📘 1. Dividend Policies

A **dividend policy** refers to a company's approach to distributing profits to its shareholders in the form of dividends. The choice depends on multiple strategic, financial, and legal considerations.

🔹 Types of Dividend Policies:

Policy Type	Description
Stable Dividend Policy	Company pays a fixed amount or steadily increasing dividend over time.
Constant Payout Ratio	Dividend is a fixed percentage of net earnings (e.g., 30% of PAT).
Residual Dividend Policy	Company retains earnings for investments first; remaining profit paid as dividend.
No Dividend Policy	Profits are fully retained, often in growth-phase companies.

✅ 2. Factors Affecting Dividend Payment

Dividend decisions are influenced by several **internal** and **external** factors:

Factor	Explanation
Profitability	Higher profits enable higher dividend payouts.
Liquidity Position	Even with profit, lack of cash may restrict dividend payments.
Earnings Stability	Stable profits support consistent dividends.
Growth Opportunities	Firms may retain earnings for future expansion rather than pay dividends.
Debt Obligations	Heavily leveraged companies may retain earnings to meet interest/repayments.
Tax Considerations	Tax treatment of dividends can influence payout decisions.
Shareholder Expectations	Companies may follow policies that meet investor expectations.
Legal Provisions	Laws restrict dividends to protect creditors and maintain capital integrity.
Access to Capital Markets	If external funding is easy to get, more earnings can be distributed.
Inflation	In high inflation, firms may retain more earnings to preserve real value.

⚖️ 3. Company Law Provisions on Dividend (As per Indian Companies Act, 2013)

🔸 Relevant Sections:

- **Section 123**: Conditions for declaration and payment of dividend
- **Section 124**: Unpaid Dividend Account
- **Section 127**: Penalty for failure to distribute dividend

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📌 **Key Provisions:**

Provision	Details
Sources for Dividend	- Current year profits after depreciation- Past reserves- Govt. grants (in rare cases)
Depreciation Requirement	Must be provided as per Schedule II before dividend is declared
Declaration	- Final dividend: declared by shareholders at AGM- Interim dividend: declared by Board
Payment Deadline	Dividend must be paid within **30 days** of declaration
Unpaid Dividend Handling	Transfer to **Unpaid Dividend Account** within **7 days**; after 7 years, moved to IEPF
Penalty for Non-Payment (Sec 127)	- Director fined ₹1,000/day of default- Interest @18% p.a. on delayed payment

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□ Interim Dividend

- Declared by the **Board of Directors** any time during the financial year
- Paid out of **profits or accumulated reserves**

📝 **Summary Table**

Aspect	Provision
Declaration Authority	Board (Interim), Shareholders (Final)
Depreciation Requirement	Mandatory before declaration
Time Limit to Pay	30 days from declaration
Transfer to Unpaid A/C	Within 7 days if not claimed
Penalty on Default	Fine + Interest @18% + Imprisonment (in some cases)

✅ **Conclusion in Financial Management Terms:**

- A **sound dividend policy** balances **shareholder satisfaction** and **company's investment needs**.
- Companies must adhere to **legal and financial guidelines** to ensure sustainable and lawful dividend payments.
- **Dividend decisions impact firm value, cost of capital, and investor perception**—making it a vital part of financial strategy.

Here's a clear summary of **various dividend valuation models and theories** under financial management, focusing on:

- ◈ **Walter's Model**
- ◈ **Gordon's Model**
- ◈ **Modigliani and Miller (MM) Hypothesis**

These models explore whether **dividends are relevant or irrelevant** to the valuation of a firm.

◈ 1. Walter's Model (Dividend Relevance Theory)

📌 Assumptions:

- All financing is through retained earnings (no external finance).
- Constant return on investment (r) and cost of equity (k).
- Earnings and dividends are never negative.
- Infinite life of the firm.

□ Formula:

$$P = D + \frac{(r/k)(E - D)}{k}$$

Where:

- PP = Market price per share
- DD = Dividend per share
- EE = Earnings per share (EPS)
- rr = Return on retained earnings
- kk = Cost of equity capital

🔍 Interpretation:

Case	When r > k	When r = k	When r < k
Dividend policy	Retain earnings	No effect	Pay higher dividends

Case	When r > k	When r = k	When r < k
Effect on share price	Increases with retention	Irrelevant	Increases with dividend

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🔷 2. Gordon's Model (Dividend Relevance Theory – "Bird in Hand")

Gordon argues that **dividends are preferred** over future capital gains due to **certainty**.

📌 Assumptions:

- Firm is all-equity financed.
- No debt.
- r and k are constant.
- Retention ratio and growth rate are constant.
- Infinite life.
- No taxes.

□ Formula:

$$P = \frac{E(1 - b)}{k - br}$$

Where:

- PP = Price of the share
- EE = Earnings per share
- bb = Retention ratio
- rr = Return on investment
- kk = Cost of equity
- g=brg = br = Growth rate

🔍 Interpretation:

Case	r > k	r = k	r < k
Retain earnings?	Yes (increase P)	No effect	No (pay dividend)

Gordon's theory supports **high dividends**, as **investors prefer certainty**.

🔷 3. Modigliani & Miller (MM) Hypothesis – Dividend Irrelevance Theory

MM argue that **dividend policy does not affect** the value of a firm under perfect market conditions.

📌 Assumptions:

- Perfect capital markets (no taxes, no transaction costs).

- Investors act rationally.
- Information is freely available.
- Investment policy is fixed.
- No flotation or issuing costs.
- No uncertainty.

🔍 **Main Argument:**

- Investors are indifferent between dividends and capital gains.
- The firm's value depends only on **investment decisions**, not on dividend policy.

□ Formula (value of the firm):

$$P0=D1+P11+kP_0 = \frac{D_1 + P_1}{1 + k}$$

Where:

- P0P_0 = Current price of share
- D1D_1 = Dividend at the end of the year
- P1P_1 = Price at the end of the year
- kk = Cost of equity

🔁 **If firm pays dividends:**

- Price drops by the dividend amount.
- Investors can create "homemade dividends" by selling shares.

🔁 **Summary Comparison Table**

Feature	**Walter's Model**	**Gordon's Model**	**MM Hypothesis**
Dividend relevance?	Relevant	Relevant	**Irrelevant**
Core idea	Retention vs payout impacts price	Dividends preferred ("bird in hand")	Value depends on investment, not dividends
Assumptions	No external financing, constant r & k	Constant r, k, g	Perfect market, no taxes
When dividend is preferred	r < k	Always preferred	No preference
Policy recommendation	Depends on r vs k	Pay dividends	Dividends don't matter

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Sure! Here are **more simple problems** on dividend valuation models — Walter's Model, Gordon's Model, and MM Hypothesis — to practice:

🔷 Walter's Model Problems

Problem 1:
Earnings per share (E) = ₹6
Dividend per share (D) = ₹3

Return on investment (r) = 14%
Cost of equity (k) = 12%

Find the market price per share.

Solution:

$P = \frac{D + \frac{r}{k} (E - D)}{k} = \frac{3 + \frac{0.14}{0.12}(6 - 3)}{0.12} = \frac{3 + 1.1667 \times 3}{0.12} = \frac{3 + 3.5}{0.12} = \frac{6.5}{0.12} = ₹54.17$

Problem 2:
E = ₹10
D = ₹6
r = 8%
k = 10%

Find P.

Solution:

$P = \frac{6 + \frac{0.08}{0.10} (10 - 6)}{0.10} = \frac{6 + 0.8 \times 4}{0.10} = \frac{6 + 3.2}{0.10} = \frac{9.2}{0.10} = ₹92$

🔷 Gordon's Model Problems

Problem 3:
Earnings per share = ₹12
Retention ratio (b) = 0.5
Return on investment (r) = 14%
Cost of equity (k) = 16%

Find the price per share.

Solution:

$P = \frac{E(1-b)}{k - br} = \frac{12 \times (1 - 0.5)}{0.16 - (0.5 \times 0.14)} = \frac{6}{0.16 - 0.07} = \frac{6}{0.09} = ₹66.67$

Problem 4:
E = ₹15
b = 0.3

r = 10%
k = 12%

Find the price.

Solution:

$P = \frac{15 \times (1 - 0.3)}{0.12 - (0.3 \times 0.10)} = \frac{10.5}{0.12 - 0.03} = \frac{10.5}{0.09} = ₹116.67$

🔷 **MM Hypothesis Problems**

Problem 5:
Expected dividend (D_1) = ₹8
Expected price after 1 year (P_1) = ₹112
Cost of equity (k) = 12%

Find current price.

Solution:

$P_0 = \frac{D_1 + P_1}{1 + k} = \frac{8 + 112}{1.12} = \frac{120}{1.12} = ₹107.14$

Problem 6:
D_1 = ₹7
P_1 = ₹98
k = 10%

Find P_o.

Solution:

$P_0 = \frac{7 + 98}{1.10} = \frac{105}{1.10} = ₹95.45$
