Integrated MBA(HA)

Fundamentals of Financial Management Code-BHI-404

Unit-5

Introduction

When the business concerns decide dividend policy, they have to consider certain factors such as retained earnings and the nature of shareholder of the business concern. The manager must take careful decisions on how the profit should be distributed among shareholders. It is very important and crucial part of the business concern, because these decisions are directly related with the value of the business concern and shareholder's wealth. Like financing decision and investment decision, dividend decision is also a major part of the financial manager.

Meaning

Dividend refers to the business concerns net profits distributed among the shareholders. It may also be termed as the part of the profit of a business concern, which is distributed among its shareholders.
According to the **Institute of Chartered Accountant of India**, dividend is defined as "a distribution to shareholders out of profits or reserves available for this purpose".

TYPES OF DIVIDEND/FORM OF DIVIDEND

Dividend may be distributed among the shareholders in the form of cash or stock. Hence, Dividends are classified into:

1. **Cash Dividend**

If the dividend is paid in the form of cash to the shareholders, it is called cash dividend. It is paid periodically out the business concerns EAIT (Earnings after interest and tax). Cash dividends are common and popular types followed by majority of the business concerns.

2. **Stock Dividend**

Stock dividend is paid in the form of the company stock due to raising of more finance. Under this type, cash is retained by the business concern. Stock dividend may be bonus issue. This issue is given only to the existing shareholders of the business concern.

3. **Bond Dividend**

Bond dividend is also known as script dividend. If the company does not have sufficient funds to pay cash dividend, the company promises to pay the shareholder at a future specific date with the help of issue of bond or notes.

4. **Property Dividend**

Property dividends are paid in the form of some assets other than cash. It will distributed under the exceptional circumstance. This type of dividend is not published in India.

FACTORS DETERMINING DIVIDEND POLICY

1. **Profitable Position of the Firm**

Dividend decision depends on the profitable position of the business concern. When the firm earns more profit, they can distribute more dividends to the shareholders.

2. **Uncertainty of Future Income**

Future income is a very important factor, which affects the dividend policy. When the shareholder needs regular income, the firm should maintain regular dividend policy.

3. **Legal Constrains**

The Companies Act 1956 has put several restrictions regarding payments and declaration of dividends. Similarly, Income Tax Act, 1961 also lays down certain restrictions on payment of dividends.

4. **Liquidity Position**

Liquidity position of the firms leads to easy payments of dividend. If the firms have high liquidity, the firms can provide cash dividend otherwise, they have to pay stock dividend.

5. **Sources of Finance**

If the firm has finance sources, it will be easy to mobilise large finance. The firm shall not go for retained earnings.

6. **Growth Rate of the Firm**

High growth rate implies that the firm can distribute more dividend to its shareholders.

7. **Tax Policy**

Tax policy of the government also affects the dividend policy of the firm. When the government gives tax incentives, the company pays more dividend.

8. **Capital Market Conditions**

Due to the capital market conditions, dividend policy may be affected. If the capital market is prefect, it leads to improve the higher dividend.

TYPES OF DIVIDEND POLICY

Dividend policy depends upon the nature of the firm, type of shareholder and profitable position. On the basis of the dividend declaration by the firm, the dividend policy may be classified under the following types:

1. **Regular Dividend Policy**

Dividend payable at the usual rate is called as regular dividend policy. This type of policy is suitable to the small investors, retired persons and others.

2. **Stable Dividend Policy**

Stable dividend policy means payment of certain minimum amount of dividend regularly. This dividend policy consists of the following three important forms:

Constant dividend per share

Constant payout ratio

Stable rupee dividend plus extra dividend.

3. **Irregular Dividend Policy**

When the companies are facing constraints of earnings and unsuccessful business operation, they may follow irregular dividend policy. It is one of the temporary arrangements to meet the financial problems. These types are having adequate profit. For others no dividend is distributed.

4. **No Dividend Policy**

Sometimes the company may follow no dividend policy because of its unfavourable working capital position of the amount required for future growth of the concerns.

Legal and procedural aspects of payment of dividend

Legal provisions relating to declaration of dividend are laid down in Section 250, 250A,206 and 207 of the Companies Act.

Divisible profits are those profits which are legally available for distribution of dividend to its shareholders.

It is the periodical payment made by the company to its shareholders out of divisible profits.

It refers to that portion of profits of a company which is distributed by the company among its shareholders.

Legal Aspects

According to Section 123 of the Companies Act, 2013, no dividend shall be declard or paid by a company for any financial year except (a) out of the profits of the company for that year arrived at after providing depreciation in accordance with the provisions of Schedule II, or out of the profits of the company for any previos financial year or years arrived at after providing for depreciation in accordance Schedule II and remaining undistributed, out of both; or (b) out of the money provided by the Central Government or a state Government for the payment of dividend by the company in pursuance of a guarantee given by the Government.

The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared. Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher that the average dividends declared by the company during the immediately preceding three financial years.

Shareholders have the right to declare the dividend at the general meeting but they can only approve the rate of dividend recommended by the directors or lower it but not increase it. As per the Companies Act, interim dividend is declared by directors, unlike the annual dividend, which is declared by the members in t he annual meeting.

Legal Aspects

The important events and dates in the dividend payment procedure are:

Board resolution The dividend decision is the prerogative of the board of directors. Hence the board of directors should in a formal meeting resolve to pay the dividend.

Shareholder's approval The resolution of the board of directors to pay the dividend has to be approved by the shareholders in the annual general meeting.

Record date The dividend is payable to shareholders whose names appear in the Register of Members as on the record date.

Dividend payment Once a dividend declaration has been made, dividend warrants must be posted within 30days. Within a period of 07 days, after the expiry of 30 days, unpaid dividends must be transferred to special account opened with a scheduled bank.

Current Issues in Financial Management

1. Strategic financial decisions
2. Drivers of present value
3. Risk and return relationship
4. Anomalies the efficient market hypothesis
5. Success of new securities
6. Dividend puzzle
7. Appropriate level of risk
8. Value of liquidity
9. Merger waves