Choosing the Right Dividend Policy – A Review

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Abstract: **Decisions regarding payment of dividends are made by company's directors at their Board level meetings. These decisions are important to maintain the reputation and image of the company among the shareholders and investors. However these decisions have to be balanced with the funds required for the growth of the company through expansion of new projects. These can be profitably financed through retained earnings which would mean a payment of lower rate of dividends. Thus it becomes a balancing act for the management to decide their dividends policy VS retained the earnings. The following article explores the various factors that influence such policy decision and can serve as guidelines to decide on payment of dividends. All the factors helpful in deciding about dividend policy are reviewed. Payment of dividend has also to be regulated according to the provisions contained in the Companies Act 1956. This may include payment of interim dividend transfer of unpaid dividends to a special bank account and transfer of unclaimed dividends to central government.**

Keywords: **Dividend, Board of director's decision, Affecting factors.**

I. INTRODUCTION

The management has a responsibility to take their company a various stage of growth. The other factors Governing the growth of the company are, Targeted market in a competitive business world, choice of technology staffing for the right talent, establishment of management system for day-to-day activity as well as future planning. The amount of profits of the company allowed to be distributed among the shareholders from the profits earned during the period of operation, generally within a year is called the dividend. The dividend amount is decided as a percentage on the share capital or at fixed amount per share. This amount is arrived at after providing for depreciation, tax payment or any other expenses as prescribed in the company act. The distribution of dividend may take several forms they are

II. FORMS OF DIVIDEND

Dividend paid may fall under different types they may be as follows:

2.1 Cash Dividend: Cash Dividend are paid shareholders in cash the company should have sufficient fund in order to pay cash dividend Stable dividend policy will require preparation of cash budget for the coming year to pre-plan needed cash towards dividend payment. If there is any difficulty in cash mobilisation the company will have to suffer and unstable policy of paying dividend.

Cash dividend may be paid in the following ways.

2.1.1. Regular Dividend: Regular dividend as decided by the board of director with the approval of shareholders is paid in cash this is also called final dividend and is usually paid after the finalisation of accounts generally at the end of the year. Shareholders withdrawing the share amount would not be entitled to receive cash dividend.

2.1.2. Interim Dividend: Where companies act allows payment of interim dividend it may be distributed before the completion of the financial accounts. No interim can be paid without providing for depreciation expenses. This arrangement has to be approved by the subsequent annual general meeting.

2.1.3. Stock Dividend: Where a company cannot afford payment of dividend in cash it can pay dividend in the form of shares and capitalised their profits for the current year. They are also known as bonus shares. In this method the company benefits in capitalising the share amount of the share holders without affecting the share value of the investors.

2.1.4. Scrip Dividend: Scrip dividend refers to the assignment of others company's debentures or issued shares and invested in the given company is assigned to shareholders in lieu of cash payment. This method may be adopted when the cash position of the given company is not adequate to pay dividend to the shareholders. Generally, they may not be preferred by the shareholders. This form of dividend is called script dividend.

2.1.5. Bond dividend: When long term debentures or bonds are issued to the shareholders barely interest at a fixed rate. Thus, shareholders security is guaranteed by making them creditors to the company. This shareholder would be considered to have a lien on the assets of the company. This is called bond dividend.

2.1.6. Property Dividend: A company may prefer to assign their property used as assets to the shareholders in place of cash asset to pay. When such property is no longer useful for the company the shareholders may decide to realise their money by suitably disposing off the assets or property.

III. OBJECTIVES OF DIVIDEND POLICY

A form dividend policy is reflection of a plan of action regarding payment of dividend. It may be guided by two major objectives.

Maximization of Shareholders Wealth and provision of sufficient funds for remaining in the business. The two are interrelated

3.1 Maximisation of Shareholders Wealth: This policy should aim at satisfying both short and long-term interest of the shareholders. Although the shareholders may desire to receive maximum benefits of dividend in a short run it becomes the responsibility of the form to take care of the shareholders long term interest by making the shareholders aware of the implications of their dividend policy.

3.2 Provision of Sufficient financing for project Profitability of projects require the resources for such financing generally to be drawn from the retained earnings. That may appear to reduce the objective of maximising shareholders wealth. Such interrelationship between the two objectives would compel the management to decide on the proper ratio between the dividend and retained earnings. Although financing of the project may be carried out through other borrowed funds. The reinvestment of retained earnings would be a better choice. The ultimate decision in this matter will depend upon multiplicity of factors.

IV. PAYMENT OF DIVIDEND TO MAINTAIN COMPANY IMAGE AND OTHER RELATED ISSUES

Dividend policy is decided by the board of directors at their meeting. Dividend declared for payment to share holders is an out flow of funds which needs to be regulated to balance the specific advantages of right dividend payment with needs of cash resources for other purposes to run the company. Therefore the dividend can be declared. The Only out of divisible profits, remained after getting of all expenses transferring reasonable amount of profit to reserve find and providing for depreciation and taxation for the year. It means, if in any year, there is no profit; no dividend shall be distributed that year. The shareholders cannot compel for payment of dividend.

V. KEY CONCEPTS IN DIVIDEND PAYMENT

Internal Factors:

5.1 Stability of earnings:

Companies dealing with industrial product are usually more comfortable to formulate dividend payment policy because of their ability to predict easily their savings and earning. Industries dealing with necessity products suffer less from uncertainties to declare dividend compare to those dealing in luxuries or fancy goods.

5.2 Age of the corporation:

Age of the company is an important factor in deciding about the dividend payment. A start up and recently established companies cannot be liberal in payment of dividend. These companies have to divert more funds for the expansion, plant improvement and therefore may have to resort to a stringent dividend payment policy, the old companies because of the ability to predict their present and future requirement funds more precisely. They can decide on liberal dividend payment.

5.3 Liquidity of funds:

Liquidity of the company decided by the available convertible assets in to cash as compared to fixed assets. Company having a higher liquidity condition can be more outgoing in payment of cash dividend.

5.4 Needs for additional finance resources:

Companies particularly in the early stages of growth often experience the need for additional capital for investment for future expansion increased working capital etc. But small company find it difficult to mobilize huge capital for these purposes. Therefore, they are compelled to apportion a large amount of the earned profit for redeployment. Therefore. they feel constraint to pay low rate of dividend.

5.5 Business Fluctuations:

Companies with prudent understanding of business fluctuations would be able to retain a substantial portion of profit earned during boom periods even after paying a higher rate of dividend. The retained portion for the profits can be utilised where they are essential. This strategy enables these companies to retain their public image.

5.6 Past dividend Rates:

Maintaining uniformity of the dividend payment over successive years becomes important normal fluctuations of dividend payment over successive years may lead to speculation. Therefore past dividend payment must be used as an index while deciding on current payment of dividend.

5.7 Borrowing ability:

Established firm may have better access to borrow for their business needs. This will also enable them to decide on payment of higher rate of dividend even in difficult times. This option may not be available for small firms.

5.8 Directors control over dividend policy

Board of directors who wish to retain their ability in controlling the affairs of the company may decide on dividend payment matching with their interest. They may choose to restrict the entry of new shareholders by declaring a lower rate of dividend.

5.9 Re-payment of Borrowing:

Where companies are under compulsion to repay borrowings may resort lower of dividend payment. Thus, they may use portion of higher profit to redeem from their debts.

5.10 Time for payment:

Financial position of the company like surplus funds being available may determine the time of payment of dividends. Shortage of funds may require postponement of dividend payment to a more desirable period of time.

5.11 Regularity and stability in dividend payment:

In order to maintain company image and reputation among stakeholders' companies may even resort to provision of equalisation funds to maintain regularity in payment of dividend.

VI. EXTERNAL FACTORS

6.1 Government Policies:

There may be occasions where government policy introduced to regulate cash flow availability through reduced dividend payment. This leads to modification of dividend policy in line with government regulations.

6.2 Taxation policy:

During the periods of high taxation companies earning are correspondingly reduced leading to lower rate of dividends. It has an impact on accumulation of capital funds.

6.3 Legal Requirements:

Company Act 1956 prescribes the following statutes to protect the interest of creditors and outsiders. These include provision for depreciation on fixed and tangible assets restrictions on payment on dividend out of capital funds.

VII. CONCULSION

It may be noted that company image and reputation is judged by shareholders based on the regularity of dividend received by them. Therefore, the management has to arrive at making decision that would ensure stability of dividend payment the good will of the company enhances in the eyes of the shareholders. This good will enable the company to satisfy the income conscious investors. The company may start enjoying higher market price of their shares in the market. Stability in a dividend payment may also encourage institutional investors to take advantage of stability and high rate of dividend enhanced by the company.

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