

A Study on Dividend Policy and its Impact on the Shareholders Wealth in Selected Banking Companies in India

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Abstract

Survival of economy depends upon smooth supply of financial resources which is possible only if nation banking sector is effective, efficient and strong. Its goodwill, fund generation and its effective allocation, profitability, efficient management of dividend payout and profit retention play important role in its survival and growth. No company can ignore dividend but strategically invite careful analysis of it to develop everlasting solution to the problem of payout and retention ratio which impact share price and maximization of wealth. The present study attempts to analyze the impact of dividend on shareholders wealth of eleven selected Indian banks listed and actively traded in National Stock Exchange (NSE) during the period 2006 to 2010 using multiple regression technique, in addition t-values, the coefficient of determination (R²) has been calculated and its significance also been tested with the help of F-Value. The first part of paper gives an insight about the dividend and its legal implications. The second part consists of data and their analysis which revealed the fact that there is significant impact of dividend policy on the shareholder's wealth in Indian banking companies. At the end, concluding remarks and suggestions are given. Gilt schemes are seen to have been positive. However, the observed positive performances of the selected schemes are not statistically significant.

Keywords: Dividend Per Share (DPS), Market Price Per Share (MPS), SD, T-Values, Sig- Value, P/E Ratio, Retained Earnings (RE).

1. Introduction of Dividend and Its Legal Implications

Business is a socio-economic activity and involves all section of society in common terms for common satisfaction. Increasing economic opportunities with diversification and opportunistically desire of society has changed the global business tremendously in hype-hazard form. Economies are no more within political boundary but have crossed it and became global and are in need of all kind of resources to be competitive and growing in size which becomes possible through banks and financial institutions support. The Indian banking structure at present is a qualitative outcome of strategic process of expansion, reorganization and consolidation and has undergone three phases. Very first phase of pre-nationalization, then second phase after nationalization and third phase which happen through market development, innovation, and diversifications into emerging areas with customer's satisfaction and mergers and acquisitions, which is a continuous process. Banks being back bone of economy need capital to cater the ever growing demand of finance which is an important factor among all the required resource to run economic activities and is scant in nature and banking companies has to generate it on their goodwill which is result of their managerial efficiency, optimum utilization of resources, efficient handling of risk and return factors; and their positive financing decisions along with the existence of efficient capital market. For capital requirement, banks pooled fund through public issues of their shares which are traded on various stock exchanges globally. With knowing the fact that high prices for their share are possible if demand for their share is high which can be due to high productivity, profitability, spread and

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financial soundness along with high rate of dividend payout and any decline in all these parameter will curb their reputation and growth. A loss of reputation and reduction in share price may necessitate further flotation to maintain the equity base which has certain irreducible administrative costs and affect the banks margin. To avoid these costs stable dividend payment ratio and frequency has to be maintained in order to consolidate investor's sentiment toward their wealth appreciation.

Bank is a service industry and it is not easy to measure the efficiency. Its financial health is an important index of efficiency, solvency and soundness which can be judged by its capital adequacy and asset quality. It has high services costs with low return and hold social responsibility of strengthening, grooming and exploring society by supplying financial assistance to economically and socially neglected sectors apart from core objective of accepting deposits and lending credit. Management of its income encompasses two broad aspects, determination of its income and its prudent allocations. Its main sources of operating revenue are interest and discount on loans, dividends on investment, services charges on deposit accounts, services charges and fee on banks and other charges. Its major expenditures are salaries and wages, interest payment and deposit liabilities and other current operating expenses. The magnitude of banks income and their profitability vary banks to banks depending upon its priority and variables of revenue and expenses essential for their survivals. The difference between operating revenue over the expenditure incurred is net operating income or loss before tax which is due to its efficient revenue function and the cost function. Its profitability are seen through net profitability as percentage of gross operating income, net profit as percentage of working funds and return on total assets.

Spiritually 'prime objective' of the firms / companies is to generate and maximize the wealth of its owners (shareholders). This is possible through successful operation of the business which generates surplus returns in comparison to financial breakeven point and later used the surplus resources for payment of dividends to its shareholders 'the ultimate owner of the company having a right to get return in form of dividend on their investment. It is a reward of risk taken by the investor on their investment which is largely distinct from the return in the form of interest of the borrowed capital and also any bonus share issued by the company to capitalize the

profit, that is not dividend. It is a share of profit of the company divided among its shareholders. It is mandatory and strategic distribution of portion of company's taxed earnings decided by the board of directors, to a class of its shareholders and is generally referred as dividend per share (DPS) which can be in the form of cash, stock or property. Payment of dividend represents a cash outflow which depletes the cash resources available for investment in future by the firms. Dividends are periodic cash payments generated from successful trading between dividend payment and retention by the companies to shareholders which ultimately improvise the corporate governance by perfuming investor risk taking appetite along with open signal about the company's futuristic financial health and maintaining its long standing discipline. It is generally used to evaluate the share and is recognized as an ultimate indicator of companies' performance. Most secure and stable organizations who have successfully achieved the growth and attained the maturity, if find that reinvestment of the profit is strategically not lucrative then they offer dividends to their stockholders. Sometimes companies running below equilibrium point or having just marginal profit status also offer dividends to keep their investors base intact.

Dividend decisions are largely concerned with the determination of quantum of profits to be distributed among the owners (shareholders) and the frequency of such payments which can be annually, biannually and quarterly may not cause any hurdle in smooth running of a concern. Generally it effect in two ways, the determined amount to be paid out as a dividend and its relative impact on share price and the quantum of profit to be retained for future investment which maximizes the value of firm and ultimately improves the share value of the firm and shareholder's wealth. It enjoys significant status in corporate finance because of its strategic relationship with capital structure; retained earnings are the cheapest and safest form of fund used by the companies, in absence of retained earnings economic activities of the entity are to be supported by external funds which lead to change in EPS and concentrate risk on equity. Dividend payout revealed the strength of company's financial capacity and indicates the extent of the net profits distributed to the shareholders as dividend. A high payout to shareholders will reduce the cash resources available with the companies and a low payout ratio will enable entities to develop healthy low cost cash reserves which are required for future capital expenditure growth and diversification, and will ultimately

results in long run capital appreciation of share prices and maximization of firm's wealth. It reacts as a motivational hormone in investor's attitude and its regular growth play important role in determining a profit making company's market value and the market value of its shares in the stock market. A low dividend payout will cause to depress the market price of the share. It is accepted fact that better financial health of the company requires balance between the retained earnings and dividend payout which are ultimately treated as the ideal one to optimize the value of the company.

Dividends are lawful protection of shareholders and adoption of dividend policies (liberal, constant or optimum) and declaration of dividend to share-holders, who are ultimate owners of the company and are entitled to the share of profit in the form of dividend which under the Act are Regulated by Provisions of Section 205, 205-A, 205-B, 205-C, 206, 206-A, 207, of the Company Act 1956. In addition to these Act, companies have to follow other Statutory governing Rules and Regulations and other Statutes and their amendments time to time "the Companies Transfer of Profit to Reserve Rules, 1975, the Companies (Declaration of Dividend out of Reserves) Rules, 1975, and the Investors Education and Protection Fund (Awareness and Protection of Investors) Rules 2001, The Provision of Section 27 of the Securities Contracts Regulation Act, 1956, in the case of listed companies, the requirement of the Listing Agreement and other specific provision relating to dividend in the Income Tax Act 1961",

All the companies which have share capital other than companies under section 25 and make profit, are bound by law to declare and distribute dividends. The term *dividend* has been inclusively defined in the companies Act "1956" that include interim dividend and did not make any distinction between interim and final dividend nor specifically defines the term dividend. In general term, it may be defined as surplus cash reserves generated through efficient overall performance and later distributed or to be distributed amongst the members of the company in proportion to their shares according to the rate mentioned in schedule XIV or any other norms specifically approved by the government in such a manner as is prescribed by the Memorandum and Article of Association of the company. The decision to declare the dividends and retention are taken in companies' annual general meeting and interim dividends are declared by the board at a

meeting of the board. Once the company declare dividend on the board recommendation, it becomes debt and may not be revoked. Only the registered shares holders are entitled to dividend. No share holders have right to get the dividends as recommended until the resolution is passed at the general meeting of the shareholders, also they do not have any right to declare more dividend than what has been recommended. Declared dividend shall not exceed the amount recommended by the board and should be paid in cash not in kind in proportion to the paid up value of shares within thirty days of declaration. By the virtue of the Indian law, the board of directors may reduce the amount of declared dividend. Preference shareholders get fixed dividend as per terms of the issue and should be paid before dividend is paid to the equity shareholders who are subject to the discretion of the Board of Directors of the companies. Before paying any dividend to equity shares, arrears of dividend on cumulative preference shares should be paid after dividend on equity are paid in accordance with the right of the respective classes, if any, of such shares. If companies have redeemable preference shares then dividend on equity shares will be declared after redemption of such preference shares on their respective due date. If the companies have irredeemable preference shares and failed to redeem them within the statutory time limit provided, then under such circumstances company cannot declare dividend.

Dividend policy of company generally determines the division of cash reserves generated through efficient overall performance between payments to shareholders and reinvestment in the firms through retention. Before declaring dividend, companies have to make many consideration under the shadow of statutory rules and regulation for their competitive survival, like firms transaction costs, personal taxation, dividend clientele, dividend payout ratio, dividend cover, dividend signaling, divisible profits, liquidity, rate of expansion, rate of return, stability of earnings, stability of dividends, legal provisions, contractual constraints, cost of financing, degree of control, capital market access and state of economy.

According to Section 205 of the companies Act, 1956, dividend must be paid out of current financial year profit of the company in which interim dividend (if any) also be included or it should be paid out of profits accumulated of early years which have not been transferred to reserves, or it can be paid out of both current financial year profit

and accumulated profit of early year after providing for depreciation according to the provisions of Schedule XIV of the Company Act 1956 (*which shall be calculated as per section 350 of the Act or in the manner provided in the Act*) for the year and arrears of depreciation before any declaration or payable of dividend or it can be paid out of the fund provided by the government (Central or State) in pursuance of guarantee (if) given. Dividend cannot be declared out of the securities premium account, capital redemption reserves account, revaluation reserves, out of profit on re-issue of forfeited or out of profit earned prior to the incorporation of the company. Before company declare any dividend out of current financial year profit for the year it has to set off loss if any of the previous years or the amount of depreciation for the previous years whichever is less. It has to ensure that the prescribed percentage of profit is transferred to reserves as per Transfer of Profit to Reserves Rules-1975.

If company declared interim dividend then it should be paid out of estimated profit according to the provisions of Section 205-1(B) of the Company Act 1956 for the period for which it has been declared and the provisions contained in Section 205, 205-A, 205-C, 206, 206-A, and 207 of the Company Act, shall also apply to interim dividend. It should not be declared out of reserves or dividend at the contracted rate on preference share, if any, or it may not be paid out of Appropriations and Transfer to Statutory Reserves or Taxation and the Provision of the Company (Transfer of Profit to Reserves) Rules-1975. Whereas, if company has issued equity shares with differential rights as to dividend then on the opinion of the board, interim dividend be declared in accordance with term of issue on all or any one or more of the class of such shares. If company does not have sufficient profits or there are no profits in a year, in such condition the company can use free reserves which are accumulated after establishing sufficient provision for depreciation and subject to the provisions of the Companies (Declaration of Dividend out of Reserves) Rules 1975 and may declare and pay dividend to their owners (shareholders). The declaration of dividend under such conditions out of reserves has certain limit which is ten percent of paid-up capital as per Companies (Declaration of Dividend out of Reserves) Rules-1975, but if the company declared dividend higher rate which exceed from 10% norms to 20% of the paid up capital then Companies (Transfer of Profits to Reserves) Rules-1975 become applicable and company has to transfer to reserve at least 10% of the current profit.

After taking dividend decision, company sends the dividend warrant to the shareholders within 30 days of the annual general meeting (AGM). The initial validity of the dividend warrant is three months and hold complete information in writing about the dividend paid and the amount of prevailing additional tax deducted at source if any on it, and are to be paid within given period of time that is 14 days of declaration, distribution or payment of any dividend whichever is earliest and would be considered as the final payment of tax in respect of dividend. If in case, the validity expired then duplicate dividend warrant will be issued. In absence of original instrument which was to be tendered to the company and has not been tendered then duplicate warrant will be issued after obtaining requisite indemnity / declaration from the shareholder. Company before paying any dividend will adjust all arrears or any other amount due from a member. In case of any amount of dividend for which an instrument of transfer has been tendered to the company and has not been registered for any valid reason, the companies have to transfer such amount to unpaid dividend account. If after the date of declaration, any amount of unpaid dividend remained unpaid or unclaimed then within seven days from the expiry date provided for payment of dividend, companies have to transfer the amount to unpaid dividend account opened in Scheduled Bank and if the amount further remains unclaimed for a period of seven years from the date of transfer of such amount to the unpaid dividend account then Education and Protection Fund (Awareness and Protection of Investors) Rules 2001 and Section 205-C of the Act will be applicable and as per rules, companies have to intimate the members and after six month of intimation, it will transfer the unclaimed amount to the Investor Education and Protection Fund and also the interest earned on it within 30 days of it becoming due for the transfer.

For transparency, after declaration of dividend by the board of director in Annual General Meeting, companies have to intimate stock exchange and have to submit details regarding declaration of dividend within 15 minutes of the closure of the board meeting. They have to open separate bank account with the companies bankers and transfer the amount of dividend in it and preserves dividend registers and dividends warrants for a period of eight years which banks return after payment. It also needs to disclose the total amount lying in the unpaid dividend account and the amount of dividend if any transferred by the company to the Investors Education and Protection Funds in respect

of the last seven years. The companies have to declare in its annual return, the amount of unpaid or unclaimed dividend and its accrued interest for a period of seven years from the due date, if any, has been credited to the Investor's Education Protection Fund.

As it is found that distribution of net cash flows generated from successful trading between dividend payment and retention is must for overall growth of the firms but under certain circumstances company cannot pay dividend, it may be due to any legal implications or due to dispute regarding right to receive the dividend or due to any direction given by the share holders to the company regarding desired dividend payment. Such direction turned down by the company or could not be compiled or company has adjusted the dividend against sum unpaid dues from the share holders lawfully or it could not be paid due to any circumstances without any default on the company side.

1.1 Pattern of Dividends Policies in Banks

The pattern of dividends policies varies from bank to bank, depending upon its characteristics. These may be stable dividend policy where bank pays fixed amount of dividends per share irrespective of any fluctuation in its earnings and follow slow and steady change, is the prime feature of stable dividend policy. A policy of no immediate dividends is adopted by new and rapidly growing banks, who needs resources for expansion and diversification or where investor agreed to accept higher return or access to capital market is difficult for banks. A policy to pay regular and extra dividends is adopted by banks in the period they accumulate higher profit and thus share extra profit as extra dividends instead of increasing the regular dividend payout ration. A policy of irregular dividends is adopted by the banks where earnings are unstable and management considers that shareholders are entitled to dividend only when the earning and liquidity positions of the banks warrant it "larger the earning higher the dividend and vice versa".

1.3 Retained Earnings as an Active Decision Variable and Dividend as a Passive Residual

After securing profit from efficient and effective utilization of assets, company has to make judicious allocation

between retained earnings and dividends. While deciding the dividend policy, it is always a balance between the current market price and the future market price. Higher retention in a growth will lead company to generate better market value than it could be achieved by higher pay out. For this, company has to treat either retained earnings or dividends as an active decision variable. If company in due course actively determines the amount of retained earnings, then the dividend will be distributed by way of dividends. On the other hand, if amount of dividends is actively determined, then the retained earnings will become the passive residual. The core consideration of the company in determining the dividend policy is the objective of maximizing the shareholders wealth; therefore company must treat retained as the active decision variable. It must retain its earning as long their productivity inside the company is equal to what the shareholders can earn from an investment of the same degree of risk outside the company. In general shareholders have to pay tax on dividend received by them and due to tax deductions they will receive relatively much smaller sum than the amount of profit earned by the company even if it is fully distributed. If the company analyzed that shareholders can earn better outside the company than what the company can earn on its internal investment then it must return the earnings to the shareholders in the form of dividends. Often it is difficult to ascertain the ROI of other companies of the same risk class. Tax status of different class of shareholders also makes it difficult to determine the amount of dividend income that will be available for investment in the hands of shareholders after paying income tax. Thus, retained earning generally constitutes the active decision variable and dividends as the passive residual. But in practice most companies determine the amount of dividends first and the residue constitutes the retained earnings. Companies believe that market value of the shares will maximize by following stable dividend policy as it have direct impact on the market price of the company shares. It is also considered that high payout ratio will attract investors and company can easily procure additional capital by selling new issues of shares capital to existing and new shareholders. Moreover, stable policy also satisfies those investors who need regular return on their investment. Generally, shares prices of those companies rise which pay regular dividends and have history of growth and are also preferred by the investors. Image of a company is more important which require new funds to be raised from the market. Due to these consideration in actual practice

dividend is considered as an active decision variable in the allocation of company's earnings between dividends and retained earnings.

1.3 Impact of Retained Earnings on Future Dividend Policy

The fundamental objective of the finance manager is to concentrate on how to maximize the shareholders wealth from whom the firm is being operational. In this context they analyze all available sources of funds depending upon their strength, weakness and future requirement. Retained earnings is one of the most important and strategic sources of finance available for the established companies to finance its capital projects, expansion, diversification programs along with redemption of shares and debentures. These funds are cheapest mode of finance for further capital expenditure, accumulated over years and belong to the equity shareholders and are distributable taxed profits kept with the company without distributing them in the form of dividends. It increases the net worth of the company without any dilution of power and risk. Company uses these surplus funds generated from operation after meeting all the contractual, statutory and working requirements of funds within the company for further profitable investment opportunities. It impacts company's growth and investor return in positive way and is an important factor determining the health of a company. Through retaining profit, company get fund at minimum cost without any flotation charges and consider retained earning equivalent to the return forgone by the equity shareholder. For the shareholders, cost of retained earnings is basically an opportunity cost of such funds. It is equal to an income that they would otherwise obtain by placing these funds in alternative investment. The cost of retained earnings is determined based on the opportunity rate of earnings of equity shareholders which is forgone continuously. If the retained earnings are distributed to the equity shareholders, then it will attract personal taxation to the individual shareholders. Till organization has profitable investment opportunity and is earning return on them it is acceptable but some time organization have negative retained earnings due to losses and if losses overtake retained earning amount then balance become negative which will impact future dividend policy to a great extent and will signal serious financial problem. Beside losses if organization pays dividend or more in dividends to shareholders then negative retained earnings is bound to occur. If profit is

retained from the start and it have negative balance then it will impact dividend policy and will lead to the problem of no dividend for long period to the shareholders or bankruptcy.

1.4 Impact of Dividends on Stock Price

Dividend policies largely depend upon the financial strength of the company which is possible with surplus profitability generated through judicious utilization of available resources, articles of association and prevailing economic conditions. It is true that dividend policy itself has a great deal of influence on the image of the company and also has implication for managers, investors and lenders and other claimholders. Its declaration has direct bearing on the market price of the company stock. For investors, dividend declarations and payment generate positive and negative sense of security and returns and are considered important input for evaluating the firm for future investment. Managers have to assess the flexibility of paying dividend and strength to invest in projects. More dividends means minimum fund available for investment and to bridge the gap manager will seek external financing from the capital market which will increase the risk. Lenders consider, that if the organization will pay high dividend then available amount will not be sufficient for servicing and redemption of their claims.

However dividends payments present an example of extraordinary agency situation which have ultimate impact on all claimholders. Its policy is used as a mechanism to minimize the agency cost and the adopted policies do not change very often. Any reduction in dividend amount will be considered as a signal of company trouble and due to its signaling affect prices of share fluctuate.

If company retains the profit cutting dividend then it gives a growth signal to the investors and when company increase dividend then it implies that it would be able to sustain the high dividend in future. It is found that stock price increases at a time of dividend increase and reflect higher expectations for future EPS and gives stronger message of growth. If increase in dividend is accompanied by increase in earning then it gives message that growth is permanent. And similarly, decrease in dividend coupled with dividend cut signifies terrible news. The company uses this information channel to inform the investors about the firms expected future cash flows which may impact the value of the firm. It has been observed by the

financial economist that the issuance of cash dividends signals management's confidence in the future and also it affect the price of a share due to various reasons.

Price of stock may not move unless the declaration of cash dividend is surprise. It is also observed that if nature of dividend is surprise and companies normally pay stock dividends and all of sudden switches to cash or vice-versa then it will impact the price of stock and it will move accordingly. If company is paying cash dividend on regular basis then it will not impact stock market as it will be considered as a routine matter. But if company dramatically increases or reduced the dividends then this fluctuation will impact stock prices and stock price will probably change on the very day. Similarly, dividend paid in the form of stock, impacts the market price to a great extent. It is a way of paying dividends by giving stocks of same company to the shareholders in the proportion of the stock already owned by them. Issuance of stock dividends leads to fall of the stock price on ex-dividend date, or the days before the record date. Sometimes, to control the price of shares, companies perform stock split according to section 94 of the Company Act, 1956. It is known as a better device to control and reduce the market value per share and to increase the liquidity of the share. Splitting stock by multiplying the numbers of stock by two, three, or even four impact more shares flotation in the market and ultimately it increase the liquidity of share. It helps small investors to hold the shares for long term benefit or can sell them for cash. However, the drop in share value will be low enough that it will probably be equaled out by transaction costs and taxes. Thus for overall betterment keeping dividend, stock price relation and investor perception in view company must adopt prudent dividend policy as it has direct impact on investor decision and the market price of the company's stock.

1.4 Impact of Clientele on Dividend Policy

Investments in companies are done by different group of investors or clientele and prefer different dividend policies. Generally, firms past dividend policy play important role in determining its current clientele of investors. Investors like senior citizens and retirees living on fixed income would prefer a steady income compensated by purchasing power and would prefer cash flow out of their investment whereas young investors and professionals prefer capital appreciation rather than current dividend. It is found that

individual investors do not have any definite dividend preferences and give wattage to current income. While deciding dividend policy, company must pay proper attention to the cliental impact on dividend policy and to control this perpetual situation companies should develop a clientele of investors whose needs match its dividend paying characteristics.

1.5 Impact of Tax Policy on Dividend

Tax policy play important role in companies dividend policy and needs to be considered paramount from the point of view of a company as well as from the shareholders. As far as the company is considered, dividend can be paid out of profit after tax. And by paying dividend, company does not get any tax advantage but it increases the tax burden which ultimately become disadvantage for the company. Further, as per the provision to Section 115-O of the Income Tax Act, 1961, company paying dividend is required to pay "tax on distributable profits" which is referred as "dividend tax". The imposed dividend tax on company is 12.5%, further increased by the surcharge of 10% and the education cess of 2%. As far as shareholders are concerned, according to the provision of Section 10(34) of the income tax Act, 1961, dividend (*interim or final*) received is tax free income and shareholders are not required to pay any tax on dividend received by them.

1.6 Factors Affecting Dividend Policy

Banks play important role in bridging the gap between the end users and operates in unpredictable social environment with changing economical norms depending upon pace of growth and development. Factors like external and internal economic condition, age of banks, capital market status, and government policies related to universal competition, taxation policy, past dividend rates, liquidity position of the banks, regularity and stability in dividend payment, strength to borrow funds can affects dividend policies of the banks to a large extent. These factors cannot be eliminated but can be minimized through judicious and efficient utilization of all available resources.

1.7 Objectives of the Study

Banking sector play important role in the development of the nation economy and entire economy activity

revolves around it. To fulfill the demand of funds, it relies on accepting deposits and lending credit and buyers of its financial instruments on which it have to pay return in the form of interest and dividend. It is found that in India very few studies have been carried out in order to analyze the relationship between the dividend payout and share holders wealth in banking sector. In general net earnings are divided into two parts “retained earnings and dividends. The earning which is retained by the concern, is reinvested with the futuristic hope and is considered as a long term funds and the remaining portion of net earnings is distributed among the shareholders in consideration to maximize their wealth as they have invested their saving in expectation of future financial gain and overall growth. Therefore, Banking sector has been chosen for the study mainly to analyze up to what extent dividend affects the shareholders wealth. Further, to assess the performance and come up with the best and worst performing bank in term of dividend payout and retention.

The core objective of this study is to examine the relationship between dividend payout and shareholders' wealth. To analyze the extent of improvisation in shareholder wealth with increased dividend and to analyze the impact of valuation in dividend policy of Indian banking companies on shareholders' wealth.

1.8 Testing of Hypothesis

The study tests the following hypothesis in respect of dividend policy in banking companies.

- **H₁**: “There is no significant difference in an average market value in relation to book value of equity of banking companies”
- **H₂**: “There is no significant impact of dividend policy on shareholders wealth in banking companies

2. Research Methodology

The study is done with special reference to renowned and most preferred Indian banks in public and private sectors. For the purpose eleven most preferred public and private sector banks listed in National Stock Exchange (NSE) have been taken. Simple Multi-Stage Random Sampling Technique has been used which depend on the availability or required financial data like share price, DPS etc. Analytical research design based on secondary data has been adopted which are collected from the respective

banks websites, annual reports and journals, periodicals published by the banks. The study period is 2006-10 and the outcome of the study depends on the selected period by the researchers which may differ from other analysis.

2.1 Tools Used for Data Analysis

The outcome of the study depends on the selected period, implemented statistical, mathematical and financial tools by the researchers which may differ from other analysis. Thus in this study, for interpreting the results and to predict the impact of the dividend policy on shareholder's wealth, statistical tools which are been justified are mean, standard deviation (SD) and multiple regression technique and stepwise regression method. Further t-values have been computed to test the significance of various explanatory variables and to determine the proportion of explained variation in the dependent variable; the coefficient of determination (R²) has been calculated. For the authentic justification, significance of R² is been tested with the help of F-Value.

For the purpose of the study the equation and variable used are as follows;

$$MPS_{it} = a + b \text{ DPS}_{it} + c \text{ RE}_{it} + \text{eit} \quad (1)$$

$$MPS_{it} = a + b \text{ DPS}_{it} + c \text{ RE}_{it} + (\text{PE})_{t-1} + \text{eit} \quad (2)$$

$$MPS_{it} = a + b \text{ DPS}_{it} + c \text{ RE}_{it} + (\text{MPS})_{it-1} + \text{eit} \quad (3)$$

Where: MPS_{it}: Market price per share
 DPS_{it}: Dividend per share
 RE_{it}: Retained earnings per share
 PE_{t-1}: Lagged price earnings ratio
 MPS_{it-1}: Lagged market price (MV_{it-1})

The subscript ‘i’ denotes the *i*th company in a sample of ‘n’ companies selected from a particular industry, and all variables are measured in the *i*th time period. Market price per share is the closing prices for the year.

Selected Banks for the Study: Axis Bank, Bank of Baroda (BOB), Bank of India (BOI), Canara Bank, HDFC, IDBI, ICICI, OBC, PNB, SBI, Union Bank of India (UBI)

3. Literature Review

Literature reviews are important for the study as it give direction and important feedback relating to the concerned topic. In this study, it is authentically undertaken to understand the inverse relationship between dividend

policy and shareholders wealth by critically examining different theories and empirical studies conducted worldwide. The judicious revelations of these studies indicate that they differ in opinion depending upon study time period, prevailing economy and market condition, companies futuristic plans, investors behavior and academic ego.

In the context of dividend and its policies Berle and Means (1932) in their study highlighted the inefficient use of funds by the management in excess of profitable investment opportunities which gave new dimension to investment and return system. The text written by Graham and Dodd (1934) emphasizes the relevancy of dividend that firm's existence is possible only through dividend which became biblical word in short period of time. They advocated in their study that if two firms are operating in the same environment and are identical in all respect, the firm who pays regular income would command higher P/E than the other with erratic dividend paying firm. But serious academic thought and judicious research in the field of dividend decision and its practice started in the early 1950s.

The debate over the controversy and importance of dividend policy became hot topic as it hold importance due to economic and financial requirement which can be achieved through motivated investors. In due importance, researcher like *Bhat and Pandey (1958)* in their study revealed that share price to a extent get influenced by the dividend policies of the companies, *Maunder (1959)* in his study attempts to explain corporate saving and justified companies savings in terms of profitability for the aggregate and for some individuals industries as well, *Gordon (1959)* indorse the idea with firm belief that dividend increases shareholders wealth and on other hand *Miller and Modigliani (1961)* who revealed that in worldwide perfect capital market dividend declaration and its payment does not impact the value of the firm and advocated that value of a firm depends only on the distribution of the future cash flows that result from the investments undertaken, *Miller and Modigliani (1966)* in his later study found that change in dividend convey healthy amount of information especially about expectations of management in respect of long run future profit, *Dhrymes and Kurz (1967)* in his study found that firm financing decision and investment decision are closely linked which impact companies various policies including dividend policies, *Akerlof (1970)* in his study

justified that once the dividend-initiation decision becomes public, the market will react favorably to the positive information, *Krishnamurty and Sastry (1971)* in their study examined the behavior of dividend in chemical industry. For the study he took cross sectional data of 40 public limited companies, *Pettit (1972)* in his study found that dividend announcement do convey valuable information, *McDonald, Jacquillat and Nusenbaum (1975)* in their study investigated the French market and supported the Lintner revelation. According to them investment or external financing levels do not have any impact. The past dividends and current earning is the major indicator of variation in dividends, *Jensen and Meckling (1976)* in their study adopted the work of Berle and Means on intellectual basis and promoted the work with new dimensions, *Charest (1978)* in their study witnessed that the announcement of a dividend increase generates an excess return, *Kalay (1979)* in his study explained that highly leveraged firms have burden of debt and choose tight dividend policy and pay fewer dividends, *Bhole (1980)* conducted the study and tested the determinants of corporate savings, dividends and share prices respectively. For the purpose he tested profit allocation and Lintners model and used time series data by using simple, multiple and stepwise regressions. The study produced the fact that Lintner's model performed well in Indian context in the conducted period, *Aharony and Swary (1980)* in their study found that there was abnormal returns on the day dividend was announced, *Asquith and Mullins (1983)* find that, like dividend increases, dividend initiations have a significant positive impact on shareholder wealth; *Patell and Wolfson (1984)* in their study analyze the stock price reactions to earnings and dividend announcements. The study shows that most of the detected price reaction occurs within the first fifteen minutes after the earnings and dividend announcements, *Miller and Rock (1985)* in their study suggested a model with dividends information about unused earnings which can exit with rational expectations. They revealed that due to information asymmetry between investors and managers dividend can result in market reaction, *Jensen's (1986)* in his study based on free cash hypotheses tried to update the assertion by making combination of market information asymmetries with agency theory, *Asquith and Mullins (1986)* in their study suggest that dividends may be a better signal than earnings announcements due to managers' ability to manipulate earnings, *Ofer and Siegel (1987)* and *Healy and Palepu (1988)* in their study

examine changes in dividend policy in relation to future earnings and related analysts forecasts, also consistent with the information-signaling hypothesis., *Lakonishok and Lev (1987)* in their study revealed an empirical evidence that is consistent with firms employing stock dividends and stock splits in order to shift share prices to an optimal trading level. In line with this notion, *Loughlin (1989)* and *Easton and Sinclair (1989)* in their study found negative correlation concerning stock price and dividend payment, *Ogden (1994)*, *Stevens and Jose (1992)*, *Kato and Loewenstein (1995)*, *Ariff and Finn (1986)* and *Lee (1995)* all endorse the same view that there is considerable positive association between stock price and dividend payment whereas *Loughlin (1988)* and *Easton and Sinclair (1989)* have common view that showed a negative correlation concerning dividend payment and stock price, *John and Lang (1991)* in their study did not indicate dividend as a sole mechanism for promoting private information to the market. According to them, that firm has multiple cost effective signals to choose from to convey their private information, *Dempsey and Laber (1992)* in their study found that there is different financial behavior between insider and common shareholder within the firm. According to their revelation that as far as insider are concerned dividend yield is negatively related to the proportion of stock held by them and positively related to the common share holder, *Noronha and Obaidullah (1993)* in his study examined the dividend behavior of Sensex 30 blue chip Companies for the period of fifteen-year and study traced the fact that firms tend to follow a stable dividend policy, *Agrawal and Jayaraman (1994)* in their study distinctly examined the hypothesis that dividend payout minimize the advantage of free cash flow to the managers, *Bernheim and Wantz (1995)* document a positive relation between increases in the tax rate on dividends and the share price response per dollar of dividends, *Michaely, and Thaler (1997)*, and *Jensen and Johnson (1995)* document that dividend cuts are followed by earnings increases, consistent with dividend cuts marking the end of a firm's financial decline and the beginning of its restructuring, *Shen (1998)* in his study produced the fact that, no average reaction to dividend initiation announcements on rivals' stock prices and their earnings forecasts, *Oludoyi (1999)* in his study investigated the impact of earnings announcements on share prices in Nigeria around annual general meeting (AGM) dates between 1986 and 1994, *DeAngelo and DeAngelo (2000)* find evidence that the market penalized

Times. Mirror for intending to poorly reinvest free cash flow and applauded later dividend redistributions of that cash flow. *La Porta et al. (2000)* in his study revealed that dividends are paid because minority shareholders pressure corporate insiders to disgorge cash, *Faccio et al. (2001)* in his study advocated that dividend rates to a large extent depend on the vulnerability to expropriation of minority shareholders which are measured by the discrepancy between the controlling shareholders ownership rights and its controlling rights, *Grullon, Michaely and Swaminathan's (2002)* in their study revealed that firms with anticipation of declining investment opportunity likely increase the dividends in order to protect the investor base, *Schleicher, Caton et al. (2003)* in their study examine whether information embedded in dividend omissions affect the cash flow expectations of rivals along with abnormal stock returns and abnormal earnings forecast revisions of rivals surrounding announcements of dividend omissions by announcing companies, *Henryk and Roland (2003)* through their study tried to justify that announced dividend blow fresh information in the stock market and stock price react with spontaneity to it and move with coordination in the same direction as dividends moves, *Uddin and Chowdhury (2005)* in their study produced the evidence that investors do not benefit from dividend announcement in DSE, their paper was based on the 137 DSE listed companies, *Daine and Paul (2006)* in their study found that dividend complexity impact change in price when the nature of news goes against the grain of recent market direction during unpredictable times, *Sharma Dhiraj (2007)* in his empirical study examined the financial and dividend behavior of selected Indian firms and tried to justify whether or not the dividends are still vogue in India with the help of signaling and tax effect theory. Study revealed firms paying dividend during this period have followed continuous progressive trend, *Kapoor (2009)* in his study identified the circumstances under which dividend policy impact the firm value. It is traditionally argued that dividends are safer than capital gains and have different implications on share price and dividend ratio, *Aasia Asifi, Waqas Rasool, Yasir Kamal (2011)* in their study examined the management concern about capital structure, its impact on profit and wealth of shareholders of Pakistan firms and found that extent of corporate debt and practiced dividend policy significantly influenced the dividend policy. They also found that leverage have negative impact on dividend payout, companies with degree of leverage pay fewer dividends.

After going through literature review, it has been found that the dividend policy is exclusively researched topic in the field of finance but to decide either dividend policy affects the share price or not is still mystifying question. Some study justifies retention and some justify the dividend payout and some studies produced that company's financial health and its futuristic capital expenditure plans play significant role in determining the payout and retention policy. Due to these facts, dividend payout and retention in banking sector invites more studies time to time in order to develop scientific and authentic policies which have answer to all complexities.

4. Analysis and Interpretation

4.1 Analysis of Market Value to Book Value Using T-Test

Analysis and interpretation are importantly to be conducted by the organization in order to trace out the real fact which may become backbone of future organizational planning. In order to produce judicious result of relationship between dividend policy and shareholder wealth of selected Indian banking companies and to justify the average wealth of investor, comparison have to be carried out scientifically and judicially. For the purpose, comparison of mean of shareholders wealth of companies have been carried out and year wise mean values of market value to book value significance are checked with t-values. For the revelation of transparent result the following hypothesis is formulated and tested.

H₁: "There is no significant difference in average market value in relation to book value of equity of banking companies."

Table 1.3: Year-wise Comparison of Market Value to Book Value of Equity of Public and Private Sector Banking Companies in India from (2006-10)

Years	Mean	SD	t-Values	Sig- value
2006	1.7399	0.848	0.086	0.993
2007	1.8303	1.180	0.315	0.759
2008	1.9450	0.970	0.776	0.456
2009	1.2869	0.770	-1.855	0.093
2010	1.7878	1.060	0.218	0.832
All years	1.71798			

(SD – Standard Deviation; Level of Significance is 5%)

Interpretation: From the above table (No. 1.3) it has been found that the mean market value of equity in relation to book value of all the banks in study is above 1 for all the years as well as for pooled year. In 2009, it was lowest to (1.2869) and in 2008, it was highest to (1.9450) with over all mean of (1.71798) for all the year. This shows that the banking companies which pay dividend have better market values than the book value. Year wise comparison

in all five years of market value to book value shows insignificance ($p > 0.05$), further it shows that,

H₁: there is no significance difference in an average equity market value in relation to book value of equity of banking companies, is accepted because at 5% significance values are insignificant, means there is no significant difference in average market value in relation to book value of equity of banking companies.

4.2 Analysis of Relationship between Dividend Policy and Shareholders' Wealth

For knowing the impact of dividend policy and shareholder's wealth it is to find out that, is there any difference

in the t values of these, and to check the significant level of these, by using multiple regression models. For this purpose the following hypothesis is formulated:

H2: hypothesis, "There is no significant impact of dividend policy on shareholders' wealth in Banking Companies in India."

Table 1.4: Results of Regression showing the Impact of Dividend Policy on Market Value of Equity of all banking companies in India from (2006-10)

Independent Variables	Regression model			
	1	2	3	4
Intercept	191.1872	184.7926	394.4205	238.0722
Dividend per share (DPS)	39.29839 (1.85693)	483.8618 (1.960846) (0.188938)	559.622 (8.197934) (0.077274)	610.131 (9.385934) (0.067572)
Retained Earnings (RE)		-96.6167 (-1.80538) (0.212772)	-112.529 (-7.61199) (0.083158)	-117.076 (-8.53182) (0.074278)
Lagged Price Earnings Ratio (Pet-1)			-20.1805 (-5.13929) (0.122344)	
Lagged market value of Share (MVt-1)				-0.75047 (-5.63136) (0.111883)
R2	0.534753	0.823080	0.993546	0.994592
Adjusted R2	0.379671	0.646160	0.974184	0.978366
F value	3.448190	4.652268	51.31383	61.29931

Interpretation: In order to know the impact of dividend policies on shareholders' wealth of banking companies with their adopted dividend policy, we have used statistical tool 'multiple regression analyses to analyze scientifically and interpret systematically and bring out the miracle truth positively. To find out the result with deep accuracy the dividend per share (DPS) of the respective banking companies and their Market value (MV) of equity are used as a proxy to measure the dividend policy and shareholders' wealth, and they are used as a dependent variable. Along with DPS, other explanatory variable like Retained Earnings (RE), Lagged Price- Earnings Ratio (Pet-1) and Lagged Market Value of Equity (MYt-1)' are

also used to analyze whether dividend policy of banking companies are important and dominating factor and can influence the wealth creation of shareholders. From the above table (No.1.4) it has been revealed that the regression results for all selected banking companies in India indicate that the fit of all four models is insignificant at 5 percent level (F=3.448190, $P>0.05$ for model 1, F= 4.652268, $P>0.05$ for model 2, F= 51.31383, $P>0.05$ for model 3 and F= 61.29931, $P>0.05$ for model 4).

It is has been found that among the four models, F value for model 4 is significantly very high. Further, it has been noted that the coefficients of DPS in all the four models are

highly insignificant at 5 percent level and positive in sign ($\beta=39.29839$, $t=1.85693$, $P>0.05$ in model 1; $\beta=483.8618$, $t=1.960846$, $P>0.05$ in model 2; $\beta=559.622$, $t=8.197934$, $P>0.05$ in model 3; and $\beta=610.131$, $t=9.385934$, $P>0.0$ in model 4). It has been found that from adjusted R2 values, it is clear that explanatory variables in the model 4 (which is higher among all R2 values) explain 97.8366 percent of the variance in market value, whereas in model 1, 2 and 3 explanatory variables explain 37.9671 percent, 64.6160 percent and 97.4184 of the variance in dependent variable respectively. For the final interpretation from all the models in the study, model 4 is recognized as a relevant model. Even though it is been found that statistically the coefficient of DPS in model 4 is insignificant and has declined to a great extent in the presence of RE and lagged MV. Further, coefficient of other variables in comparison also found to be an insignificant. The revealed intercepts in the study are found insignificant in the entire model which indicated that there are certain factors which are inherent in the market and dominated dividend policy especially when market has started excepting RE and lagged MV of banking companies under banking sector.

So 'H2 hypothesis, there is no significant impact of dividend on share holders wealth in banking companies in India is rejected and it is concluded that different determinant factor of dividend policy affect differently on creating the share holder wealth. (There is significant impact of dividend policy on the shareholders wealth in banking companies in India.)

5. Economic Implication of Dividend

The study revealed that all the banking companies in the study are paying dividend and are having better market values than the book value. By implementing various tools and technique it is also found that there is significant impact of dividend policy on the shareholder wealth in Indian banking companies. Having better market value than book value means banks are having sound position and can attract more funds if required through issue of new shares in order to fund their capital expenditure programs. With better market value and increase dividend they would be in position to sustain high dividend in future and can reflect higher expectations for future EPS and can give stronger message of growth. Having better market value they can satisfy clientele of investors positively. The study revealed that dividend policy has deep impact on the image of the company and can influence market

price to a great extent which largely depends on collective economic environment not only on dividend policy alone. It implicates economy in many ways as it has inverse relation with inflation, recession, tax policies, and fiscal policies. Better market value of stock price due to high dividend will impact purchasing power and ultimately implicates investors by generating trust, sense of security and returns on their investment which they use to evaluate the market status of the company for future investment and on other hand it implicate investor to pay tax on received dividend. It implicates decision makers to judge their dividend frequency and their financial strength in order to invest in capital projects. Paying more dividends means cash out flow which will reduce fund available for investment and to adjudicate the gap banks have to depend upon external fund which will impact increase in cost and risk. Its implicate lenders that by paying high dividend to the shareholder would impact servicing and redemption of their claims. These impacts and implications cannot be eliminated but can be controlled through developing optimal dividend policy which absorb all the consequences and integrate the entire participant positively.

6. Findings of the Study

The study conducted to examine the relationship between dividend payout and shareholders' wealth passed various measures in order to find the true results and to check the authenticity of formulated hypothesis and produced the facts with due relevancy which can be helpful to analyze the future relation.

- The study found that the average of all years Market Value to Book Value is 1.72.
- The study found that in the year 2008 the Mean Market Value to Book Value is highest which 1.9450 and in the year 2009 it is lowest which 1.2869.
- The study found that in the year 2007 Standard deviation (SD) is highest which is 1.180 and lowest in 2009 which is 0.77
- The study found that by analyzing revealed data through T-Test of Market Value to Book Value 'there is no significance difference been found in the Market Value to Book Value' and thus the hypothesis which was assumed in this study is accepted after analyzing the data.
- The study found that revealed F-values by implementing tools is 61.29931 which are the highest

among all the models as shown in regression model 4, but the study also witnessed that the highest F-Value has insignificant impact of dividend given by the companies on the shareholder's wealth and due to this there is no positive impact of dividend on market price of the shares.

- The study found that market price do not depend on the dividend policy alone but many factors play a vital role in price determination like Price Earnings ratio (P/E ratio), Retained Earnings (RE) and past history of company market price, market conditions of the respective industry, inflation, recession, tax policy, fiscal policy of the nation, global trend, companies overall competitive strength etc.

7. Conclusion

Globally, academic researchers and corporate community never had been able to justify any dividend policy that can fit all economic entities. Due to size of the firms, nature of business, their different complexities and combination of potential different market frictions it is impossible to adopt and implement any policy in general. Each entity has a unique optimal dividend policy framed according to their strength. It is generally observed that decision of dividend has a significant impact on the value of the company and the study strongly support the strategically revealed truth that market infers different messages with respect to different type of dividend. It reacts in strong confidence to regular dividend increase in comparison to specially designed dividends. Dividends are lawful protection of shareholder and choosing dividend policy is strategic puzzle for the company as it holds the answer to future expansion and diversification in those projects that pass the NPV rule. The wealth of shareholders largely depends on high EPS which is possible if company have positive ROI which is an outcome of efficient and effective management of liquidity, optimum utilization of asset and employed debt. The study examined the truth and realized that protected shareholders normally indorse low dividend payout and high reinvestment rates from a company with good opportunities and fair records and avoid high payout if they do not have protected future opportunities and they try to get what they can which reflects ambiguous relationship between growth prospects and dividend payout. The study support the fact that dividend is not paid in the status in which it should be paid as they are paid out of profits or lawful reserves

which are produced after the efficient manipulation by the companies. The study of literature also revealed that ownership is one of the most important variables which influence the dividend payout policies. Sometime dividend are result of effective pressure mounted by the minority shareholders to force insiders to disgorge cash or it may be the insider's strategy to establish positive reputation in market in handling sensitively the minority shareholders return on their investment in respect of issuing equity in future. It becomes more sensitive and unexplainable when shareholders are taxed heavily on their dividend receipts than on capital gain. The study support the revealed fact that no corporate want to distribute surplus profit to their investors to which they deserve, either in greed to enjoy the surplus and accumulate hidden wealth for themselves or to use the surplus resource to grow the business in diversified form and control the status of corporate and thus they follow extremely deliberate dividend payout strategies. Though, it is futuristic and strategic balancing decision between quality of investor's protection and lower agency cost. The study of literature constitute the fact that payments of dividends have effective edge on retaining surplus profit as it consolidate investor protection and bonding which result in economic growth through balance resource allocation and establish its market reputation. Thus companies should not underpay dividends, having too much ideal cash lying will hamper banking companies' growth.

Finally, the study focuses on dividend payment performance of banking companies in India and justifies the strategic importance of dividend and retention and their impact on shareholders wealth. In the examined period of five years, the study found that there are different determinant factor of dividend policy which affect differently on creating the share holder wealth and market value do not only depend on dividend but it is influenced by collective factors among them dividend is one. The study concludes that dividend payouts have strategic influence on shareholders wealth and there is significant impact of dividend policy on the shareholder's wealth in banking companies in India.

8. Suggestions

Banks and financial intermediaries are stoking engines of economic structure and growth rotates on their axis. For the longevity of overall survival, banks have to develop perpetual relation with common investors which is possible

only with collective protection of investor's interest especially dividend. For this they have to consolidate transparent mechanism in all regards and must follow the norms which are laid in basil I, II & III. They have to establish excellent and integrated service standards, loyalty and financial literacy of under privileged in the society; they have to improvise supervision, internal control and competitiveness, they have to ensure financial innovation and updated technological infrastructure, safety, soundness and financial as well as dividend payout stability. These entire things will ultimately lead to increase in banks credit expansion, economic and investor's integration, productivity, profitability with investor's confidence and growth in their wealth.

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Appendix 1

Market Price per Share and Dividend Price per Share are as laid below:

Table 1.1: Five years Market Price per Share of the Selected Banks from (2006-10)

DPS	2006	2007	2008	2009	2010
Axis Bank	103.06	120.8	245.13	284.5	395.99
Bank of Baroda	215.35	237.46	303.18	352.37	414.71
Bank of India	99.03	117.89	168.06	224.39	243.75
Canara Bank	171.19	197.83	202.33	244.87	305.83
HDFC	169.24	201.42	324.38	344.44	470.19
IDBI	88.04	86.09	93.82	102.71	113.5
ICICI	249.55	270.37	417.64	444.94	463.01
OBC	206.39	223.53	230.54	257.54	292.19
PNB	287.79	321.65	341.98	416.74	514.77
SBI	525.25	594.69	776.48	912.73	1,038.76
Union Bank of India	81.02	93.71	111.33	139.66	174.37

Table 1.2: Dividend Price per Share of the Companies of Last Five Years from (2006-10)

DPS	2006	2007	2008	2009	2010
Axis Bank	3.5	4.5	6	10	12
Bank of Baroda	5	6	8	9	15
Bank of India	3.4	3.5	4	8	7
Canara Bank	6	7	8	8	10
HDFC	4.5	5.5	7	8.5	10
IDBI	1.5	1.5	2	2.5	3
ICICI	8.5	10	11	11	12
OBC	4.5	4.7	4.7	7.3	9.1
PNB	6	10	10	20	22
SBI	14	14	21.5	29	30
Union Bank of India	3.5	3.5	4	5	5.5