International Journal of Engineering Research and Science & Technology

www.ijerst.org

ISSN : 2319-5991

Vol. 21 No. 3 (1) 2025

ijerst.editor@gmail.com

editor@ijerst.com

ISSN 2319-5991 www.ijerst.com
Vol. 21, No. 3(1), 2025

Research Paper

AN ANALYTICAL STUDY ON DIVIDEND DECISIONS AND THEIR INFLUENCE ON FIRM PERFORMANCE WITH REFERENCE TO ICICI BANK

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ABSTRACT

The Dividend Decision, in corporate finance, is a decision made by the directors of a company. It relates to the amount and timing of any cash payments made to the company's stockholders. The decision is an important one for the firm as it may influence its capital structure and stock price. In addition, the decision may determine the amount of taxation that stockholders pay.

There are three main factors that may influence a firm's dividend decision:

- Free-cash flow
- Dividend clienteles
- Information signaling

The free cash flow theory of dividends

Under this theory, the dividend decision is very simple. The firm simply pays out, as dividends, any cash that is surplus after it invests in all available positive net present value projects.

A key criticism of this theory is that it does not explain the observed dividend policies of real-world companies. Most companies pay relatively consistent dividends from one year to the next and managers tend to prefer to pay a steadily increasing dividend rather than paying a dividend that fluctuates dramatically from one year to the next. These criticisms have led to the development of other models that seek to explain the dividend decision.

Dividend clienteles

A particular pattern of dividend payments may suit one type of stock holder more than another. A retiree may prefer to invest in a firm that provides a consistently high dividend yield, whereas a person with a high income from employment may prefer to avoid dividends due to their high marginal tax rate on income. If clienteles exist for particular patterns of dividend payments, a firm may be able to maximize its stock price and minimize its cost of capital by catering to a particular clientele. This model may help to explain the relatively consistent dividend policies followed by most listed companies.

A key criticism of the idea of dividend clienteles is that investors do not need to rely upon the firm to provide the pattern of cash flows that they desire. An investor who would like to receive some cash from their investment always has the option of selling a portion of their holding. This argument is even more cogent in recent times, with the advent of very low-cost discount stockbrokers. It remains possible that there are taxation-based clienteles for certain types of dividend policies.

Information signaling

A model developed by Merton Miller and Kevin Rock in 1985 suggests that dividend announcements convey information to investors regarding the firm's future prospects. Many earlier studies had shown that

stock prices tend to increase when an increase in dividends is announced and tend to decrease when a decrease or omission is announced. Miller and Rock pointed out that this is likely due to the information content of dividends.

When investors have incomplete information about the firm (perhaps due to opaque accounting practices) they will look for other information that may provide a clue as to the firm's future prospects. Managers have more information than investors about the firm, and such information may inform their dividend decisions. When managers lack confidence in the firm's ability to generate cash flows in the future they may keep dividends constant, or possibly even reduce the amount of dividends paid out. Conversely, managers that have access to information that indicates very good future prospects for the firm (eg. a full order book) are more likely to increase dividends.

Investors can use this knowledge about managers' behavior to inform their decision to buy or sell the firm's stock, bidding the price up in the case of a positive dividend surprise, or selling it down when dividends do not meet expectations. This, in turn, may influence the dividend decision as managers know that stock holders closely watch dividend announcements looking for good or bad news. As managers tend to avoid sending a negative signal to the market about the future prospects of their firm, this also tends to lead to a dividend policy of a steady, gradually increasing payment.

Received: 03-7-2025 Accepted: 07-8-2025 Published: 14-8-2025

1. INTRODUCTION

The term Dividend refers to that part of the profits of a company which is distributed amongst its shareholders. It may therefore be defined as the return that a shareholder gets from the company, out of its profits, on his share holdings. “According to the Institute of Charted Accounts of India” dividend is a “Distribution to shareholder out of profits or reserves available for this purpose”

The Dividend policy has the effect of dividing its net earnings into two Parts: Retained earnings and dividends. The retained earnings provide funds two finance the long-term growth. It is the most significant source of financing a firm’s investment in practice. A firm, which intends to pay dividends and also needs funds to finance its investment opportunities, will have to use external sources of finance. Dividend policy of the firm. Thus has its effect on both the long-term financing and the wealth of shareholders. The moderate view, which asserts that because of the information value of dividends, some dividends should be paid as it may have favorable affect on the value of the share.

The theory of empirical evidence about the dividend policy does not matter if we assume a real world with perfect capital markets and no taxes. The second theory of dividend policy is that there will definitely be low and high payout clients because of the differential personal taxes. The majority of the holders of this view also show that balance, there will be preponderous low payout clients because of low capital gain taxes. The third view argues that there does exist an optimum dividend policy. An optimum dividend policy is justified in terms of the information in agency costs.

2. OBJECTIVES OF THE STUDY

The basic objective of this study is as follows:

1. To understand the importance of the dividend decision and their impact on the firm’s capital budgeting decision.
2. To know the various dividend policies followed by the firm.
3. To understand the theoretical backdrop of the various divided theories.
4. To compare the various theories of dividend with reference to their assumptions and conclusions.
5. To know whether the dividend decisions have an impact on the market value of the firm’s equity.

6. To see the various dividend policies of the INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA
7. To derive the empirical evidence for the relevance theories of dividends WALTER'S MODEL AND GORDON'S MODEL

IMPORTANCE OF THE STUDY

The dividend policy of a firm determines what proportion of earnings is paid to shareholders by the way of dividends and what proportion is ploughed back in the firm for reinvestment purposes. If a firm‘s capital budgeting decision is independent of its dividend of its dividend policy, a higher dividend payment will entail a greater dependence on external financing. On the other hand, if a firm' s capital budgeting decision is dependent on its dividend decision, a higher payment will cause shrinkage of its capital budget and vice versa. In such a case the dividend policy has a bearing on the capital budgeting decision.

Any firm, whether a profit making or non-profit organization has to take certain capital budgeting decision. The importance and subsequent indispensability of the capital budgeting decision has led to the importance of the dividend decisions for the firms.

NEED FOR THE STUDY:

The principal objective of corporate financial management is to maximize the market value of the equity shares. Hence the key question of interest to us in this study is, "What is the relationship between dividend policy and market price of equity shares?"

Most of the discussion on dividend of dividend policy and firm value assumes that the investment decision of a firm is independent of its dividend decision. The need for this study arise from the above raised question and the most controversial and unresolved doubts about the relevance of irrelevance of the dividend policy.

SCOPE OF THE STUDY:

Investment Decision Investment decision relates to selections of asset in which funds will be invested by a firm. The asset that can be acquired by a firm may be long term asset and short term asset. Investment Decision with regard to long term assets is called capital budgeting. Decision with regard to short term or current assets is called working capital management.

Dividend Decision A firm distributes all profits or retain them or distribute a portion and retain the balance with it. Which course should be allowed? The decision depends upon the preference of the shareholders and investment opportunities available to the firm.

Dividend Decision Dividend decision has a strong influence on the market prize of the share. So the dividend policy is to be determined in terms of its impact on shareholder's value. The optimum dividend policy is one which maximizes the value of shares and wealth of the shareholders.

Dividend Decision The financial manager should determine the optimum pay out ratio I.e. the proportions of net profit to be paid out to the shareholders. The above three decisions are inter related. To have an optimum financial decision the three should be taken jointly.

3. RESEARCH METHDOLOGY:

HYPOTHESIS FOR THE STUDY:

A proposition is a statement about concepts that may be judged as true Or false if it refers to observable phenomena. When a proposition is formulated for empirical testing, we call it a hypothesis. Hypotheses have also been described as statements in which we assign variables to cases. A case id defined in this sense as the entity or the thing the hypothesis. Talks about The variable are the characteristic, trait, or attribute that, in the hypothesis, are imputed to the case. In research, a hypothesis serves several important functions. The most important is that it guides the directions of the study. It defines facts that are relevant and those that are not: in doing so, it suggests which form of research design is likely to be most important. A final role of the hypothesis is to provide a framework for organizing the conclusions of that result.

In classical tests of significance two kinds of hypotheses are used. The null hypothesis, which is a statement that they're no difference, exists between the parameter and the statistic being compared to it. A second or alternative hypothesis is the logical opposite of the null hypothesis.

The null hypothesis in this study is as following:

'The dividend decisions are relevant to the capital budgeting decisions of the firm's belonging to the cement industry and the in turn effect the market value of the firms' equity.

To prove this hypothesis we shall try to prove the two theories of relevance of dividend-Walter's model and Gordon's model

The alternate hypothesis in this case shall be as fallows:

The dividend decisions are irrelevant to capital budgeting decisions of the firm belonging to the INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI) and they in turn have no effect on the market value of the firm equity.

SAMPLE OF THE STUDY:

A sample is a part of the target population, carefully selected to represent that population. When researchers undertake sampling studies, they are interested in estimating one or more population values and/ or testing one or more statistical hypothesis.

The sample of our study consists of the financial data of INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI) for the past five financial years.

DESIGN AND METHODOLOGY

Database for the Study:

The sources of information are classified to two-primary data and secondary data. The data collected by the researcher and agent known to the researcher, especially to answer the research question, is known as the primary data. Studies made by others for their own purposes represent secondary data to the researcher.

Secondary sources can usually be found more quickly and cheaply than primary data especially when national and international statistics are needed. Similarly, data about distant places often can be collected more cheaply through secondary sources.

The data used for this study is mostly secondary data. The information regarding the financial data of the past five years has been collected from the various website like the indiainfoline.com, the web portals of the respective company and other related sites.

Sampling Design:

A variety of sampling techniques is available. The one selected depends on the requirements of the project and its objectives. The various methods of sampling have been classified basing on the representation – probability or non probability and on element selection-restricted.

The sampling technique selected for conducting this study is judgment sampling. This is a restricted and non- probabilistic method of sampling; where the sample consisting of one company has been selected on basis of the past dividend payment made by the company.

Tools of Collecting Data :

There are various ways of collecting the data. Some of the most commonly used ones are telephone interview, personal interview and, questionnaire administering. These are basically the methods for collecting the primary data the data required for conducting this study it has been collected from the various web portals as the data is basically secondary in nature.

LIMITATIONS:

Every research conducted has certain limitations. These arise due to the method of sampling used, the method of data collation used and the source of the data apart from many other things. The limitations of this study are as follows:

The data collected is of secondary nature and hence it is difficult to ascertain the reliability of the data.

1. The scope of the study has been limited to the impact of the dividend on the market value of the firm's equity. Others factors affecting the firm's market value have been assumed to have remained unchanged.
2. The period of the study has been limited to only five years.
3. The method of sampling used is 'judgment sampling' hence the choice of the sample has been left entirely to the choice of the researcher. This has led to some amount bias being introduced into the research process.

DIVIDEND DECISIONS- THEORITICAL FRAME WORKS

DIVIDEND PRACTICES AND MODELS A CONCEPTUAL FRAME WORK:

Dividend refers to that portion of a firm's net earnings, which are paid out to the shareholders. Our focus here is on dividends paid to the ordinary shareholders because holders of preference shares are entitled to a stipulated rate of dividend. Moreover, the discussion is relevant to widely held public limited companies, as the dividend issue does not pose a major problem for closely held private limited companies, since dividends are destroyed out of the profits, the alternative to the payment of dividends is the retention of earning profits. The retained earning constitutes an accessible important source and financing the investment requirements of firms. There is, thus a type of inverse relationship between retained earnings and cash dividends: larger retentions, lesser dividends smaller retentions, larger dividends. Thus, the alternative uses of the not earnings-dividends and retained earnings are competitive and conflicting.

A major decision of financial management is the dividend decision in the sense that the firm has to choose between distributing the profits to the shareholders and plugging them back into the business. The choice would obviously hinge on the effect of the decision on the maximizations of shareholders wealth. Given the objective of financial management of maximizing present values, the firm should be guided by the considerations as to which alternative use is consistent with the goal of wealth maximization. That is, the firm would be well advised to use the net profits for paying dividends to the shareholders if that payment will lead to the maximization of wealth of the owners. If not, the firm should rather retain theme to finance investment programmers. The relationship between dividends and value of the firm should therefore, be the decision criterion.

There are however, conflicting opinions regarding the impact of dividends on the valuation of a firm. According to one school of thought, dividends are irrelevant so that the amount of dividends paid has no effect on the, valuation of a firm.

On the other hand, certain theories consider the dividend decision as relevant to the value of the firm measured in terms f the market price of the shares.

Factors influencing Dividend Decisions

There are certain issues that are taken into account by the directors while making the **dividend decisions:**

- Free Cash Flow
- Signaling of Information
- Clients of Dividends

Free Cash Flow Theory

The free cash flow theory is one of the prime factors of consideration when a **dividend decision** is taken. As per this theory the companies provide the shareholders with the money that is left after investing in all the projects that have a positive net present value.

Signaling of Information

It has been observed that the increase of the worth of stocks in the share market is directly proportional to the dividend information that is available in the market about the company. Whenever a company announces that it would provide more dividends to its shareholders, the price of the shares increases.

Clients of Dividends

While taking **dividend decisions** the directors have to be aware of the needs of the various types of shareholders as a particular type of distribution of shares may not be suitable for a certain group of shareholders.

It has been seen that the companies have been making decent profits and also reduced their expenditure by providing dividends to only a particular group of shareholders. **For more information please refer to the following links:**

Forms of Dividend

- **Scrip Dividend-** An unusual type of dividend involving the distribution of promissory notes that calls for some type of payment at a future date.
- **Bond Dividend-** A type of liability dividend paid in the dividend payer's bonds.
- **Property Dividend-** A stockholder dividend paid in a form other than cash, scrip, or the firm's own stock.
- **Cash Dividend-** A dividend paid in cash to a company's shareholders , normally out of the its current earnings or accumulated profits
- **Debenture Dividend**
- **Optional Dividend-** Dividend which the shareholder can choose to take as either cash or stock.

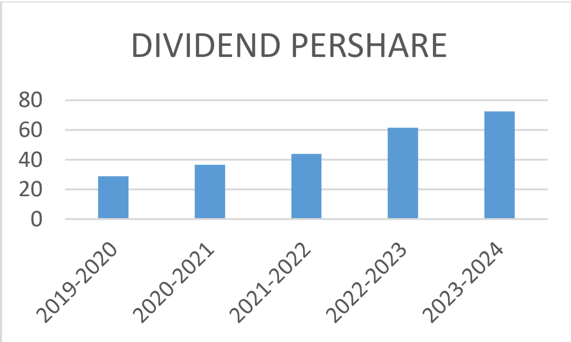
Significance of dividend decision

- The firm has to balance between the growth of the company and the distribution to the shareholders
- It has a critical influence on the value of the firm
- It has to also to strike a balance between the long term financing decision(company distributing dividend in the absence of any investment opportunity) and the wealth maximization
- The market price gets affected if dividends paid are less.
- Retained earnings helps the firm to concentrate on the growth, expansion and modernization of the firm
- To sum up, it to a large extent affects the financial structure, flow of funds, corporate liquidity, stock prices, and growth of the company and investor's satisfaction.

4. DATA ANALYSIS AND INTERPRETATION

COMPARISION OF DIVIDEND PER SHARE OF THE INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI).

YEAR	DIVIDEND PERSHARE
2019-2020	28.83
2020-2021	36.67
2021-2022	43.95
2022-2023	61.53
2023-2024	72.54



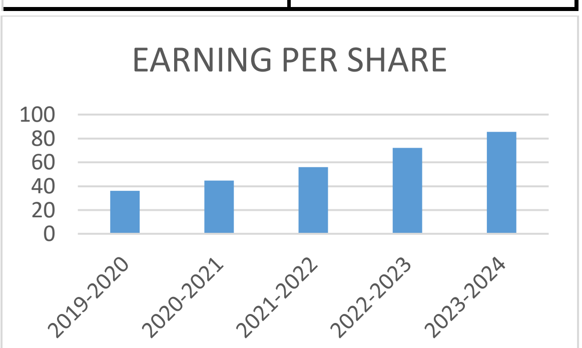
Interpretation:

The dividend Per Share of ICICI ltd., is Rs 28.38 in the year of 2019-2020. The dividend per share for the next two financial years is constant (i.e. Rs 36.67)

When it is compared with the year 2019-2020 the dividend per share in the year 2020-21 it is increased at the rate of 28.83 % and72.54 % in the year of 2023-24.

COMPARISION OF EARNING PER SHARE OF THE FIRM FOR THE LAST FIVE YEARS

YEAR	EARNING PER SHARE
2019-2020	36.1
2020-2021	44.73
2021-2022	56.09
2022-2023	72.17
2023-2024	85.61

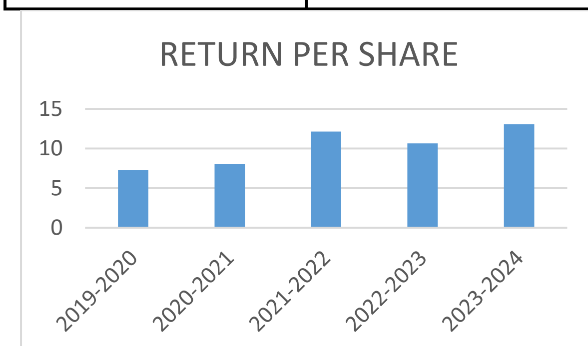


Interpretation:

The Earning per share of the firm is very low in the year 2019-20, but it is doubled in the next year. The Earning per share fluctuated slightly during the financial years 2021-22 and 2023-24. However, there is massive increase reported (about 2 times to the starting year of 2019-20) in the year 2023-24. It indicates the increase in the revenue of the profit.

A PROFILE OF RETURN PER SHARE OF THE FIRM

YEAR	RETURN PER SHARE
2019-2020	7.27
2020-2021	8.06
2021-2022	12.14
2022-2023	10.64
2023-2024	13.07



Interpretation:

Return per share of ICICI Ltd is low of in the year 2019-20 and in the next year it has increased normally and after next year it is highly decreased. The year of 2023-24 the return per share highly increased that is 13.07.

5. FINDINGS

FINDINGS:

Following are the findings from the dividend decision analysis of the ICICI:

1) Profit After Tax has increased from Rs 59.67 Cores to Rs. 55.87 Cores.

2) Earning per share has improved from Rs 85.54 to Rs. 72.17

3) Dividend has been benched from Rs 43.95 to 61.93

4) Increased net worth from Rs. 415.68 Cores to Rs. 658.69

5) The dividend carries some informational content.

6) The dividend pay out ratio has an impact on the firm.
7) The dividend per share increased normally.
8) There is a fluctuation in earning per share
9) The Return per share has been increased gradually.

SUGGESTIONS:

The following Suggestions are being provide to The ICICI industry.

1) Investors always prefer the dividend payment for Capital appreciation. Hence some amount of Dividend must be paid regularly. Unless the Payment will reduce the net worth of the industry.
2) The industry should improve the dividend per share.
3) The industry should follow stable dividend policy.
4) The industry should maintain high per share.
5) The industry must improve and maintain high ratio.
6) When the industry gets the price earning highly, that industry will grow
7) In The industry Net worth is very good. The industry has to maintain this type of Net worth.

6. CONCLUSIONS

Efficient market with no taxes and no transaction costs, the free cash flow model of the dividend decision would prevail and firms would simply pay as a dividend any excess cash available. The observed behaviors' of firm differs markedly from such a pattern. Most firms pay a dividend that is relatively constant over time. This pattern of behavior is likely explained by the existence of clienteles for certain dividend policies and the information effects of announcements of changes to dividends.

The dividend decision is usually taken by considering at least the three questions of: how much excess cash is available? What do our investors prefer? and What will be the effect on our stock price of announcing the amount of the dividend?

The result for most firms tends to be a payment that steadily increases over time, as opposed to varying wildly with year-to-year changes in free cash flow.

- Investors in aggregate cannot be shown to uniformly prefer either high or low dividends
- *Individual investors*, however, have strong dividend preferences and will tend to invest in companies whose dividend policies match their preferences
- Regardless of the payout ratio, investors prefer a stable, predictable dividend policy

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