Financial Management For Managers
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Lecture 60
Dividend Decisions - Part II

Welcome all, so we are starting now the last and the final lecture of this course 60^{th} lecture and I am discussing with you as I discussed in the previous class also the dividend decisions that how the firms take the dividend decisions. So after this completing discussion, conceptual discussion on the dividend decision so I will close discussion on the dividend decisions as a whole and even the course as a whole.

So, let us learn about the remaining parts, important parts which are concerning the dividend decision of the firms. How different other important say aspects affect the dividend decision of the firm. So, one another important aspect is apart from the things we have discussed so far, so the one important aspect here is the legal aspects. So, there are some say legal components also because dividend is paid by the joint stock companies which are under the preview of the Ministry of Company Affairs or the corporate affairs you can say.

And companies act also applies on the companies even the say income tax also applies on the companies. So, there are certain provisions of the Indian Companies Act 1956 and later on amended from time to time. Major amendments were recently done say in the companys act in 2013. So, I will like to give you a snapshot of the important things, a snapshot of the important legal aspects which affect the dividend decisions. But I will not take more time in discussing of this because this is something where you cannot add any value. You will have to reproduce these provisions or so simply you should be learning it about.

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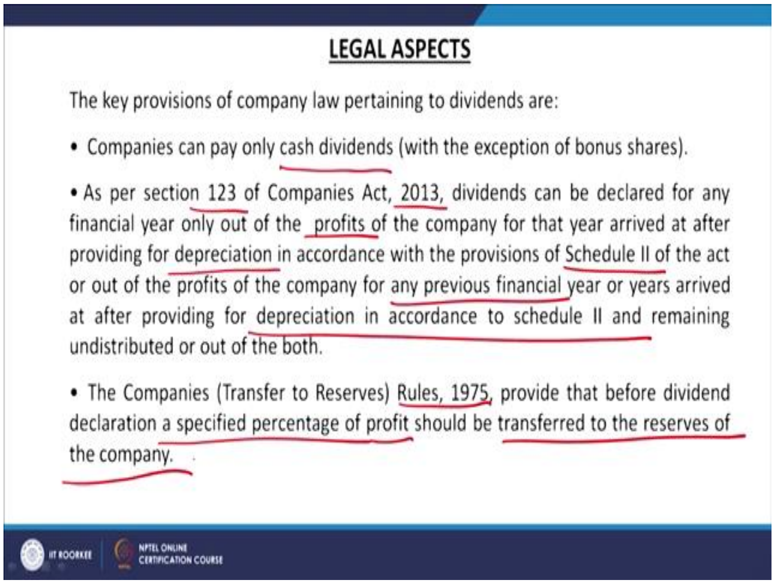

So, the key provisions of the company law pertaining to the dividend decisions are first point is dividends can, companies can pay the say only cash dividends. Companies can pay only the cash dividends. Sometimes the bonus shares can also be given, but largely the dividend has to be paid as the cash dividend. And next important point is as per the Section 123 of the Companies Act 2013 dividends can be declared for any financial year only out of the profits, only out of the profits of the company.

For that year arrived at after providing for depreciation in accordance with the provisions of the schedule two of the act or out of the profits of the company for any previous financial year or years arrived at after providing for the depreciation in accordance with the Schedule 2 of the act and the remaining undistributed profit or both off that. Either from the profit of the current year or from profit, undistributed profit of the previous year or from the sum total of the both the profits.

But after providing for the depreciation, it should not happen that you have not provided the sufficient amount for the depreciation for the fixed assets and you are distributing the entire profit as a dividend to the shareholders. So, the problem will come when the assets have to be replaced. We not have the any sufficient amount available with us. So, that is the reason that is the say important say consideration here that under the legal aspects, this provision for the depreciation has been necessitated.

That first of all depreciation provision has to be made after that whatever the residual profits are left with you. You can distribute part of that as a dividend. So and the dividend has to be paid from the profits only maybe the profits of the current year or maybe the undistributed profit of the previous year or maybe from the sum total of the profit of the both of the year.

Next important legal aspect is the Companies Transfer to Reserves Rules 1975 provide that before dividend declaration a specified percentage of the profit should be transferred to the reserves of the company. Some amount of the profit should also be transferred to the reserves and surpluses of the company in the form of the retained earnings, so that in the event of non-availability of the funds for meeting any kind of the exigencies or for any kind of contingencies, we have the sufficient funds available with us. So, these are the major legal aspects.

One thing is that it can be paid as a cash dividend. Second thing is as it can be paid say from the profits of the current year or from the previous year, but after providing for the say depreciation. And another important aspect is that out of the total profits, some part of the profits should be transferred to the reserves and surpluses we must create some reserves and surplus and then only the remaining part or part of the profit can be distributed as dividend.

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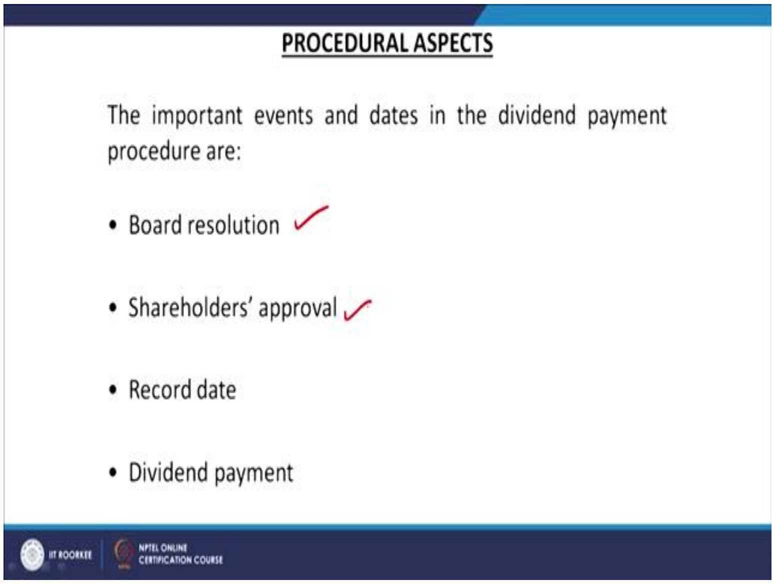

Procedural aspects, there are the four points involved in the procedural aspects. Number one is the board resolution. Board of directors have to pass a resolution and they have to say ultimately it is their prerogative. How much dividend they want to pay? They want to pay any dividend or do not want to pay any dividend. It may be possible that there is a profit in the company, but BOD feels that entire profit is required for reinvestment in the company. So, they will not declare any dividend.

So, first of all board resolution is important. Second thing is a shareholders approval. So, it has to be got approved in the shareholders meeting, annual general meeting of the shareholders. So their approval is also must and record date. Record date is that date means on the date of paying the (dividend) on the date of the declaration of the dividend not paying on the date of the declaration of the dividend, the number of shareholders whose names are appearing in the register of the company will be entitled to receive the amount of the dividend declared by the company.

But the shareholders whose name is not appearing on the date of the declaration of the dividend in the register of the company will not be titled for the dividend for that year. So, record date is basically the date on which the dividend is declared and the shareholders name is appearing in the register of the company. And dividend payment, finally the dividend has to be paid within 30 days.

Within 30 days it has to be transferred, dividend warrant has to be sent within a period of 30 days from the date of declaration of the dividend. And if there is any amount of the dividend left unpaid maybe because of some reasons, sometimes what happens that we send the dividend warrant but the address of the shareholder is not correct. So, it is not reaching at the proper time. Or maybe some details of the shareholders are not available with the company.

So, it is not clear to whom to send the dividend or maybe when to send the dividend. So, it may be possible that out of the total declared dividend as per the number of shares shareholders name appearing in the companys registered. Some of the shareholders are not locatable, so their dividend remains undistributed or unsent.

So, that amount of the dividend has to be say deposited in a special account to be opened in a scheduled bank within the 7 days from the last date of the payment of the dividend. That is after the completion of 30 days period of time, within which the dividend warrant has to be sent to the shareholders within the next 7 days the undistributed dividend has to be deposited in a special account, open in a scheduled bank.

So that that I amount can be later on transfer to the shareholders when their details will be locatable. And then finally, that amount in that special account becomes a zero because total undistributed amount has been passed on to the shareholders as an even their details were available.

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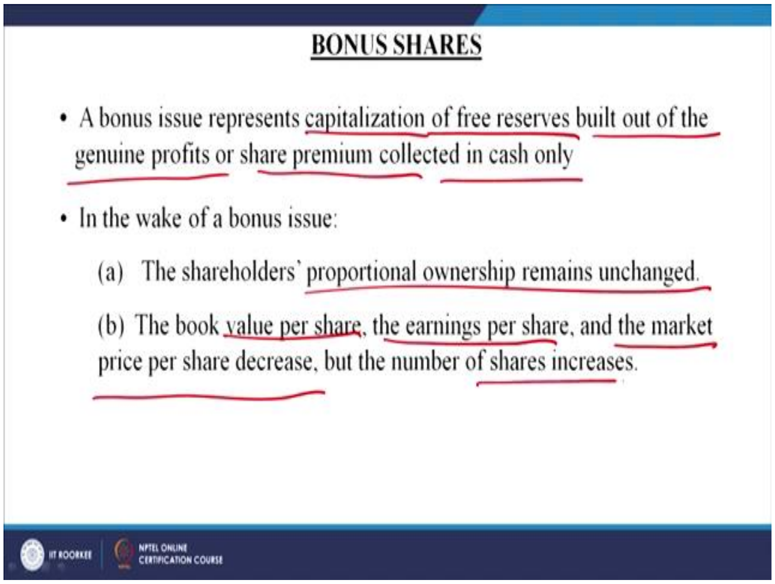

Now, we discussed some other important concepts like bonus shares. And then we will discuss some buyback issues and some other things which are again linked to the dividend decisions. So what is a bonus share? Bonus issued represent capitalization of the free reserves, bonus issued to represent capitalization of the free reserves. It is just basically that capitalization of the free reserves. In the balance sheet of the company there are certain free reserves.

Sometimes the company feels that entire amount of these reserves and surpluses is not required all the times. So why not to capitalize it? And why not to say transfer it to the account of the shareholders and say the benefit of which can be passed on to the shareholders. So capitalization of the free reserves build out of the genuine profits or the share premium collected in cash only. A bonus issue represents capitalization of free reserves built out of the genuine profits or that shared premium collected in cash only.

In the wake of the bonus issue, number 1, what happens now? Shareholders proportional ownership remains unchanged. Proportional ownership means in the percentage wise, if you talk about the ownership of the shareholders that remains unchanged because every shareholder is getting the bonus share in the proportion of the shares he or she is holding. So, ultimate proportional remains the same total number goes up. But the ultimate proportion remains the same.

Second is the book value per share, earning per share, and the market price per share decrease. The book value per share, earning because number of shares has increased total capital amount remaining the same that is equity paid up capital plus pre-reserves. Total amount is remaining the same. Earlier for example, there were 1000 shares now there are 1500 shares. So what will happen?

Value per share and earning per share because number of shares you have increased, so value per share, earning per share and the market price per share will decrease. But the number of shares increase but the number of shares is increase and it is only because of increasing the number of shares other things decrease, right. So this is the bonus shares, which is issued to the existing shareholders out of the say free reserves which were built out of the genuine profits on the share premium collected in the cash by the company.

Then we talk about the stock split. Stock split is a very important concept sometimes. What happens, companies say they split their stocks into the smaller amounts. One share will be divided into 2 shares or one share will be divided into 5 shares. So, something like that, why it is done? Sometimes largely the objective remains that when the share price or the when the companys share is trading in the stock market at a very high price, when it is trading at a very high price in the stock exchange.

So, sometimes it goes out reaches beyond the reach of a common man. Everybody cannot think of purchasing that share in the from the market, from the stock exchange. So, what the companies do to increase the trading of the share of the company they split into the smaller number of means into the multiple number of shares. So the price per share comes down and it becomes within the reach of a common man.

So the trading for the shares increases because trading is the only mechanism which helps to reflect the true price of the share, right. So, stock split is many times used. So what normally we do, let us understand and then we will understand the difference between the bonus issue and the stock split.

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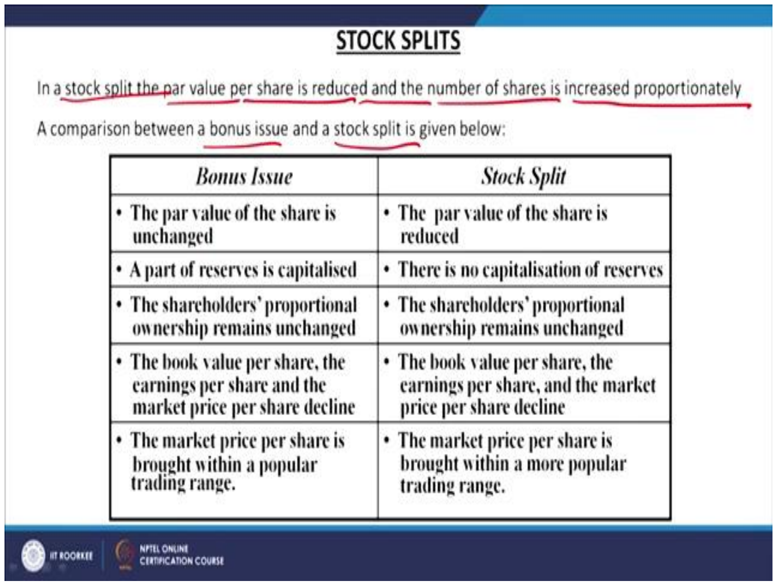

In a stock split the par value per share is reduced, the par value share reduced and the number of shares is increased proportionately. In a stock split the par value because again same thing you are doing, in the bonus share also number of shares is increasing and in the stock split also number of shares is increasing. So what will happen? The par value per share is reduced and the number of shares is increased proportionately. A comparison between the bonus issue and the stock split is given to below. Between the two is given below so what happens?

In both the cases number of shares goes up, right. So, share price goes down in case of the bonus share also, in case of that split of the shares also. So, what is a bonus issue and what is a stock split, this table is given quickly let us have a glance on it. You can read it later on also but let us discuss the important points. Bonus issue, the par value of the share is unchanged and stock split the par value of the share is reduced.

Number 2, a part of the reserve is capitalized, there is no capitalization of the reserve. Only the existing shares are bifurcated into the smaller number of shares. And yes, the par value does not change because total common stock remains the same paid up capital plus the pre-reserves are same right. So par value is not going to change, it remains unchanged. And in this case, the par value changes.

A part of the reserves is capitalized. And in this case, there is no question of capitalization of reserves. The shareholders proportional ownership remains unchanged. As I told you, percentage ownership remains unchanged. The shareholders proportional ownership remains again unchanged in this case also. One share divided into 2 so proportional ownership is the same. The book value per share, the earning per share and the market price per share decline.

The book value per share, earnings per share and the market price per share decline, in this case, the book value per share the earnings per share and the market price per share declines. So same thing happened in both the cases and number four, the market price per share is brought within a popular trading range. That is why the say bonus shares are issued so that the per share price goes down and it number of shares increase means you can say by increasing the number of shares in the market.

It comes with the within the popular trading range and the market price per share is brought with within a more popular trading range. So, here the number of shares is increased. So, it comes within the more trading range. And in this case price per share is reduced so that it also comes within the range of say more trading range.

So more popular trading range and in both cases when there is more trading of any company shares taking takes place in the stock market. So what happens? It comes in the reach of the common man trading increases and when the trading of any share in the stock market increases, I repeat that the true price of the share can be reflected. It is the only mechanism, not CAPM, not any other mechanism, but only the trading frequency of any company share in the market helps to reflect the true price of share that what is the worth of the share, how much price people are ready to pay, that all depends upon the trading volumes.

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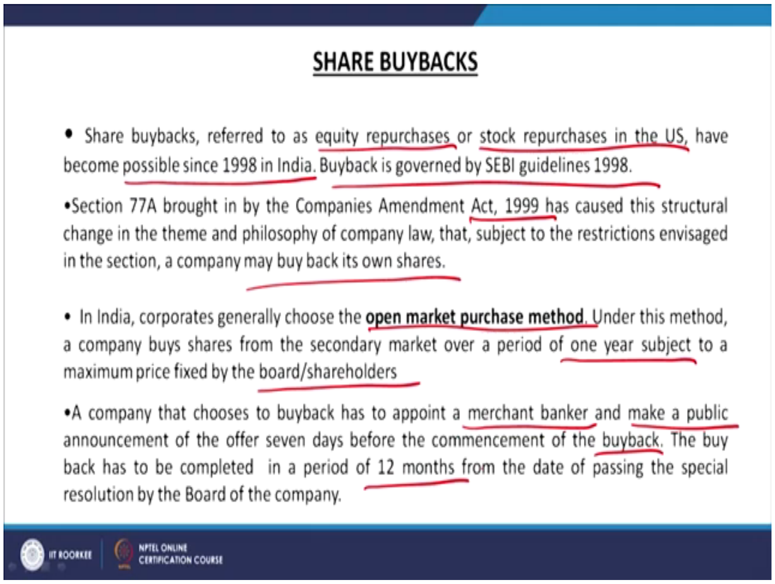

Now, we discussed some next important concept and that is called the share buybacks. Share buybacks is again a very-very important concept, which is also linked to the say dividend decisions because when share buyback will happen dividend will also change. Dividend decisions will also be affected. So whether it is a bonus issue, whether it is a stock split or whether it is a share buyback all the three are say affecting your dividend policy. That is why we are discussing these important concepts here.

First point, share buyback referred to as equity repurchase or stock repurchase in the US in the US had become possible since 1998 in India also. This process of share buyback originated in the US, came from the US to other economies and in India also this was allowed in 1998 and buyback is governed by the SEBI guidelines issued in 1998, right. So, SEBI guidelines are important for the first time. Buyback was allowed in India in 1998 and SEBI formed the guidelines that how the buyback of the shares will be done by the different companies.

After that, many companies Reliance Industries, Bajaj Auto Limited and many other bigger companies they have gone for the share buyback. And this process has been means very-very facilitating for many companies who wanted to buy back their shares from the market, because sometimes what happens the company is overcapitalized, the company is overcapitalized they are not justifying, their investment in the company and the total capital invested in the company is more than the say requirement, real requirement of the capital in the company.

So, in that case, sometime the company feels that if the part of the capital means the same level of operations, if they can be carried over a big 1000 rupees. So why should we invest 2000 rupees for carrying on that kind of operations. So if 1000 is returned back to the investors, only 1000, which is really required, if it is retained in the firm, then I think it improves the overall financial health of the company, capitalization of the company and dividend to be pay to the shareholders also to the of the company.

Section 77A brought in by the Companies Amendment Act of 1999, has caused this a structural change in the theme and philosophy of the company law that is subject to the restrictions and envisaged in the section. A company may buy back its own shares subject to the restrictions and envisaged in the Section 77A.

Company may buy back its own shares. In India Corporates generally choose the open market. There are basically two methods of purchasing the, rebuying the or repurchasing the shares from the market or buying back the shares from the market. One is the tender method, second one is the open market purchase method. Under the tender method company who want to buy back its own shares, they fix up a price, right?

They prefix price and that price is normally which is a fixed price remains more than the normal market price. So, they give the allurement, they give the reasons, they give the allurement to the shareholder. That if you want to sell off your shares or return it back to the company, you can and they normally fix a price which more than the normal market price. Now for example, a company whose shares are more than the genuine requirements of the company.

So naturally, the demand for the shares of that company will be very less in the market because dividend paid is also very less because companys earnings are not justifying that amount of the say shares. So, it means the price which is available at which the share is available in the market must be comparatively lesser. So, if the company want to buy back the shares from the market by following a tender method they have to fix up a price, offer it to the people by way of advertising it in the newspaper that we are ready to buy this much number of shares at this much of the price.

If anybody want to sell it back, return it back to the company, then it can be done. So, that is a tender method and open market purchase method is that when the company purchases it shares from the open market stock exchange with the help of or through the brokers. This is called as the open market purchase method and broker is told the maximum price he can pay for buying the share from the market and maximum number of the shares he can purchase from the market.

That is told to the broker and with the help of the broker the shares are purchase at the open market price from the market but the maximum price to be paid is told to the broker. And on that say prefixed price which is communicated to the broker the broker tries to buy the shares of the company for the company from the open market.

So, in India corporates generally choose the open market purchase method under this method. A company buys a shares from the secondary market over a period of 1 year, over a period of 1 year subject to a maximum price fixed by board or shareholders in their annual general meeting. A company that chooses to buy back has to appoint a merchant banker and make a public announcement of the offer 7 days before the commencement of the buyback.

The buyback has to be completed in a period of 12 months from the date of passing the special resolution by the board of the company or board of directors of the company. So, these are some of the important provisions. It was initiated buyback was allowed in 1998, SEBI guidelines for the first time were issued in 1998 and open market purchase method is used. There are two methods tender method and the open market purchase methods.

So, open market purchase method is used in India and section 77A of the Companies Amendment Act 1999 deals with the provisions of the buyback of the shares.

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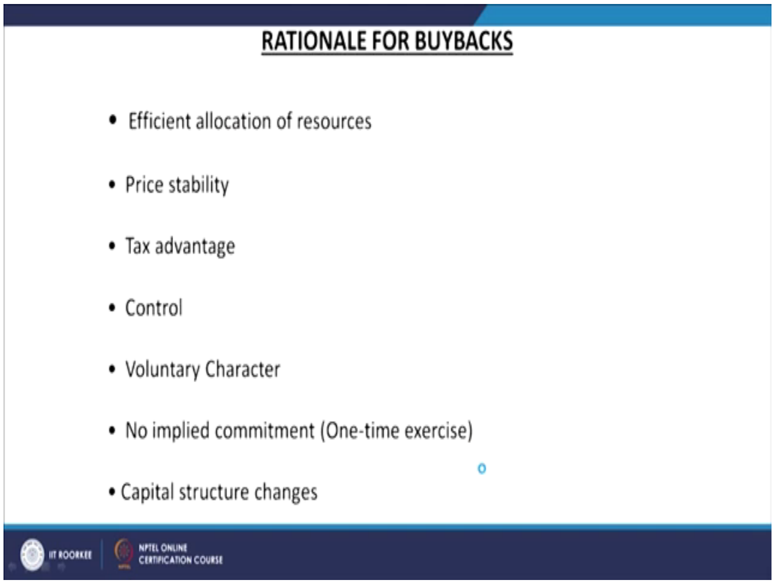

Why the companies want to go for buyback of the shares or why the government has allowed, you can look at that from this angle. Number 1, efficient allocation of the resources. Sometimes the companies are overcapitalized, right. So, if you are using if you have invested 2000 rupees at the place of 1000, if the 1000 is actually required and we are say investing 2000 rupees. So, the companies overcapitalized, nowhere it will be justified by the operations of the company that this company required 2000 rupees, right. So, that 1000 can be withdrawn can be invested elsewhere. Second, price stability because if the say number of shares are optimum, which are justified by the companys overall net worth, performance, operations, everything, then price will be more stable.

Otherwise, if the large number of shares are say floating in the market. Then price may not be stable sometime depending upon the performance of the company. The price may go up, but largely the price will remain lower because dividend is also affected in case of the over capitalization. So, price stability is another important objective.

Tax advantage, right, tax advantage is in terms of that for example, you want to talk about let say by way of the capital gain. People should earn more as compared to buy way of the dividend because dividend is taxable. It is not taxable at the hands of the shareholders, but it is taxable at the hands of the company when the company declares dividend, right. But if the company declares a dividend so tax will have to be paid.

But if the people want to earn or a company want the people to earn more through the capital gains, right. So, in that case they should be able to sell the share at a price which is substantially higher than their purchase price. But that will not happen because price of the share will not change or especially change upwards because company is already overcapitalized control, right. So, buyback is that shareholders (())(23:45) means the promoting shareholders.

The major shareholders of the company want to increase strength and their control up on the companys ownership so they buyback most of the shares from the market if it is possible and then overall control comes within the say within the hands of the few major owners of the company or shareholders of the company. Voluntary character, so,it is up to the shareholders. It is not compulsory for the shareholder to sell back their shares to the company.

If they want to, company can offer to buy it back, but if they want to sell it back to the company then it is up to them. If they do not want to sell it back to the company nobody can force them. So, it is a voluntary character. No implied commitment, (one) once the buyback is done by the company do not expect in future also it will be done. It is only a one time commitment. It may be done once. It may not be done in future or it may be done again also but no commitment.

Capital structure changes, certainly the capital structure will change because debt equity ratio will change. Your capital will come down, your debt will remain the same. Equity will come down. So your capital structure will change. Certainly it will impact the capital structure and debt equity ratio will be certainly changing. Objections to buy back.

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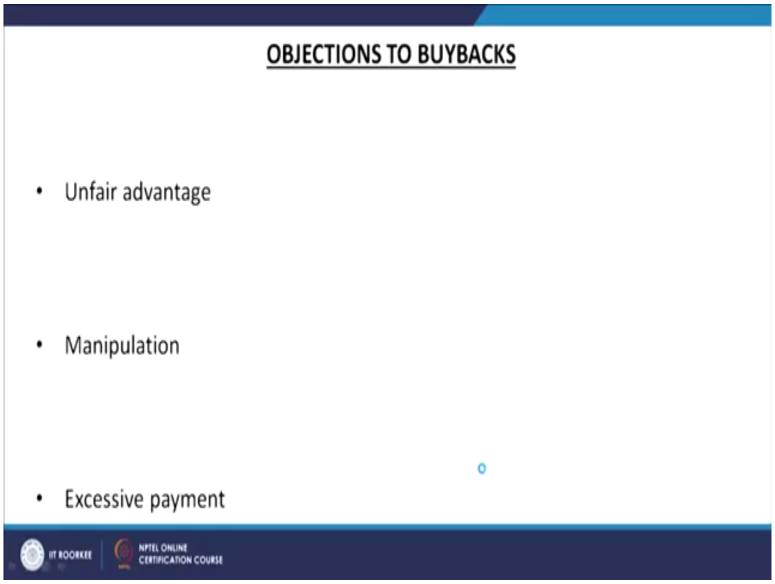

There are 3 objections, first is unfair advantage, second is the manipulation, third is excessive payments. Unfair advantage is basically sometimes what happens that it may be blamed that the major shareholders who have the controlling stake in the company, they would like to increase their stake in the company and enjoy the maximum dividend or the returns on their investment. So to have that unfair advantage in the favour of the majority shareholders the shares are bought back from the minority shareholders. This is one important point of a criticism.

Manipulation, sometime by manipulating or maybe artificially increasing or decreasing the price of the shares in the stock market or increasing the fluctuation in the share price the minority shareholders or retail shareholders may be compelled to sell back the shares to the company so that the major shareholders gain the maximum control. So this way they can do the manipulation

And third one is excessive payment, sometime to meet this objective of maximizing the control they want to buy back the shares from the retail shareholders by hook or by crook at any cost, right. So, sometimes they make the extra payment also, which affects the reserves of the company. So excessive payment is being made through the management of the company by the majority shareholders to compel the say minority shareholders or retail investors to sell off their shares back to the company.

Ultimate objective is strengthening the control but the payment is going from the accounts of the company and the reserves of the company are getting affected. So these are the 3 points of criticism, but largely it is means a very-very carefully done exercise. SEBI also remains in the picture company, law is there and the provisions of the company law are also there. So, taking into consideration keeping into consideration many important components, the final decision is taken.

But still, we should be careful about that if any company is offering to buy back its shares as a investor we have to be careful whether we would like to sell the shares back to the company or not would like to sell the shares because basic character of the buyback is voluntary, it is not a compulsion on the shareholders. It is only offer if they want to accept it, fine. If they do not want to accept it nobody can compel them.

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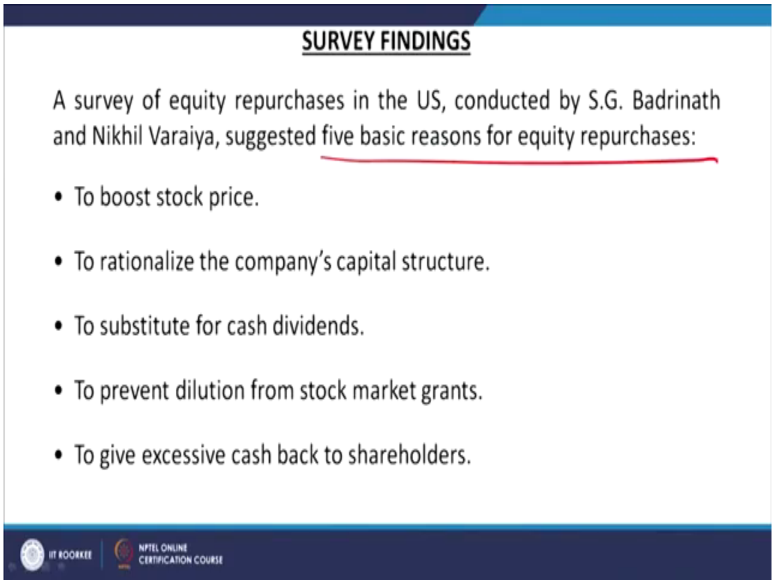

So, there was a survey conducted in US by two people. Survey there why the say the buyback is done, which was I told you earlier this buyback process initiated in US, so why companies go for the buyback of the shares? A survey was conducted by two people Mr S.G Badrinath and Nikhil Varaiya who suggested 5 basic reasons for equity repurchase. Survey of the equity purchase in US. See what is written here.

A survey off equity repurchase is in the US conducted by S.G. Badrinath and Nikhil Varaiya suggested 5 basic reasons for equity repurchase, why the companies go for the equity repurchase. First one is, to boost the stock price. As I told you when the number of shares trading in the market at too large not justified by the companys net worth. Then it is better to reduce the number of shares by proportionately buying it back from the market, so that price of the remaining shares goes up.

Second is to rationalize the companys capital structure, to rationalize that companys capital structure sometime your say equity is too much in the market as compared to the debt and that larger part of the capital which is available with the company is not justified and company is overcapitalized right. So, to bring it equal to that 2 is to 1 of the debt equity ratio or just to keep their entire capital structure within control this buyback is done. This is a second finding of the survey done by these two people.

Number three, to substitute for cash dividends. Sometimes what happens, the companies are not able to pay the cash dividend to their shareholders because their reinvestment needs are very high. So, how they substitute the shareholders that they return the cash back to the shareholders by buying back the shares. So, any person whose say investment is blocked into the stocks of the company and the share price is not going up in the market. Share price is very low in the market. So, he is caught in the net that he is not able to retain the share.

He is not able to sell the share, the price which you want to sell, the share at in the market that is not available and the say the price which is available in the market. He does not want to sell the shares. So, neither he is getting the desired amount of dividend. Nor he is able to sell the shares back in the market. So, to compensate those kind of the shareholders this buyback is offered by the companies.

Fourth important point or outcome of the survey is to prevent dilution from the stock market grants that say to prevent the dilution. That how means when I told you when the share is trading in the market the price comes down. There is a dilution in the price of the shares because number of shares trading in the market are too many and they are not justifying. The companys earnings are not justifying, dividends are not justifying, companys operations not justifying. So, prices coming down, dilution in the prices there in the stock market.

And number five, last point of finding was to give excessive cash back to the shareholders. Sometime company has excessive reserves, they are not required within the company. Reinvestment needs are not there. And company do not does not look forward that any investment needs are there where these excessive funds can be used. Reserves surpluses are mounting they are too much.

And in a way they are taking the company from the optimum capital structure towards the over capitalization, so to avoid that particular situation. When you have the excessive cash available that is not required within the firm. So what you can do is you can distribute the excessive cash back to the shareholders that way you can rationalize the capital structure of the company. You can deal with the over capitalization problems and you can even say improve the companys share price in the stock market also the optimum price of the share can be attained in the market.

So, people while trading in the market, they might feel that yes now this is optimum price. We should re-pay to buy the shares of a company and if they buy the stock of the company from the market the desired amount of the dividend will also be available. So, these are the findings of a survey which is conducted by the two people about the buyback of the shares in the US market from where this concept of the buyback was started in the beginning.

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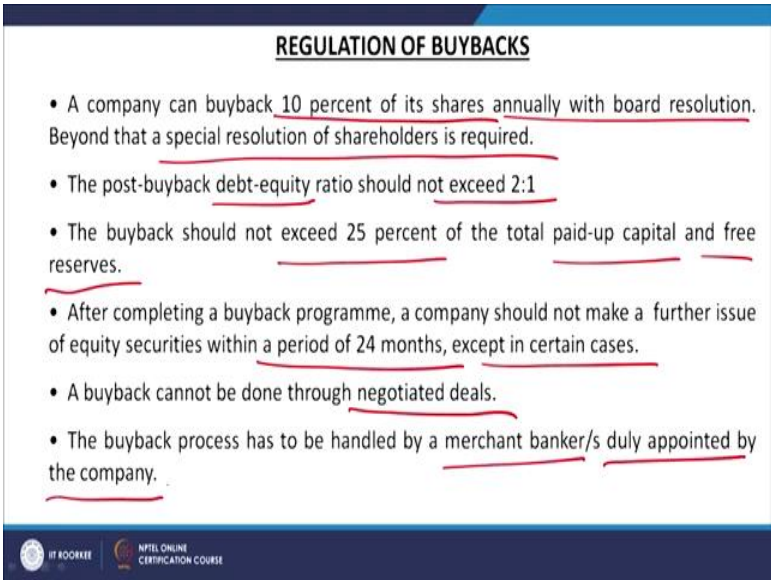

Now quickly let us go for the points of the regulation of the buybacks. There are the again important points of the regulations because buyback is regulated by SEBI also and the Indian companys act also. So what are the important points of regulation? You can read them yourself also, but I will just means discuss quickly with you. First point, a company can buy back 10 percent of its shares annually with the board resolution.

Beyond that a special resolution of the shareholders is required which is passed in the annual general meeting of the company, special resolution of the shareholders up to 10 percent, normal resolution will help which will be passed by the board. Post buyback debt equity ratio should not exceed 2 is to 1. The standard debt equity ratio 2 is to 1. If you invest 1 rupee from the pocket, 2 rupees can be borrowed from the market.

So, buyback should not affect this ratio, post buy back your debt equity ratio should be 2 is to 1. The buyback should not exceed 25 percent of the total paid up capital and the free reserves another important provision, 25 percent of that total paid up capital and free reserves. After completing a buyback program a company should not make a further issue of the equity securities. It is a very important point.

After completing a buyback program, a company should not make a further issue of the equity securities or equity shares within a period of 24 months, except in certain cases. These cases are so many lined up in the say is clearly depicted in the say different say books also, for example, they want to redeem the adventures or they want to say go for an investment with a special new projects. Then it can be done.

But normally new equity cannot be issued within a period of 2 years, 24 months from the process of completing the buyback process by any company. A buyback cannot be done through negotiated deals, no, it has to be either by the means say two methods. Tender method and the open market method, right. Under the tender method the price has to be prefixed, which will be little more than the normal price of the share.

And on the open market, the price at which the company is willing to buy the share has to be communicated to the broker and broker if that price, if the share is available in the market or from the market broker will buy it back for the company otherwise not. No negotiated deals between the company and the shareholders can be done nothing, it has to be crystal clear and as per the provisions of the SEBI guidelines.

The buyback process has to be handled by a merchant banker duly appointed by the company. Merchant bankers assistance is also important and when the merchant bankers existence is there in any buyback process, then the negotiated deals are impossible to happen. Negotiated deals cannot take place.

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And then is the we talk about the say last part here. And the this last part is regarding the dividend policies in practice in India. Three important points are available here. So from where of these 3 important points have come up with regard to the dividend policies in practice in India. A survey was conducted actually, a survey was conducted by Professor Prasanna Chandra, who has author the book Financial Management, very popular book financial management, which I been referring during my discussion of this course here all the delivery of my lectures here I have been referring to that book.

The author of the same book Financial Management by Prasanna Chandra he conducted a survey of the large 20 large sized Indian companies, 20 large sized Indian companies in the belonging to the different industries, different sectors, right. And on the basis of the survey which he conducted himself on the 20 large sized the Indian companies, he has found out that how the dividend policies are in practice in India.

So, he has given all those findings of his survey. Industry wise that, if he went to the chemical industry what the people said or the CF of the company he has in tribute basically. He has conducted the survey with the CFOs of the different companies, 20 large sized companies who were belonging to different industries and different sectors. So in that in his own book itself, he has given he has reported those findings in a detailed manner.

For example, he has written that when he went to the chemical industry or companies belonging to a chemical industry, what was the response of the CFO, when he went to any other manufacturing sector what was the response of the CFO and even to the automobile sector what was the response of CFO, that what dividend policy they follow?

So, on the basis of his survey of the 20 large sized Indian companies he has which the detailed say findings of the surveys are available in his book. If you want to see the detailed findings, you can refer to his book. Chapter number 22 is there, which is on the dividend decisions, so you can refer to that. But the crux of his survey, his findings is given pair in the 3 points. Crux is given here in the 3 points.

Number 1, generous dividend and the bonus policy. Companies in India follow a generous dividend bonus and the bonus policy. They are quite generous. They want to take care of the shareholders and they want to pay as much as possible the dividends the return back to the equity shareholders in the form of the dividend and in the form of the bonus issues.

Second, important finding is more or less fixed dividend policy. The companies follow more or less the fixed dividend policy. They do not change it means every year, fixed dividend policy is followed. And erratic dividend policies, erratic dividend policies means sometime when the profit is there dividend is paid, but when the profit is not there dividend is not paid right. When the profit is there dividend is paid when the profit is not there dividend is not paid.

So certainly profit is the major source from where the dividend has to be paid so precondition also that the dividend will be paid from the profits of the company. Maybe the profit of the current year or the profit of the previous year, undistributed profit of the previous year. So if there is a profit yes. The dividend is paid. There is no profit. No dividend is paid. But more or less dividend say fixed dividend policy is followed by the companies. And generous dividend and the bonus policies are in practice or these policies are in book.

So we have found out the 3 major points with regard to the dividend policies in practice in India. First one is which is on the basis of the survey conducted by the Prasanna Chandra have come up and we have been able to understand that how the companies say have their dividend policies in

India. So, first point says the companys pay generous dividend and their policy with regard to the, their policy with regard to the dividend and the say bonus issue is quite generous.

More or less fixed dividend policy they follow, an erratic dividend policy because sometime in the say event of non-availability of the profit, dividends are not paid, right. So, this is a conceptual discussion. I could do or I could complete till now. And now in the next 5 to 10 minutes time I will discuss 1 or 2 problems with you that how the dividend means can be calculated by following number one, following the Lintners model.

And second thing is when there is a say earnings available with the company. So how those earnings will be say bifurcated into that capital expenditure and the dividend and how finally practically that earning will be used or that amount of the earnings will be used by the company that I will discuss with you.

So, the first part here is which is very simple and the first problem which is here, that is very simple problem.

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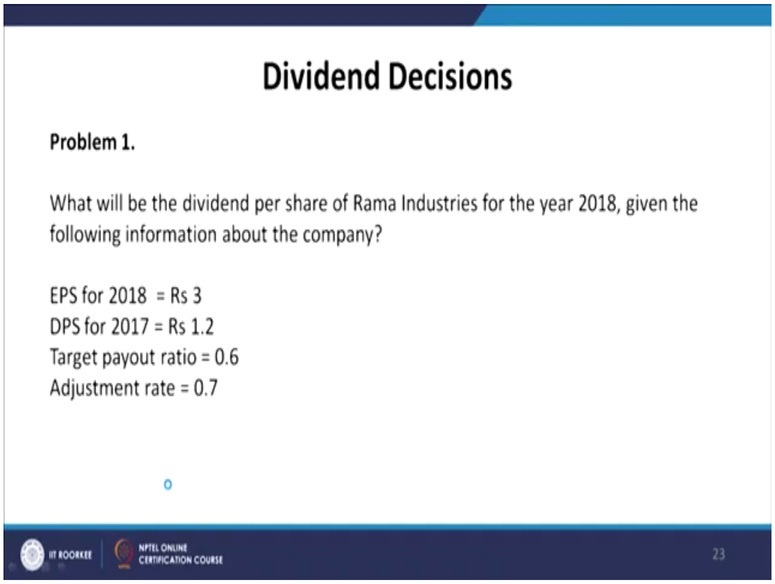

What will be the dividend per share? The first problem, what will be the dividend per share of Rama Industries for the year 2018 given the following information about the company. This is a first problem that relating to the dividend decisions where given the EPS for the current year, 2018 and that is rupees 3. That is earning per share, dividend per share for the previous year 2017 that is rupee's 1.2.

Target pay-out ratio that is 0.6 and then is the adjustment rate that is 0.7 so, now you look at whatever the information is given to us nowhere it is written that you have to apply the Lintners model and calculate the dividend amount to be paid. What will be the dividend per share? So you have to means nothing is mentioned here that by applying the Lintners model, you calculate the dividend to be paid by the Rama Industries.

But you see depending upon the input information given to us, we are given the EPS for the current year, we are given the DPS for the previous year. We are given the target pay-out ratio for the say which is the companys target pay-out ratio and we are given that adjustment rate, right. So, looking at these 4 inputs it is a clear indication that you can find out the amount of the dividend to be paid per share by the Rama Industries by following or by using the Lintners model. So if you use the Lintners model here, so how you can calculate the model is very simple, right?

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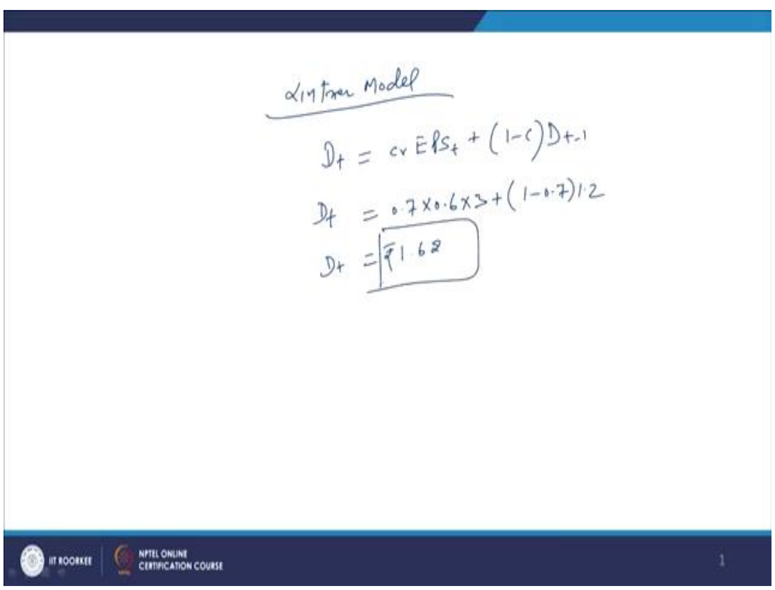

Lintners model is very simple. So, with the help of Lintner model they are going to make use of the Lintner model and by using this model Lintner model, you can try to find out that is the amount of the dividend that will be paid by the company and the models says here. Dt is equal to cr small cr EPS for the year t plus 1 minus C into Dt minus 1, right, cr so c is a small here it is not a capital c you have to take it as a small c.

So this is cr EPSt EPS for the year t plus 1 minus c into Dt minus 1 and what is a Dt here? Dt is basically the dividend payable by the company for the current year from the say earning per share available for the current year and keeping into consideration the dividend per share paid in the previous year or during the previous year target pay-out ratio and the adjustment rate, right.

So in this case if you apply if you put all these values. So what these values are given to us, adjustment rate is given to us is 0.7, right. And what is the pay-out ratio is 0.6. And what is the earning per share? Earning per share is 3 plus you are given 1 minus c so c is again the amount that is 0.7 and the dividend for the previous year is 1.2.

So, we have put all the values which were available with us that is 0.7 into 0.6 into 3 plus 1 minus 0.7 into 1.2. And if you solve this equation, you will find out that Dt is equal to 1.62 rupees. So, you can easily understand what this amount is, Dt is equal to rupees 1.62. It means it is a dividend. What we wanted to find out? What will be the dividend per share, so dividend per share will be 1.62 rupees to be paid. What was the dividend paid by the Rama Industries in the previous year? 1.2, right.

1 rupees 20 paisa was paid the dividend in the previous year and this is going to be increased in the current year for 1.2 rupees to 1.62 rupees in the current year depending upon the EPS of the company, depending upon the target pay-out ratio and depending upon the adjustment rate of the company. So, this is the way we can solve this very simple problem and apply the Lintners model for calculating the dividend to be paid per share.

In the current year where the different factors which are to be generated first of all as input factors and if they are available, you can apply the Lintner model and calculate the dividend payable in the absolute amount. This is the beauty of the model that in the absolute amount per share dividend payable by the company in the current year can be calculated. Now we do one more problem here quickly. And the second problem is a little lengthier. So, I will do the one part of it and the remaining I will give you the hints so you can do it yourself.

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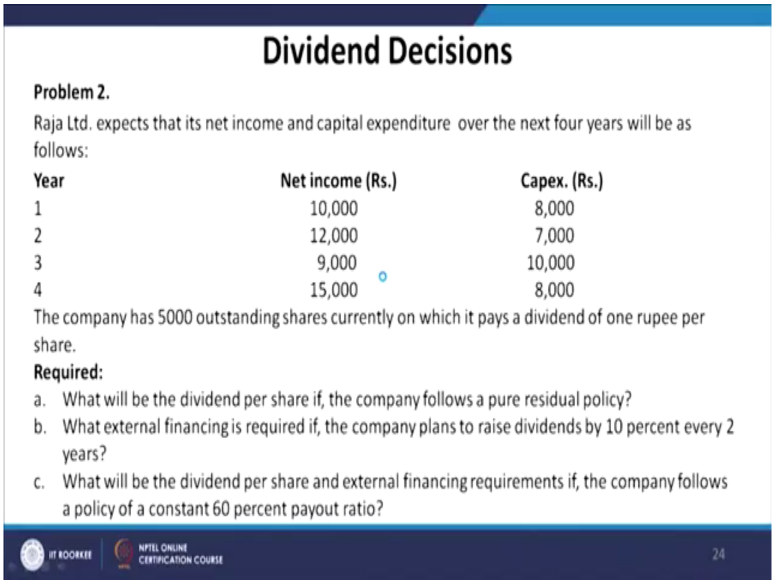

The problem is Raja Limited expects that it is net income and the capital expenditure over the next 4 years will be as follows. We are given the 4 years, right? First year the net income will be 10000 rupees and Cap-ex, capital expenditure will be 8000 rupees. Second year the net income will be 12000 rupees, Cap-ex will be 7000 rupees. Third year net income will be 9000 rupees. Cap-ex will be 10000 rupees. And fourth year the net income will be 15000 rupees, Cap-ex will be 8000 rupees.

Company has 5000 outstanding shares currently or which it pays a dividend off 1 rupees per share dividend of 1 rupee per share. What is now required to be done? First point, what will be the dividend per share if the company follows a pure residual policy, what will be the dividend per share if the company follows a pure residual policy. B, what external financing is required if the company plans to raise dividend by 1 percent.

What external financing is required if the company plans to raise dividend by 10 percent. Every 2 years. And c, what will be the dividend per share and external financing requirements if the company follows a policy of a constant 60 percent pay-out ratio. So, these are the three requirements which you have to work out with the help of this information which is with regard to the net income and the Cap-ex, right.

So, let us do the first part here quickly and then we will understand that how the others two part can be done and how the different requirements of this problem can be answered here. So first, is that is the under the pure residual dividend policy, pure residual dividend policy means out of the total earnings first of all, you have to deal with the capital expenditure. And after that, whatever the amount is left with us that will be used for paying the dividend to the shareholders.

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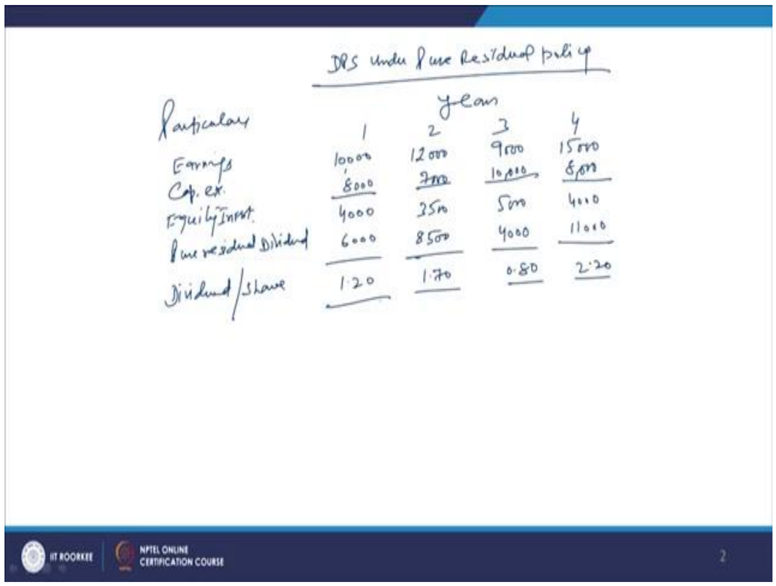

So, under the pure residual policy, you can call it as DPS Dividend Per Share under a pure residual policy. So here you can take the particulates and here you can take the years, right. Here you can take the years because we are given the information in terms of the years. So here you can take the years and years are 1, 2, 3 and it is 4 right, years are 1, 2, 3 and 4. So first thing is the earnings EPS or total amount of the earnings.

It is not earnings but EPS But the total amounts of earnings. So, total amount of earning given is to us is how much? Total amount of earnings given to us we have to find it out from this. And earnings are given year wise 10000 rupees, then we are given the next earning is that 12000, then we are given the earnings is 9000 and then we are given the earnings is 15000, right. So what is a cap-ex? Capital expenditure, it is also given to us Capital expenditure in this case, we first take the 8000, right.

Second is 7000, then we are to take 10000 which is given to us, these two informations are given to us, right. And then is the now out of this, for example, earnings are 10000, capital expenditure we want to make is 8000, right. Now in this case we assume that equity investment is done is equity investment which comes or which the say has to be made here is that is for example we assumed equity investment.

Equity investment has to be done here is the, we assume that 4000 rupees, the companys policy is that equity investment will be 4000 here. In this case, it will be 3500. In this case, it will be 5000 and in this case, it will be 4000, right. Equity investment has to be made is 4000 and 5000 and this amount that is the equity investment. So, equity investment will come from where, from the retained earnings.

So from this means this is a total expenditure 8000 that is a capital expenditure, which we want to make in year 1, this in the year 2, this in the year 3, this in the year 4 right. And it is decided by the company and that equity investment will be 4000 only, remaining amount in this case, 4000 will come from the borrowings. In this case, the remaining amount will come from the borrowings. In this case, 5000 will come from the borrowings. In this case 4000 will come from the borrowings, right.

So in this case, what is a pure residual amount? If you talk about the pure residual dividend this will be, so it means out of 10000 if 4000 is invested into the capital expenditure, so pure residual dividend left with us is 6000. In this case it will be 8500. In this case, it will be 8500. And in this case will be how much? 4000, and in this case, it will be 11000, right. So, you can easily calculate what is a dividend per share, how many total number of shares are there?

Total number of shares are 5000 shares on which dividend of 1 rupee the company pays normally, but depending upon the amount available here, now the pure residual dividend available here. 6000 is available in the first year, 8500 is available in the second year, 4000 is available in the third year and 11000 is available in the fourth year. So, you can calculate the dividend per share.

If you calculate the dividend per share, how much it is going to be? It is going to be 1.20 because 6000 will be divided by 5000 shares. So, it is 1.20, 1.70. It is 0.8 and in this case it will be maximum 2.20, it will be 2.20. So, this is the dividend per share under the pure residual policy. And why we call it as a pure residual policy, that out of the total earnings, first of all we will decide the capital expenditure.

And in that capital expenditure, how much part will come from the equity investment that is from the retained earnings, that is from the earnings and amount which is remaining after making investment for meeting the capital expenditure requirement. The remaining amount will be paid will be distributed as a dividend. That is why it is called as a pure residual amount, pure residual dividend. And this amount is called as the in this case, this amount has worked up as the 6000 rupees. And total number of shares are 5000.

So if you divide this 6000 by the 5000 so in the first year, the dividend per share is 1.2 rupees. It is in the absolute value rupees 1.20. In the second case rupees 1.70, in the third case is rupees 0.80. And in the fourth, here it is rupees 2.20. So, similarly you have to say answer the other two questions, which I leave it to you. You can do it yourself. And for example, in this case, what is the second question?

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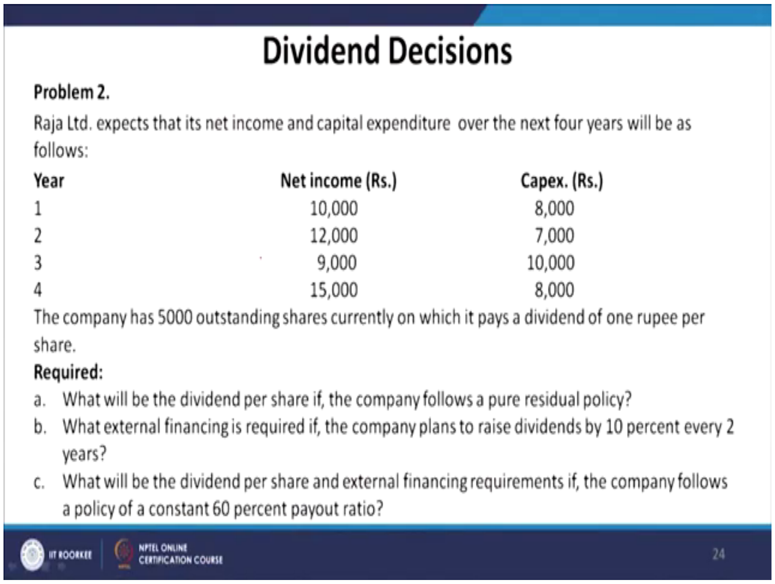

Second question is what external financing is required if the company plans to raise dividend by 10 percent every 2 years? So, you can simply understand that out of the. But you have to do in this case is. So, if you want to find out that how much is the, the question here is that external financing required, right. So, for example in this case say how much external financing is required. So first of all, you take in the second question to answer the second question first step process I am explaining. And other you can do to yourself.

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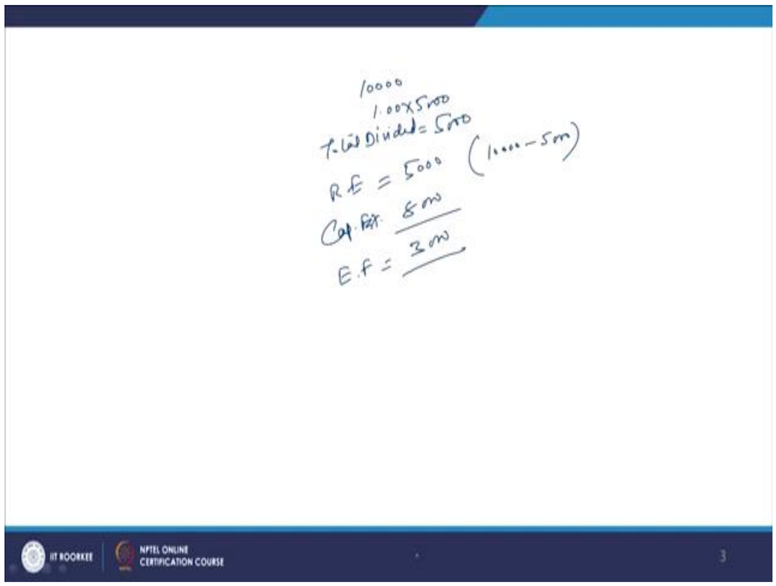

So, it is 10000, DPS is for example. Dividend Per Share is 1, so total dividend paid will be how much? Multiplied by 5000, right. So it will be total dividend will be how much? Total dividend will be rupees 5000. I am explaining it to you. You can do it yourself, 5000, right. What is the retained earnings? Retained earnings are now we are left with 5000 only, so how it is, that is 10000 minus 5000.

So it is 5000 retained earnings and what is the cap-ex? Cap-ex is going to be how much, 8000? So, external financing requirement in the first year will be equal to 3000 rupees, right. So this way you can solve other problems means the other years also you can do it yourself. And in the other case, for example, now the next question is that it is asked here us is, what will be the dividend per share and external financing requirements, if the company follows a policy of a constant 60 percent pay-out ratio?

So there you can change the dividend up to 60 percent of the earnings, the dividend amount will become 60 percent. So, from the earnings 60 percent, dividend amount will be first subtracted whatever the balance is left. That will be available for the capital expenditure meeting requirement. And the balance amount that is the amount total required as a capital expenditure and available from the earnings.

After paying the dividend the amount available from the earnings that will be used for the capital expenditure plus the balance amount will be generated from the external financing. So, this is how the dividend decisions are means taken or they affect the overall financing requirements as well as the overall financial performance of the company and how means important considerations of the dividend decisions are born in mind while framing the dividend policies by the companies.

So, with this discussion for the past to say 60 lectures, including todays lecture, I could discuss some important relevant concepts of the financial management. We started with the basic introduction of the financial management and then we moved to the financial planning. Then we discussed some other important concepts like capital budgeting. Then the say cash flow analysis with regard to the capital budgeting projects.

Then the risk analysis we did then we went forward with the cost of capital then we say carried forward the process with the process of learning of the capital structure. And finally this dividend decisions. So, whatever the important possible topics were there with regard to this subject or which would pertaining to this subject to pass on you or share with you the complete knowledge on the financial management, I have tried to do and say I hope that this course will be very useful to you.

You will find it quite interesting and means your whatever the doubts queries are there will be meeting on the discussion forum also when the course will be starting. So you attend this course, you become the part of this course, try to listen to the video lectures very carefully. If there are any kind of the improvement or any suggestions please, we will discuss on the discussion forum and in the end I would like to say conclude the discussion on this say.

This the course as a whole with my observations that whatever possible was to be done I have done and I have tried to bring in the best possible topics and the most suitable topics which are very useful in our day to day knowledge. And I am sure that if you become a part of this course and if you enrol for this course, you will be really finding this course very useful. Thank you very much. See you on the discussion forum. After you joined the course. Thank you very much.