Dividend and Bonus Policies of Indian Companies: An Analysis

Pitabas Mohanty

This article presents the findings of a study of dividend paying behaviour of more than 200 Indian companies over 15 years. It attempts to examine whether the companies offering bonus issue have been able to generate greater returns for their shareholders than those that have not offered any bonus issue but have maintained a steadily increasing dividend rate. It is found that most of the companies either maintained the dividend rate after the bonus issue at the pre-bonus level or decreased it (but not proportionately) thereby increasing the dividend payments to the shareholder. In fact, a few companies increased the dividend rate after a bonus issue. It is found that, during 1982-91, the bonus issuing companies yielded greater returns to their shareholders than those that did not make any bonus issue but maintained a steadily increasing dividend rate. This phenomenon got reversed during 1992-96. The declining tendency of the MNCs to issue bonus shares is found to be one of the reasons for such behaviour.

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The theory of finance considers a bonus issue as a financial illusion because it does not add value to the company under the symmetric information assumption. This is because bonus issue is just an accounting adjustment. The accountant just makes a book entry by debiting some free reserves account and crediting the share capital account. It does not directly affect any cash inflow or outflow and, therefore, it is assumed that it does not add value to the company. If a company distributes a known fraction of its earnings each year as dividend, then the bonus issue will bring down the dividend in proportion to the bonus ratio and hence the theoretical ex-bonus share price will go down in proportion to the bonus ratio. However, the number of shares the company holds increases in the same proportion and hence the shareholders' wealth remains unchanged. If, however, management has better information about the future prospects of a company than the shareholders, then a bonus issue may convey some value relevant information to the shareholders. The shareholders, for example, may think that the management is more confident of the future and hence the cash flows due to dividends will increase after the bonus issue. In this case, the bonus issue will be welcomed by the shareholders.

Empirical research on the effects of a bonus issue on the stock prices gives evidence that the market reacts favourably to a bonus issue. Fama, Fischer, Jensen, and Roll (1969), Charest (1978), Grinblatt, Masulis, and Titman (1984), for example, have documented evidence of a favourable reaction of the stock market to a bonus issue in the US. Ramachandran (1988) and Obaidullah (1992) have found out similar evidences in India. When there is a bonus issue, the ex-bonus price is usually higher than what the theoretical price should be. This is because the dividend rate (defined as a percentage of the face value) is not expected to change after the bonus issue. When the company makes a bonus issue, the shareholders perceive that the management is confident of the future.

A study done by Gupta (1973) finds out that as
many as one third of the companies issuing bonus shares did not increase the total dividend payments. The study period was 1948-71. A lot of changes have taken place since then. This warrants a study of the behaviour in subsequent years. In India, companies declare dividend as a percentage of the face value of the share. Thus, when a company with a face value of Rs 10 per share gives a 30 per cent dividend, each shareholder gets Rs 3 as the dividend per share. This practice, however, is completely different from the practices followed abroad where a company declares dividend as a percentage of the profit after tax (PAT) or the net profit. In the US, payout ratio is an important parameter in the dividend policy of any company. Lintner (1956), for example, observed that managers focused on the change in the existing rate of dividend payout ratio, and not on the amount of the newly established payout as such. One can also observe the important role the dividend payout ratio plays in the US corporations' dividend policy in Fama and Babiak (1968).

In India, the payout ratio does not appear to matter much as it is the dividend rate and not the payout ratio that is important to explain the dividend paying behaviour of the companies. The appendix summarises our study that shows the irrelevance of the payout ratio in the Indian context. It is in this context that the bonus issue by a company becomes important. The shareholders do not expect the dividend rate to fall proportionately after the bonus issue. Hence, the cash flow to the shareholder is expected to increase after the bonus issue. The ex-bonus stock price would, therefore, be less than the theoretical ex-bonus price. Therefore, the shareholders expect the bonus issuing companies to generate more returns than the non-bonus paying companies.

Grinblatt, Masulis, and Titman (1984) have observed that for a large number of US companies, the dividend per share has actually increased after a bonus issue. "For instance, many firms that pay small stock dividends (bonus issue) report nothing to the Wall Street Journal about cash dividends, and it is understood that the per share dividend will remain unchanged. Yet this represents an increase in the total cash dividend payout, once the additional shares are issued." However, it may be perfectly possible to think of a situation where the company, after making a bonus issue, is not able to maintain the dividend rate because of cash flow problems. Here, the expectations of the shareholders get belied and, therefore, the share prices tend to fall. We need to examine whether the actual dividend rate movement is consistent with the shareholders' expectations.

This paper attempts to study the dividend and bonus policies of Indian companies and tries to see how much returns such companies have been able to generate for their shareholders.

Sample

The entire sample period — 1982-1996 — is divided into two sub-periods, viz., 1982-91, and 1992-96. Such a division was made to account for differences in the sources of data. Data for the 1982-91 period were obtained from the Stock Market Yearbook (SMYB) published by Quantum Financial Services Private Limited and for the 1992-96 period from the Prowess Database of CMIE. Information on 250 companies was available on SMYB. Though it is desirable to have the same sample in both the sub-periods, it could not be done for the following reasons.

- Some companies have already been merged with one another.
- Some companies no longer exist or have been referred to the BIFR.

Information about certain companies is also not available in the CMIE Database. Therefore, in the second sub-period, the sample size got reduced to 201.

As already mentioned, one of the objectives of this paper is to study the behaviour of the dividend rate of the companies after the bonus issue is made. The following section broadly summarises the findings for both the periods.

First Sub-period

Out of the 250 companies, only 160 companies offered bonus issue during 1982-91. The total number of bonus issues offered was 236. The bonus issues have been divided into four categories namely, A, B, C, and D depending on the number of new shares given for each existing share. The distribution was as in Table 1.

As can be seen here, in 81 per cent of the cases, the bonus ratios are greater than 50 per cent. Gupta (1973) found out that most of the bonus issues were in a

<table>
<thead>
<tr>
<th>Category</th>
<th>Bonus Ratio*</th>
<th>No of Bonuses</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>More than 1:1</td>
<td>2</td>
</tr>
<tr>
<td>B</td>
<td>1:1</td>
<td>90</td>
</tr>
<tr>
<td>C</td>
<td>Between 1:1 and 1:2</td>
<td>99</td>
</tr>
<tr>
<td>D</td>
<td>Less than 1:2</td>
<td>45</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>236</td>
</tr>
</tbody>
</table>

* Here, a m:n bonus ratio means that for each n shares the shareholder has, he/she will get m shares free.
relatively higher ratio of 20 per cent and above during 1948-71. Over time, the bonus ratios of the bonus issuing companies have gone up.

The dividend rates of the companies in the year following the bonus issue are given in Table 2. As can be seen, in 52 per cent of the cases, the dividend rate either increased or remained constant. In another 41 per cent of the cases, though the dividend rate declined, the decline was not proportionate and, therefore, the cash inflow of the shareholders increased.

Table 2: Category-wise Behaviour of Dividend Rate (1982-91)

<table>
<thead>
<tr>
<th>Description</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in Dividend Rate</td>
<td>0</td>
<td>15</td>
<td>27</td>
<td>12</td>
<td>54</td>
</tr>
<tr>
<td>Same Dividend Rate</td>
<td>1</td>
<td>25</td>
<td>24</td>
<td>18</td>
<td>68</td>
</tr>
<tr>
<td>Less than Proportionate Decline</td>
<td>1</td>
<td>44</td>
<td>39</td>
<td>14</td>
<td>98</td>
</tr>
<tr>
<td>Proportionate Decline</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>More than Proportionate Decline</td>
<td>0</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>2</td>
<td>90</td>
<td>99</td>
<td>45</td>
<td>236</td>
</tr>
</tbody>
</table>

The figures indicate the number of bonuses during the period.

Second Sub-period

In the second sub-period, out of the 201 companies, only 91 companies offered bonus issues. The total number of bonus issues offered was 134. The distribution of the bonus issue is given in Table 3.

In the second period, 88 per cent of the bonus ratios are greater than 50 per cent. The dividend rates in the year following the bonus issue are given in Table 4. In 43 per cent of the cases, the dividend rate either increased or remained constant. In another 44 per cent, though the dividend rate declined, the decline was not proportionate and, hence, the total cash dividend payments to the shareholder increased.

If we combine both the periods, in a little more than 91 per cent of the cases, the cash dividends to the shareholders increased after the bonus issue. These findings differ from those of Gupta (1973). They imply that the bonus issuing companies have become more generous than in 1971. Thus, we see that the expectation of the shareholders that the dividend rate either remains constant or declines less than proportionately is justified if one looks at the actual dividend policies of the companies. This is consistent with the signaling hypothesis that a bonus issue signals an increase in the cash dividend. These findings are consistent with those of Grinblatt, Masulis, and Titman (1984) and Fama (1976).

Presumably, a company will make a bonus issue only if it is reasonably sure that the future cash flows will be large enough to support an increase in the cash dividend payments. However, it may so happen that the future cash flows are not adequate and hence the company is forced to reduce the dividend rate that results in a reduction of cash dividend vis-a-vis the cash dividends before the bonus issue. So we tried to investigate how the rupee dividends (adjusted for the bonus issue) of the companies behaved in the three-year period immediately after the bonus issue is offered.

It has been observed that, in most cases, the rupee dividend payments to the shareholders increased in the years after the bonus issue. However, in some cases, the companies could not increase the dividend payments. The findings for the two sub-periods have been summarized in Tables 5 and 6. Here, increases means that the rupee dividends have increased in all the subsequent three years. Increase2 means that the rupee dividend payments have increased in the two years immediately following the dividend rate. Increase 1 has got a similar meaning. Here, it is important to note that whenever the rupee dividend payments have decreased in the year immediately following the

Table 4: Category-wise Behaviour of Dividend Rate (1992-96)

<table>
<thead>
<tr>
<th>Description</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in Dividend Rate</td>
<td>0</td>
<td>11</td>
<td>12</td>
<td>6</td>
<td>29</td>
</tr>
<tr>
<td>Same Dividend Rate</td>
<td>1</td>
<td>12</td>
<td>11</td>
<td>5</td>
<td>29</td>
</tr>
<tr>
<td>Less than Proportionate Decline</td>
<td>3</td>
<td>26</td>
<td>27</td>
<td>3</td>
<td>59</td>
</tr>
<tr>
<td>Proportionate Decline</td>
<td>0</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>More than Proportionate Decline</td>
<td>0</td>
<td>1</td>
<td>12</td>
<td>2</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>4</td>
<td>52</td>
<td>62</td>
<td>16</td>
<td>134</td>
</tr>
</tbody>
</table>

The figures indicate the number of bonuses during the period.

Table 3: Category-wise Bonus Issues (1992-96)

<table>
<thead>
<tr>
<th>Group Name</th>
<th>Bonus Size</th>
<th>No of Bonuses</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>More than 1:1</td>
<td>4</td>
</tr>
<tr>
<td>B</td>
<td>1:1</td>
<td>52</td>
</tr>
<tr>
<td>C</td>
<td>Between 1:1 and 1:2</td>
<td>62</td>
</tr>
<tr>
<td>D</td>
<td>Less than 1:2</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>134</td>
<td></td>
</tr>
</tbody>
</table>
increased in the subsequent years or not.

category irrespective of whether the dividend rate has

Table 5: Distribution of Dividends in the Three
Years After the Bonus Issue (1982-91)

<table>
<thead>
<tr>
<th>Description</th>
<th>Less than 1:2</th>
<th>1:2 and 1:1</th>
<th>More than 1:1</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases</td>
<td>38</td>
<td>88</td>
<td>74</td>
<td>2</td>
</tr>
<tr>
<td>Increase2</td>
<td>5</td>
<td>39</td>
<td>0</td>
<td>17</td>
</tr>
<tr>
<td>Increase1</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Decrease</td>
<td>1</td>
<td>6</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>99</td>
<td>90</td>
<td>2</td>
</tr>
</tbody>
</table>

Table 6: Distribution of Dividends in the Three
Years After the Bonus Issue (1992-96)

<table>
<thead>
<tr>
<th>Description</th>
<th>Less than 1:2</th>
<th>1:2 and 1:1</th>
<th>More than 1:1</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases</td>
<td>11</td>
<td>53</td>
<td>45</td>
<td>4</td>
</tr>
<tr>
<td>Increase2</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Increase1</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Decrease</td>
<td>5</td>
<td>7</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>16</td>
<td>62</td>
<td>52</td>
<td>4</td>
</tr>
</tbody>
</table>

bonus issue, it has been clubbed in the decrease
category irrespective of whether the dividend rate has
increased in the subsequent years or not.

It can be seen from the tables that the cash flows
to the shareholders in the subsequent three years have,
in fact, increased in most of the cases after the bonus
issue.

We saw that the cash flows due to dividends
increased after a bonus issue. It is possible that the
cash flows due to dividends increased to the same
extent even for a non-bonus issuing company. It is
also possible that the cash flows due to dividends
increased for a bonus issuing company even before
the bonus issue was offered. It is important to address
these issues to see if bonus issues really signal any
dividend-relevant information to the shareholders.

Here, an attempt has been made to see if the cash
flows due to dividends of a bonus issuing company
are any different from a non-bonus issuing company.
The average dividend per share of all the companies
has been estimated for the sample period. Here, the
face value of the share has been normalized to Rs 10
per share. There are a few companies with a face value
of Rs 100 each. When such a company gives a 20 per
cent dividend, for example, the dividend payout will
be Rs 20 per share. This is equivalent to a 200 per
cent dividend rate for another company with a face
value of Rs 10 per share. Hence the normalization.

The average rupee dividend payout per share per
year for a non-bonus issuing company in the 1982-
91 sample period was Rs 1.55. The corresponding
figure for a bonus issuing company was Rs 8.05
adjusted for the bonus issue per share. This clearly
shows that the shareholders of a bonus issuing
company got rewarded through a high dividend
payment during 1982-91. The findings are, however,
completely different for the period 1992-96. The
dividend payout for a non-bonus issuing company
was Rs 10.2 per share. The corresponding figure for
the bonus issuing companies was Rs 8.99 per share".
Though this difference is not statistically significant
at the 5 per cent significance level, one can clearly
see a change in the bonus policies of companies in
the second sub-period.

We saw earlier that the dividend rate of a
company increased after a bonus issue. If we observe
a stagnant dividend rate before a bonus issue, then
it would imply that the companies in India do really
reward the shareholders through a bonus issue. If,
however, one observes increasing dividend rates, then
it may imply that the bonus issue is immaterial for
the determination of the dividend per share. A quick
check on the dividend rates of the bonus issuing
companies in 1982-91 before the bonus issue revealed
that the dividend rates were, in fact, increasing or were
constant. Only for a very few stocks the dividend rate
had actually declined. However, this result is not
surprising. Only profit making companies can support
an increasing dividend rate. And only a profit making
company can offer a bonus issue because a company
must have sufficient free reserves (excepting share
premium reserve, the other free reserves come out of
retained earnings only) to capitalize them.

It was then decided to find out the growth rates
in dividend per share of a bonus issuing company
both before and after the bonus issue. If the dividend
per share increases at a much higher rate after a bonus
issue, then the findings will be consistent with the
signaling hypothesis. Table 7 summarizes the findings.
Here the computations are made for six-year periods.
This includes the three years prior to the bonus issue
and three years after a bonus issue (including the year
in which the bonus issue was offered). The analysis
was done for the entire sample period and any bonus
issue made before 1984-85 or after 1993-94 was
ignored.

Here, we can see that the dividend per share
continues to grow at a much higher rate after a bonus
issue than before when the dividend rates increase
even before a bonus issue is made.
Table 7: Growth Rate of Dividend Per Share

<table>
<thead>
<tr>
<th>Category</th>
<th>Average Rupee Dividends Before the Bonus Issue (Rs)</th>
<th>Average Rupee Dividends After the Bonus Issue (Rs)</th>
<th>Growth Rate of Dividend Per Share Before the Bonus Issue (%)</th>
<th>Growth Rate of Dividend Per Share After the Bonus Issue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2.05</td>
<td>5.20</td>
<td>4</td>
<td>18</td>
</tr>
<tr>
<td>B</td>
<td>7.37</td>
<td>15.67</td>
<td>13.73</td>
<td>46.27</td>
</tr>
<tr>
<td>C</td>
<td>5.58</td>
<td>8.04</td>
<td>16.6</td>
<td>26.16</td>
</tr>
<tr>
<td>D</td>
<td>2.45</td>
<td>5.37</td>
<td>7.24</td>
<td>20.26</td>
</tr>
</tbody>
</table>

Thus, we see that a bonus issue gives a credible signal to the shareholders about a rapid increase in the dividend per share. But a company can give this signal even by a mere dividend increase. As we saw in the second sub-period, the non-bonus issuing companies gave a higher cash dividend to their shareholders vis-a-vis companies that offered a bonus issue in the same sub-period.

A cash rich company can reward its shareholders by either increasing its dividend rate or by issuing bonus shares without (or even in some cases with) increasing the dividend rate. There are certain reasons to believe that bonus issuing companies will give higher returns than the non-bonus issuing (but maintaining a steady increase in the dividend) companies which are as follows:

Market expectations of an increase in cash flow to the investors because of an increase in dividend rate: The market becomes more confident of the cash flow for a company that gives bonus issue compared to another company that does not give any such bonus. This happens because only after a company declares a higher dividend rate that the market knows how much dividend a company is paying. In case of a bonus issuing company, however, the market expects that the dividend rate will not decline proportionately. As observed in the previous section, this expectation is not without any basis.

Increase in liquidity: After the bonus issue, the price goes down, though not proportionately and, therefore, the stock will presumably be more attractive to the investors. In fact, in the US, as Lakonishok and Levy (1987) have found out, companies do split their stocks in order to keep the price in a desirable trading range. It was decided to see if the liquidity of a stock actually increased after the bonus issue. Since the number of shares increases after a bonus issue, if one looks at the number of shares traded after a bonus issue, then one will observe an increasing trend. This, however, does not mean that the liquidity of the stock has increased. Therefore, it was decided to use the number of transactions as a proxy for liquidity. The information about the number of transactions was obtained from the Stock Exchange Review/Directory for the period 1988-97. Data about the earlier period could not be obtained. The SMYB gives the average trading volume for the year 1992 only. The average daily number of shares was found for sixty trading days before and after the stock went ex-bonus (XB). The percentage increase in the number of transactions was computed for this period. The average increase was 91.43 per cent and the corresponding t-statistic was 3.16. Thus, the number of transactions after a bonus issue increased on an average by 90 per cent. It is important to note that this number has an upward bias. If the denominator is small, then the percentage increase will get magnified. In 28 per cent of the cases, the post-bonus number of transactions was actually lower than the corresponding pre-bonus figure.

It is decided to compare the returns that the bonus issuing companies have been able to generate vis-a-vis the companies that have rewarded their shareholders via an increase in dividend rate year after year in the same period.

Here, the returns of bonus issuing companies were compared only with companies that maintained a steadily increasing dividend rate and not with non-bonus issuing companies because there was no theoretical reason as to why the bonus issuing companies would be able to generate a higher yield compared to the companies that do not offer any bonus issue. A company that has got a good investment proposal that can yield a return that is higher than its cost of capital will be able to generate more returns if it invests in that proposal than if it gives its earnings as dividends.

No attempt has been made to see the effect of bonus ratio on the stock returns. This is because the companies do not necessarily maintain the same bonus rate. Bata India, for example, issued bonus shares in the ratio of 2:5 in 1984 and in the ratio of 1:1 in 1987. This study computes how much return Bata India had
generated for its shareholders over the sample period rather than how much return it generated in the year 1987 when it offered a bonus issue in the ratio of 1:1 and how much return it generated in the year 1984 when the bonus ratio was 2:5.

In the 1982-91 period, there were altogether 23 companies that had a steadily increasing dividend rate (with stagnant dividend rate in one or two years) that did not give any bonus in the nine-year period.

It is possible to think that the bonus issuing companies are more risky compared to the non-bonus issuing companies. Hence, the risk-adjusted returns of the two groups of stocks were compared in the two sub-periods. Beta was used as the proxy for risk. As has been explained later, certain profit-making companies have stopped issuing bonus shares to their shareholders. If we believe that bonus issue is linked to the riskiness of the security, then it is possible that their betas will be different in the two sub-periods. Only weekly stock prices could be obtained for the period 1986-91. Hence, the beta for the first sub-period was computed using weekly stock returns. Data for the 1982-1986 period could not be obtained. Estimates of beta for the second sub-period were obtained using daily stock price figures.

The market model was used to estimate excess return of the stocks. The model is given by:

\[ R_i = a + B \times R_m + e_i \]

Here, \( e_i \) is used as the risk-adjusted excess return for stock \( i \). Since companies do not necessarily offer bonus issue every year, there is no point comparing yearly returns of the companies. The excess return has been computed for all the companies in both the sub-periods (using different estimates of \( \alpha \) and \( \beta \)). The average abnormal returns have been computed for both the sub-periods. The findings are shown in Table 8.

The excess return differences in both the sub-periods are statistically significant at 10 per cent significance level. A careful look at the average beta\(^9\) figures shows that bonus issue has no effect on the beta of the company. Here, for the sake of simplicity, the betas have been averaged using the market capitalization figures of 1991 (in case of the first sub-period) and 1996 (in case of the second sub-period).

**Explanation for Poor Performance of the Bonus Issuing Companies in the Second Period**

An attempt is made here to find out the possible reasons as to why the returns in the second period were less for the bonus issuing companies.

As we saw in the preceding section, in the second sub-period, the average rupee dividend paid by the non-bonus issuing companies was higher than that paid by the bonus issuing companies. The above findings suggest that the dividend effect of a bonus issue is probably more important than the liquidity effect.

Earlier, there was a restriction on the MNCs repatriating profits to their parent company. An MNC could either offer a bonus issue and pay a reasonable rate of dividend, or not offer a bonus issue and ensure the same dividend cash flow but with what could be seen as a politically incorrect high rate. But, after the recent liberalization process, the MNCs have started giving more dividends. The number of bonus issues offered by MNCs has also declined\(^11\). This is evident from the fact that in the first sub-period, out of 57 MNCs, only 16 did not have any bonus issue in the 10-year period\(^11\). In the second period, however, out of 49 MNCs, as many as 22 did not have any bonus issue\(^12\).

**Limitations of the Study**

No attempt has been made in the study to see how the shareholders form expectations about the bonus policy of the company. If one studies the stock return figures clearly in the two sub-periods, then one will find that the companies that pay a high dividend have generated higher returns vis-a-vis companies that pay lower dividends. In the first sub-period, presumably, the market returns for the bonus issuing companies are higher because they give higher dividends. An event study needs to be done to see the way the market is reacting to a change in the dividend rate (keeping the bonus and other factors like earnings changes, etc. constant). This issue will be addressed in our future research.

<table>
<thead>
<tr>
<th>Period</th>
<th>Bonus Issuing Companies</th>
<th>Non-bonus Issuing Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average Beta</td>
<td>Average Excess Return</td>
</tr>
<tr>
<td>1982-91</td>
<td>0.85</td>
<td>10%</td>
</tr>
<tr>
<td>1992-96</td>
<td>0.98</td>
<td>-2%</td>
</tr>
</tbody>
</table>

Table 8: Average Abnormal Returns

Vikalpa
Conclusions

A study of the dividend and bonus policies of Indian companies revealed that most of the companies do not maintain a constant payout ratio. Most of the companies reward their shareholders by offering a bonus issue. The dividend rate does not fall proportionately in most cases and hence the cash dividend paid to the shareholder increases after a bonus issue. It was observed that most of the companies have been successful in maintaining (or at least not reducing) the dividend rates after the bonus issue. It was also observed in the 1982-91 sub-period that the returns that the bonus issuing companies have been able to generate are higher than the returns generated by companies that do not issue bonus shares but prefer to increase the dividend rate over time.

However, in the 1992-96 sub-period, the bonus issuing companies have been found to under-perform companies that have increased the dividend rate but have not issued any bonus shares. Possible explanations for this phenomenon were offered.

Appendix: Payout Ratio — A Survey

A quick survey of the payout ratio of the 2535 companies (from Prowess Database) shows that most of the companies do not maintain a constant payout ratio. The companies prefer to maintain a more or less constant dividend rate and, therefore, the dividend payment remains constant year after year. Thus, when the PAT changes, the payout ratio also changes. The findings have been briefly summarized here.

Since it is not practical to maintain an exact payout ratio every year even if a company wants to (because the companies will usually round-off the rupee dividend to the nearest five APIs), it was decided to see how many companies maintain a payout ratio that fluctuates in the range of 1 per cent over the previous year. Thus, for example, if the payout ratio of a company in 1993 was 20 per cent, then it was included in the sample only if its payout ratio was between 19 per cent and 21 per cent in 1994.

Out of 2535 companies, only 274 (i.e., only 11%) have maintained a payout ratio within a range of 5 per cent in three out of the five-year period 1992-96. There were other 128 companies where the payout has increased in four out of the five years.

Eighty-six companies (a little more than 3%) have maintained a payout ratio in the range of 1 per cent in three of the last five years. This shows that payout ratio is certainly not a major consideration when dividend policies are formulated in most companies.

Notes

1 Where the management has no information about the future prospects of the company which the shareholders do not have.
2 This can be illustrated by using William's (1938) dividend discounting model:
   \[ P_0 = S \{ D_t / (1 + k_r) \} \]
   where \( t \) varies from 1 to infinity...
   Here \( D_t \) is the dividend expected to be paid in time \( t \), \( k_r \) is the discount rate reflecting the particular risk characteristic of the stock.
3 It is possible to contend that a bonus issue requires some cash outflow (for printing extra shares in case they are not dematerialized, etc.) and hence the value of the firm should decline after the bonus issue.
4 In the sense that the management is confident that the future cash flow of the company will be higher and hence increased dividend payments can be made.
5 These figures have been adjusted for all the bonus issues made from 1982 so that the figures can be compared across years.
6 If we ignore the concept of face value, stock splits and stock dividends (or bonus issue) will be identical in all respects.
7 Liquidity, measured in trading volumes, after accounting for changes in overall market trading volumes would, of course, have been a more appropriate measure of liquidity.

Nevertheless, these findings are consistent with an attention getting hypothesis.
8 Data about stock prices were obtained from ICFAI, Economic Times (for the first sub-period), and CMIE Database (for the second sub-period).
9 It has been assumed that the betas remain stationary over time.
10 Chandra (1997) has also given similar explanations while explaining why companies offer a bonus issue. One of the reasons cited is that a bonus issue declines the nominal rate of dividend (dividend rate as used here) and hence dispels the impression of profiteering.
11 In the sample period, the average ROE reported by the MNCs is 15.86 per cent. It is only 11.85 per cent for other companies. To the extent that the stock returns are affected by the profitability of a company, it seems reasonable to assume that the inclusion of MNCs will affect the returns yielded by any particular group.
12 Here companies are divided into bonus issuing and non-bonus issuing in both the sub-periods independently. Thus, any company that has offered even one bonus issue in the first sub-period was treated as a bonus issuing company. However, if the same company has not offered any bonus issue in the second sub-period, then it is treated as a non-bonus issuing company.
References


