An Analysis of Dividend Policy and Its Effect on Shareholder Value in the Indian Corporate Sector

Dr. Sushma Karnati

Associate Professor
Department of Management, Aurora's PG College, Hyderabad

Abstract
This study explores the impact of dividend policy on shareholder value within the Indian corporate sector, a topic of significant relevance in the context of emerging markets. Utilizing panel data from 50 companies listed on the National Stock Exchange (NSE) spanning the years ten, the research investigates how various dividend strategies influence both market valuation and financial performance. The core objective is to evaluate the effect of three key dividend-related variables : Dividend Payout Ratio (DPR), Dividend Yield (DY), and Earnings Per Share (EPS) on two primary indicators of shareholder value: Market Price per Share (MPS) and Return on Equity (ROE).

The study employs multiple regression analysis to quantify the relationships between the dividend policy components and shareholder value metrics. The results indicate that consistent and well-structured dividend policies are positively associated with shareholder value. Notably, EPS emerged as the most significant predictor of both MPS and ROE, reflecting the centrality of profitability in shaping investor perception.
The insights gained have practical implications for corporate finance managers formulating dividend policies, as well as for investors seeking to optimize returns. The study affirms that dividend policy, when aligned with firm performance and investor expectations, plays a pivotal role in enhancing shareholder value in the Indian corporate landscape.

Keywords: Dividend Policy, Shareholder Value, Indian Corporate Sector, Dividend Payout Ratio, Dividend Yield, Return on Equity, NSE, Emerging Markets

1. Introduction
The dividend policy of a firm is a critical decision area in corporate finance, directly influencing investor perception, stock price volatility, and the overall valuation of the firm. Dividend decisions reflect management's confidence in future earnings, serve as a signaling mechanism to the market, and often represent a trade-off between immediate shareholder income and long-term reinvestment strategies. The optimal dividend policy continues to be debated extensively in financial literature, as firms strive to balance the interests of investors with the internal capital needs for growth and expansion.

Traditional financial theories, such as the Dividend Irrelevance Theory proposed by Miller and Modigliani (1961), argue that in perfect capital markets—where there are no taxes, transaction costs, or information asymmetries—dividend policy has no effect on firm valuation. According to this view, investors are indifferent between dividends and capital gains. However, this idealized model rarely holds in real-world financial environments, particularly in emerging economies like India. In practice, market imperfections,

investor behavioral biases, asymmetric information, and differing tax treatments for dividends and capital gains challenge the assumptions of irrelevance.

Empirical studies in India and other emerging markets increasingly support the Dividend Relevance Theory, which suggests that dividend policy does matter, especially where investor confidence is shaped by transparency, consistent performance, and stable returns. Indian investors, in particular, often associate regular dividend payments with financial health and managerial discipline, making dividend announcements a key market event. Furthermore, India's corporate landscape—characterized by diverse ownership structures, family-controlled firms, and evolving governance standards—adds complexity to dividend decision-making.

In this context, the current study seeks to analyze the extent to which dividend policy impacts shareholder value among NSE-listed companies. By evaluating variables such as Dividend Payout Ratio (DPR), Dividend Yield (DY), and Earnings Per Share (EPS) in relation to Market Price per Share (MPS) and Return on Equity (ROE), the study aims to bridge the gap between theoretical constructs and real-world investor behavior in the Indian corporate setting.

2. Literature Review

Past studies show mixed results regarding the impact of dividends on firm value. Gordon (1963) and Lintner (1956) advocate the relevance of dividend policy, asserting that dividends reduce uncertainty and are valued by investors.

On the contrary, Miller and Modigliani (1961) argue for dividend irrelevance in a perfect market. Recent empirical research in emerging economies, however, tends to support the relevance theory, especially in markets characterized by information asymmetry and weaker investor protection.

3. Research Methodology

This study employs a quantitative approach using secondary data collected from annual reports and financial databases such as CMIE Prowess and Capitaline. The sample includes 50 companies listed on the National Stock Exchange (NSE) across various sectors such as IT, FMCG, banking, manufacturing, and energy. The selection is based on consistent dividend payment history over a 10-year period (2013–2023) and data availability.

3.1 Sample Design and Data Sources

The sample comprises companies that have:

● A continuous listing on NSE during the study period.
● Availability of complete annual reports and financial statements.
● Declared dividends in at least 6 out of 10 years.
● Data was sourced from:
● Company annual reports (2013–2023)
● Financial databases like CMIE Prowess, Moneycontrol, and Capitaline

3.2 Variables Used in the Study

To examine the effect of dividend policy on shareholder value, the study uses the following key variables:
● Independent Variables (Dividend Policy Indicators):
● Dividend Payout Ratio (DPR): Ratio of total dividends paid to net income.

- Dividend Yield (DY): Dividend per share as a percentage of market price per share.
- Earnings Per Share (EPS): Indicates company profitability on a per-share basis.
- Dependent Variables (Shareholder Value Indicators):
- Market Price Per Share (MPS): Reflects market valuation of the company.
- Return on Equity (ROE): Indicates financial performance and shareholder returns.

3.3 Method of Analysis

The statistical method employed is multiple regression analysis, using the Ordinary Least Squares (OLS) model. Two models are developed:

Model 1: MPS = f(DPR, DY, EPS)
Model 2: ROE = f(DPR, DY, EPS)

These models are intended to analyze how dividend policy components influence both market perception (MPS) and financial performance (ROE). The regression analysis helps in identifying the strength and direction of these relationships.

Diagnostic checks such as multicollinearity (VIF), autocorrelation (Durbin-Watson), and heteroskedasticity (Breusch-Pagan Test) are conducted to ensure the robustness of the regression models.

3.4 Sectoral Analysis

To enhance the depth of the study, a sector-wise analysis is performed to explore how the impact of dividend policy varies across different industries. This helps in understanding whether capital-intensive industries react differently to dividend strategies compared to service-oriented sectors.

3.5 Tools Used

The statistical analysis is carried out using:
- Microsoft Excel for data cleaning and visualization.
- SPSS and R for running regression and diagnostic tests.

This detailed methodology ensures that the findings are data-driven and analytically sound, offering relevant insights into the dividend practices in the Indian corporate sector.

4. Results and Discussion

The regression analysis was conducted using panel data from 50 NSE-listed companies over a ten-year period (2013–2023). Descriptive statistics indicated that the average Dividend Payout Ratio (DPR) was 38.5%, with significant variation across sectors. The average Dividend Yield (DY) stood at 2.4%, while the mean Earnings Per Share (EPS) was ₹18.7.

Model 1 Results (MPS as dependent variable):

R-squared: 0.68, indicating that 68% of the variation in MPS is explained by DPR, DY, and EPS.

- Significant Variables: EPS and DPR showed strong positive coefficients ($p < 0.01$), indicating that higher profitability and consistent dividend payouts are associated with higher market prices.
- Dividend Yield: Showed a weaker but still positive influence ($p < 0.05$).

Model 2 Results (ROE as dependent variable):
- R-squared: 0.59, suggesting a moderately strong model.
- EPS: Again emerged as the most significant predictor of ROE ($p < 0.01$).
- DPR and DY: Both had positive, though less statistically significant, coefficients ($p < 0.10$), implying their secondary role in determining ROE.

Diagnostic Checks:
- Multicollinearity: VIF values were below 5, indicating acceptable levels.
- Durbin-Watson Statistic: Approximately 2.1, suggesting no significant autocorrelation.
- Heteroskedasticity: Breusch-Pagan tests were insignificant, confirming homoscedastic residuals.

Sector-wise Observations:
- Capital-intensive industries (e.g., manufacturing, energy) demonstrated stronger responsiveness to dividend signals, possibly due to higher information asymmetry.
- Service sectors (e.g., IT, telecom) placed relatively more weight on EPS over dividends.
- These findings suggest that dividend policy, especially a high and stable DPR, positively affects market valuation. However, profitability (EPS) remains the most critical factor in determining shareholder value.

5. Conclusion

The findings confirm that dividend policy plays a significant role in influencing shareholder value in the Indian corporate sector. Companies with consistent and transparent dividend policies tend to be rewarded by investors, especially in environments where trust and signaling are important. These insights can aid corporate managers in structuring dividend strategies that align with investor expectations and enhance firm valuation.

References:
1. Gordon, M. J. (1963). "Optimal Investment and Financing Policy." The Journal of Finance, 18(2), 264-272.
2. Lintner, J. (1956). "Distribution of Incomes of Corporations Among Dividends, Retained Earnings, and Taxes." American Economic Review, 46(2), 97-113.
3. Miller, M. H., & Modigliani, F. (1961). "Dividend Policy, Growth, and the Valuation of Shares." The Journal of Business, 34(4), 411-433.
4. Baker, H. K., & Powell, G. E. (1999). "How Corporate Managers View Dividend Policy." Quarterly Journal of Business and Economics, 38(2), 17-35.
5. Allen, F., & Michaely, R. (2003). "Payout Policy." In G.M. Constantinides, M. Harris, and R.M. Stulz (Eds.), Handbook of the Economics of Finance, Vol. 1, 337–429.
6. Gupta, A., & Banga, C. (2010). "The Determinants of Corporate Dividend Policy." Decision, 37(2), 63–77.
7. Kumar, J. (2006). "Corporate Governance and Dividend Policy in India." Journal of Emerging Market Finance, 5(1), 15–58.
8. Reddy, Y. S. (2006). "Corporate Governance and Dividend Policy in Emerging Markets: Evidence from India." Indian Journal of Corporate Governance, 1(1), 94–112.