COURSE. : III B. COM (CA)

SEMESTER. : 6

SUBJECT. : FINANCIAL MANAGEMENT (18BCA62C)

PREPARED BY. :DR. P.SRIDEVI

PHONE NO. :9894025186

UNIT – V

DIVIDEND THEORIES

This theory states that dividend patterns have no effect on share values. Broadly it suggests that if a dividend is cut now then the extra retained earnings reinvested will allow futures earnings and hence future dividends to grow.

WALTER MODEL

Walter has developed a theoretical model which shows the relationship between dividend policies and common stocks prices. According to him the dividend policy of a firm is based on the relationship between the internal rate of return (r) earned by it and the cost of capital or required rate of return (Ke).

WALTER's MODEL $= \dfrac{D + \dfrac{r(E - D)}{Ke}}{Ke}$

Consider the following data.

Rate of return 20%, capitalization 15%, EPS Rs.4 calculate the market price of share of the firm is payout ratio is 25%.

Walter model $= \dfrac{D + \dfrac{r(E - D)}{Ke}}{Ke}$

Dividend payout ratio = Earing per share x dividend payout ratio

$= 4 \times 25\%$

$D = 1$

$D = 1, r = 20\%, E = 4, Ke = 15\%$

$$= \frac{\dfrac{1 + 0.20\,(4 - 1)}{0.15}}{0.15}$$

$= 33.33$

GORDON MODEL

Gordon's theory on dividend policy is one of the theories believing in the 'relevance of dividends' concept. It is also called as 'Bird-in-the-hand' theory that states that the current dividends are important in determining the value of the fir m. Gordon's model is one of the most popular mathematical models to calculate t he market value of the company using its dividend policy.

Determine the market price per share under Gordon model. EPS Rs 8, Payout r atio 75%, Capitalisation (k) 10%, Rate of return (r) 15.

SOLUTION :

Market price per share $P = \frac{D}{K - g}$ D = Dividend, G = Growth rate

$D = \text{EPS} \times \text{Payout ratio}$

$= 8 \times 75\%$

$= \text{Rs } 6$

$G = b \times r$

$= 0.25 \times 0.15$

$= \text{Rs. } 0.0375$

$P = \frac{D}{K - g}$

$= \frac{6}{\quad}$

0.10 – 0.0375 **P = Rs. 96**

MM MODEL

Modigliani- Miller Theory on Dividend Policy. Modigliani – Miller theory is a major proponent of 'Dividend Irrelevance' notion. According to this concept, investors do not pay any importance to the dividend history of a company and thus, dividends are irrelevant in calculating the valuation of a company.

DIVIDEND POLICY

The Dividend Policy is a financial decision that refers to the proportion of the firm's earnings to be paid out to the shareholders.The amount of earnings to be retained back within the firm depends upon the availability of investment opportunities.

FORMS OF DIVIDEND

Cash dividend

Stock dividend

Property dividend

Scrip dividend

Liquidating dividend

DETERMINANTS OF DIVIDEND POLICY

Determinants of dividend policy are:

Type of Industry

Age of Corporation

Extent of share distribution

Need for additional Capital

Business Cycles

Changes in Government Policies

Trends of profits
Trends of profits
Taxation policy
Future Requirements and
Cash Balance.