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Impact of Dividends on Share Prices of Select It Firms

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ABSTRACT

Dividend policy has been an issue of interest in financial literature since Joint Stock Companies came into existence. Dividends are commonly defined as the distribution of earnings among the shareholders of the firm in proportion to their ownership. Dividend policy connotes to the payout policy, which managers pursue in deciding the size and pattern of cash distribution to shareholders over time. Managements' primary goal is shareholders' wealth maximization, which translates into maximizing the value of the company as measured by the price of the company's common stock. This goal can be achieved by giving the shareholders a "fair" payment on their investments. However, the impact of firm's dividend policy on shareholders wealth is still a debatable issue. Dividend policy can be of two types: managed and residual. In residual dividend policy the amount of dividend is simply the cash left after the firm makes desirable investments using NPV rule. If the manager believes dividend policy is important to their investors and it positively influences share price valuation, they will adopt managed dividend policy. Three companies are chosen for the study – Wipro Ltd, Infosys Ltd and TCS Ltd. The study takes into consideration the pre and post dividend announcements share prices of the respective companies. The study compares the pre and post dividend announcement share prices to analyze the impact of dividend announcement on share prices.

Keywords – Dividend relevance, Dividend irrelevance, Wipro Ltd, Infosys Ltd, TCS Ltd, Dividend Impact.

1.1 INTRODUCTION

The primary objective of financial management is the maximization of Shareholder's wealth. To achieve this objective, management, the custodians of shareholder's interests, are faced with three important categories of decision making namely, investment, financing and dividend decisions. Investment decisions determine the total value and types of assets a firm employs. Financing decisions determine the capital structure of the firm and forms the source on which investment decisions are made. Dividend decisions in the form of dividend policies, form the focus of this study, involve the determination of the payout policy that management follows in determining the size and pattern of cash distributions to shareholders over time.

The prospect of earning periodic dividends and sustained capital appreciation are the main drivers of investor's decision to invest in equity. Dividends are periodic payments to holders of equity which together with capital gains are the returns for investing in a firm's stock. According to Botha, the investment, financing and dividend decisions are interdependent and must be resolved simultaneously. A combination of these policy decisions should theoretically maximize shareholders' wealth. Capital markets are not perfect and because of market imperfections and uncertainty, shareholders may prefer near dividends to future dividends and capital gains. Thus payment of dividends may significantly affect market prices of the share. In order to maximize the wealth under uncertainty, the firm must pay enough dividends to satisfy investors. Investors in high tax brackets may prefer to receive capital gains rather than dividends when dividends are taxed at a higher rate than capital gains.

The dividend decision of firm and the issues involved pertains to

- Deciding the percentage of profits to be retained with the firm for future growth needs and the percentage of profits to be distributed as dividends amongst shareholders.
- Level of dividends to be maintained and funds raised to finance profitable growth opportunity.
- Deciding whether the dividends are to be paid in the form of cash or management has to go for share buyback.

1.2 NEED FOR THE STUDY

In present scenario, the business faces a lot of challenges, rapid advances in technology, changes in political, economic and cultural trends and changes in competitive position of the business in the market makes it difficult for the businesses to maintain its position in the market. All these factors in turn affect the share prices of the companies. Dividends that many companies pay out regularly to shareholders from earnings, send a clear, powerful message about future prospects and performance. A company's willingness and ability to pay steady dividends over time - and its power to increase them provide good clues about its fundamentals which in turn affect the share prices. The prospects of earning periodic dividends and sustained capital appreciation are the main drivers of investor's decision to invest in equity. Hence there is a need to analyze the dividend payments of the companies to see its effect on shares prices.

1.3 OBJECTIVES OF THE STUDY

1. To analyze the dividend policies of TCS Ltd, Wipro Ltd and Infosys Ltd.
2. To study the impact of dividends on the share prices of TCS Ltd, Wipro Ltd and Infosys Ltd with respect to the period 1st January 2014 to 31st December 2017.
3. To compare the share prices of TCS Ltd, Wipro Ltd and Infosys Ltd before and after dividend announcements.

1.4 RESEARCH METHODOLOGY

Research Design

Analytical research design is used to analyze the existing facts from the secondary data.

Sources of Information

Secondary data: Information related to dividend announcements, dividends and share prices of Wipro Ltd, Infosys Ltd and TCS Ltd is collected from the company's websites and annual reports.

Sample size

The sample of three companies of the IT sector of four year share prices and dividend policies is taken for study.

Tools and Techniques of Analysis

The technique of comparative analysis of pre and post dividend announcements is done to study the impact of dividends on share prices. The dividend announcements made by the companies reflect their dividend policies.

Scope of the Study

The study deals with dividend impact and dividend policies of three companies of the IT sector. They are Wipro Ltd, Infosys Ltd and TCS Ltd. The past three years data is taken to see the impact of dividends on share prices. It covers the period from 1st January 2014 to 31st December 2017. It also analyses the relationship between dividends and share prices. Comparative analyses of share prices pre and post dividend announcement is also done.

1.5 REVIEW OF LITERATURE

Dividend policy theories explain the rationale and major arguments relating to payment of dividends by firms. Firms are torn in between paying dividends or reinvesting their profits on the business. Dividends are periodic payments to holders of equity which together with capital gains are the returns for investing in a firm's stock. The prospects of earning periodic dividends and sustained capital appreciation are the main drivers of investor's decision to invest in equity.

There are two opposing schools of thought at the heart of the dividend policy theories. One side holds that whether firms pay dividends or not is irrelevant in determining the stock price and market value of a firm. In retrospect the opposing side holds that firms which pay periodic dividends eventually tend to have higher stock prices and market values. The existence of these two sides has spawned vast amounts of empirical and theoretical research. The arguments about dividend policy theory are so discordant in modern day research, that at least there is consensus with Black's famous words who defined dividend policy as a puzzle: "the harder we look at the dividends picture, the more it seems like a puzzle, with pieces that just do not fit together"

Dividend Irrelevance Theories:

The Modigliani and Miller Theorem

The main proponents of dividend irrelevance theories are Franco Modigliani and Merton Miller (1958, 1961). Modigliani and Miller in 1961 rattled the world of corporate finance with the publication of their paper: Dividend policy, Growth, and the Valuation of Shares in the Journal of Business. They proposed an entirely new view to the essence of dividends in determining the future value of the firm. The 1961 paper was a sequel to the 1958 paper in which they argued that the capital structure of a firm is irrelevant as a determinant factor in its future prospects.

The key premise of this theory is that to investors, payment of dividends is irrelevant as investors can always sell a portion of their equity if they need cash. Therefore two firms of the same industry and scale should have the same value even when one of the firms pays dividends and the other one does not. The M&M theorem holds that capital gains and dividends are equivalent as returns in the eyes of the investor. The value of the firm is therefore dependent on the firm's earnings which result from its investments policy and the lucrativeness of its industry.

The Residual Theory

The residual theory holds that dividends paid by the firms have retained cash for all available and desirable positive NPV projects. The gist of this theory is that dividend payment is useless as a proxy in determining the future market value of the firm. As such the firm should never forego desirable investment projects to pay dividends. Investors who subscribe to this theory therefore do not care whether firms pay dividends or not, what they are not concerned with is the prospect of higher future cash flows which might lead to capital appreciation of their stocks and higher dividends payouts.

Dividend Relevance Theories:

The Gordon/Linter (Bird in the Hand) theory

The bird in the hand theory, hypothesized independently by Gordon (1963) and by Linter (1962) states that dividends are relevant to determining the value of the firm. The dividend yield and the future growth of the dividends provide the total return to the equity investor than the future growth rate of the dividends. Future growth and capital gains cannot be estimated with accuracy and are not guaranteed at all as firms might lose even their entire market value in the stock exchange and go bankrupt.

Dividend Policy in Practice

Mohanty survey (1999) of the dividend payout ratio of the 2535 Indian companies indicate that firms maintain a constant dividends per share and have fluctuating payout ratio depending on their profits.

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Raghunathan and Dass find that the top 100 and high net worth companies have maintained a stable dividend payout policy of around 30 percent during the period 1990 to 1999 in India.

Anand surveys 81 CFOs of bt-500 companies of India and her most valuable PSUs to find out the corporate finance practices with respect to capital budgeting decisions, cost of capital, capital structure and dividend policy decisions.

The findings of the survey are in agreement with the findings of Lintner study on dividend policy. Most of the respondents strongly agree that the firm has a long-run target dividend payout ratio, policy provides signaling mechanism of the future prospects of the firm and thus affects its market value, the management should be responsive to the shareholders preference regarding dividends and dividend payments provide a bonding mechanism so as to encourage managers to act in the best interest of the shareholders. This belief is shared by the CFO's of the private sector than the public sector. The companies, which are creating shareholder value, are significantly more willing to rescind dividend increase in the event of growth opportunities available to the firm than the non-EVA firms etc. The large firms significantly strongly disagree to the belief that share buyback programme should replace dividend payments of the firm than the small firms are. The highly profitable and growth firms significantly less strongly disagree to the share buyback programme replacing dividend payments than the low profitable and low growth firms are.

1.6 ANALYSIS OF THE DATA

Table 1.6.1 – Four year Share Prices of Wipro Ltd

Wipro Ltd			
Dividend Type	**Date**	**Share Prices**	**Trade Volume**
Interim Dividend	22-Jan-14	577.45	1,54,582
	23-Jan-14	578.4	1,09,142
Final Dividend	21-Jul-14	545.1	86,910
	22-Jul-14	558.9	1,38,352
Interim Dividend	22-Jan-15	594.45	1,50,607
	23-Jan-15	601.5	1,90,233
Final Dividend	20-Jul-15	567.4	5,02,688
	21-Jul-15	577	1,14,683
Interim Dividend	25-Jan-16	546.85	25,513
	27-Jan-16	552.45	38,814
Final Dividend	11-Jul-16	567.4	4,95,764
	12-Jul-16	569.55	47,121
Interim Dividend	2-Feb-17	227.60	3,05,006
	3-Feb-17	228.35	3,91,532

Interpretation - From the table it has been observed that post interim and final dividend announcements the share prices have increased. In 2014 it has been observed that post dividend announcement the trade volume has declined from 1,54,582 to 1,09,142. This shows the impact of dividend announcement on share prices as the value of the firm has reduced adjusting to the amount of dividends paid by the firm to its shareholders.

Similar observations were made for the post final dividend announcement during the years 2015 and 2016. Post payment of final dividend in 2014 and post interim dividend in 2015, 2016 and 2017 it was observed that the trade volume has increased.

Table- 1.6.2 – Four year share prices of Infosys Ltd

Infosys Ltd			
Dividend Type	Date	Share Prices	Trade Volume
Final Dividend	29-May-14	731.08	16,17,620
	30-May-14	735.38	39,69,168
Interim Dividend	16-Oct-14	966.4	2,41,512
	17-Oct-14	963.46	1,99,420
Final Dividend	12-Jun-15	916.45	7,28,812
	14.75 Dividend 1:1 bonus share		
	15-Jun-15	932.95	3,52,567
Interim Dividend	16-Oct-15	1,093.75	1,45,067
	19-Oct-15	1,112.20	1,58,370
Final Dividend	09-Jun-16	1,185.45	4,95,595
	10-Jun-16	1,180.80	2,47,826
Interim Dividend	21-Oct-16	1,038.10	70,432
	24-Oct-16	1,029.00	75,995
Final Dividend	01-Jun-17	957.59	1,03,112
	02-Jun-17	956.11	3,06,705
Interim Dividend	31-Oct-17	921.65	2,12,404
	01-Nov-17	926.25	1,17,668

Interpretation - From the table it has been observed that post final dividend announcements the share prices for the year 2014 the share prices have increased and the trade volume also increased. For the year 2015 it has been observed that the share price has declined and trade volume has also declined. For the year 2016 share price has increased and trade volume has declined, this shows the impact of dividends on share prices where the market has adjusted itself to the amount of dividends paid by the firm. For the year 2016 post final dividend announcement the share price fell and trade volume also reduced. Post interim dividends, the share price has reduced and trade volume increased. For the year 2017, post final dividends the share price reduced marginally and the trade volume increased three times. Post interim dividend announcement the share price increased and the trade volume reduced adjusted itself to the amount of dividends paid by the firm.

Table -1.6.3 – Four year share prices of TCS Ltd

TCS Ltd			
Dividend Type	Date	Share Price	Trade Volume
Interim Dividend	27-Jan-14	2,230.30	66,514
	28-Jan-14	2,213.30	2,14,870
Final Dividend	09-Jun-14	2,115.25	95,614
	10-Jun-14	2,157.10	74,071
Special and Interim Dividend	31-Jul-14	2,577.30	33,363
	01-Aug-14	2,516.45	60,588
Interim Dividend	30-Oct-14	2,557.90	1,22,521
	31-Oct-14	2,604.55	3,54,492
Interim Dividend	27-Jan-15	2,502.80	52,192
	28-Jan-15	2,534.70	85,871
Final Dividend	08-Jun-15	2,578.65	34,962
	09-Jun-15	2,558.10	26,815
Interim Dividend	21-Jul-15	2,562.85	39,620
	22-Jul-15	2,528.10	67,868
Interim Dividend	26-Oct-15	2,535.20	42,329
	27-Oct-15	2,529.80	31,507
Interim Dividend	21-Jan-16	2,261.20	52,981
	20-Jan-16	2,277.60	59,597
Final Dividend	06-Jun-16	2,611.35	31,912
	03-Jun-16	2,630.85	36,021
Interim Dividend	25-Jul-16	2,551.55	62,922
	22-Jul-16	2,509.15	42,665
Interim Dividend	24-Oct-16	2,427.85	20,032
	21-Oct-16	2,428.70	43,212
Interim Dividend	23-Jan-17	2,267.66	85,630
		2,279.76	1,16,887
Final Dividend	13-Jun-17	2,439.87	58,017
	14-Jun-17	2,457.17	63,778
Interim Dividend	24-Jul-17	2,525.78	57,594
	25-Jul-17	2,563.68	51,526
Interim Dividend	25-Oct-2017	2,561.75	13,157
	26-Oct-2017	2,543.00	23,932

Interpretations- For the year 2014 post interim dividend given in January and July, it is observed the share prices have fell and the trade volume have increased. Post final dividend announcement the share prices were observed to be increasing and trade volume fell. For the year 2015 post interim dividend announcement share price was observed to be increasing and the trade volume increased. Post final dividend announcement the share price fell and the trade volume also fell down. Post interim dividend announcement pertaining to July, the share price fell and trade volume rose. For the year 2016 the share prices post interim(January) and final dividend were observed to be increasing and the trade volume was also observed to be increasing. Post interim dividends (July) share prices fell and trade also fell. Post interim dividends (Oct) share prices and trade volume both increased. Post interim (Jan) and final dividends for the year 2017, the share prices and trade volume both increased. Post interim dividends the share price increased and trade volume fell, but post interim dividends pertaining to October the share price fell and trade volume rose.

1.7 FINDINGS

The following are the findings of the study of three IT companies that is TCS Ltd, Wipro Ltd and Infosys Ltd with respect to the period 1st January 2014 to 31st December 2017.

- The analysis of pre and post dividend announcements share prices shows the short term relation between the share prices and the dividend announcements.
- It has been observed that Wipro Ltd and Infosys Ltd are paying dividends twice a year and TCS Ltd is paying dividend four times in a year.
- TCS Ltd apart from paying dividends four times a year in 2014 has also paid a special dividend of Rs.40 per share .
- It has been observed that Infosys is paying the highest of amount of dividends to its share holders but the total amount of dividend paid by Infosys to its share holders per year is less than the total amount of dividends paid by TCS to its shareholders per year.
- In the year 2014 post final dividend announcement the share price and trade volume of Wipro and Infosys has increased.
- In 2014 Post interim dividend announcement the share price of Wipro Ltd has marginally increased and trade volume has fallen.
- In 2014 Post interim dividend announcement it has been observed that the share price and trade volume has fallen.
- In 2014 it has been observed that post dividend announcement the trade volume of Infosys has increased and share prices have been slightly varying.
- In 2015 the share price and trade volume of Wipro Ltd has increased post dividend announcement.
- It has been observed that in June 2015 Infosys Ltd had paid final dividend equivalent to 14.75 per share after 1:1 bonus issue i.e. one equity share for every one equity share held. The company has fixed June 17, 2015 as record date for the purpose of ascertaining the entitlement of the members for the issue of bonus shares and final dividend.
- Post final and special dividend announcement of Infosys Ltd the share price increased and trade volume has fell to nearly half of what it was on the date of dividend announcement, this shows that the firm value got adjusted to the amount of dividend paid.
- Post Interim dividend announcement of Infosys Ltd in 2015, it has been observed that the share price and trade volume has increased.
- It has been observed that except for the Post Interim dividend announcement in January 2015 the share prices of TCS Ltd has decreased and trade volume was varying.

- In 2016, a few days prior to dividend announcement the share price of Wipro Ltd has been observed to be increasing and trade volume was observed to be declining and post dividend announcement its share prices continued increasing but the declining trade volume was observed to be increasing.
- In 2016 post final dividend announcement of Wipro Ltd the share price was observed to increasing but the trade volume fell remarkably from 4,95,764 to 47,121.
- In the year 2017, it was observed that the share price and trade volume of Wipro ltd were increasing.
- In the year 2017, it was observed that post final dividends the share price fell and trade volume surged remarkably and post interim dividends the share price increased, trade volume of Infosys Ltd fell showing that the firm has adjusted itself to the value of dividends issued by the firm.
- Post interim (Jan) and final dividends for the year 2017, the share prices and trade volume of TCS Ltd both increased. Post interim dividends (Jan) the share price increased and trade volume fell, but post interim dividends pertaining to October the share price fell and trade volume rose.

Suggestions

- As it has been observed that Infosys Ltd and TCS Ltd paid more dividend than Wipro Ltd, the shareholders looking for current returns can prefer buying the shares of Infosys Ltd as they offer the highest amount of dividends to its investors.
- TCS Ltd paid dividends four times a year and so investors or shareholders can prefer buying the stocks of TCS Ltd.
- The companies should continue their good dividend policies as the share prices and trade volume of these companies have mostly been observed to be increasing post dividend announcements.
- The Share Price of TCS Ltd is observed to be the highest because of the company's inherent strength and strong fundamentals, the shareholders are having a positive image of the company, similarly the other two companies i.e. Wipro Ltd and Infosys Ltd should also strengthen their dividend policies to attract the investors attention.

Conclusion

The study examines the relationship between the share prices and the dividend announcements to ascertain the impact of dividend announcements on the share prices. The pre and post dividend announcements share prices are taken into consideration to ascertain the impact of dividend announcements on share prices.

A comparative analysis of pre and post dividend announcement share prices of the companies in study for three years suggest that there is a short term relationship between the share prices and dividend announcements.

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