Karur Vysa Bank	0.91220138	0.00749307
South Indian Bank	0.89724391	0.010976921
Karnataka Bank	0.15085688	0.915020923
City Union Bank	0.95691003	0.001307469
DCB Bank	0.88924879	0.01315673
Dhanlaxmi Bank	0.40698878	0.546342251
State Bank of India	0.89565578	0.011392018
Punjab National Bank	0.64614183	0.194806591
Bank of Baroda	0.81048772	0.047314448
Canara Bank	0.67998848	0.156413111
Bank of India	0.82835473	0.037483781
Union Bank of India	0.78518361	0.063371525
Syndicate Bank	0.87184608	0.018694088
IDBI	0.56895755	0.29549141
Dena Bank	0.72917006	0.1077559
Allahabad Bank	0.77410423	0.071189659
Central Bank of India	0.23436464	0.813455753
Andhra Bank	0.55119684	0.320885552
Oriental Bank of Commerce	0.5121973	0.379000068
Corporation Bank	0.75921998	0.082443603
Indian Bank	0.6649362	0.173014445

Table 2

IV. Conclusion

The above analysis and results shows a mixed result. In case of correlation analysis it was found that some public and private sector banks shows positive correlation with dividend payout ratio while some have positive correlation with total assets. In case of regression analysis it was found that majority of private sector banks showed a statistically significant f value while in case of public sector banks like SBI, BOB, Bank of India shows statistically significant f value. As a whole it can be concluded that dividend policy has significant impact on the share price of organization.

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