In the previous Chapter it has been stated that the dividend policy of a company or industry is a matter of judgement based on factors which have effect on a concerned company or industry. In this Chapter a study of a group of companies commonly called 'Sterling Tea Companies' has been made.

Sterling tea companies have made a major contribution in development of tea industry in India and placing it as an important foreign exchange earner. These tea companies are characterised by the fact that they are incorporated in England though they operate in India. By virtue of the fact that they have a strong base in London, these companies can organise their tea to be sold at handsome margin at the London auction.
These tea companies were solely owned by non-residents and as such there was a great motivation to repatriate as much profit in the form of dividend as possible. The peculiarity of sterling tea companies which has provoked their selection of this study is fluctuating circumstances under which these companies had to formulate the dividend policy.

Tea is one of the most important foreign exchange earning industries in India. From an output of 4.8 million tonnes in 1975, production has risen to 6.6 million tonnes in 1988, an increase of 37.5 per cent. The demand for tea has been strengthening owing to brisk buying by internal blenders as well as overseas customers. The buying spree of overseas countries has increased because of a set back in the tea industry in Sri Lanka due to internal disturbances. In 1986, an export of 230 million kgs of tea could be achieved earning foreign exchange of Rs 7250 million.

Prior to 1973 the foreign exchange of the country was regulated by The Foreign Exchange
Regulations Act, 1947. In the light of experiences gained during the last few decades, the enforcement directorate of the Reserve Bank of India suggested certain amendments to the 1947 Act, to regulate inter alia, concerns with substantial non resident interests. Following recommendations of Public Accounts committee in its 56th report of 1968 a study team was appointed. to look into the question of "Leakage of Foreign Exchange by Invoice Manipulation." After taking into account the recommendations of the study team and the 47th report of the law commission, the Foreign Exchange Regulation Act, 1973 (FERA) was introduced. One important provision in the 1973 Act was Section 29 which is reproduced in Annexure I. This section intends to regulate the trading, commercial and industrial activities of non-resident, non-indian citizens and foreign companies and their offices or branches in India. Ministry of Finance, Government of India has issued a guideline for administering this section which is reproduced in Annexure II.

According to the guidelines non-resident companies with substantial export earnings (which included tea
industry) were allowed to retain up to 74 per cent of foreign holding.

Prior to independence the emphasis has been on remittance of as much dividend as possible even at the cost of the welfare of the firm. This trend continued even after independence till FERA was amended in 1973 with more regulatory provisions for foreign companies. Though tea companies by virtue of export orientation were allowed to retain up to 74 per cent by non-residents in view of the restrictive provisions in FERA for foreign companies, most of the Sterling tea companies diluted their holding to become Indian companies. With the Indian interest coming in, these tea companies showed a difference in their policy of dividends, investments in the industry becoming important for survival and payment of dividend did not become the sole factor.

In Annexure III dividend paid out by ten important sterling companies have been shown. These figures relate to the period subsequent to the
dilution of foreign holding in these companies. The dividend payout of these companies, particularly during recent years would definitely indicate a concern for ploughing back part of the profits.

The figures for only the profit-making companies would show that taxes took away over 60 per cent of the pretax profit between 1978 - 79, and 1980 - 81 - the high point being reached in 1979 - 80 (62.5 per cent). There was a decline in the depressed years but thereafter again rose in the boom year of 1983 - 84. The fall in the marginal tax rates from 1985 - 86 had the effect of lowering both effective tax and dividend allocation and increasing the percentage of profit retention despite a certain decline in profitability.

If dividend allocation is viewed in relation to the profits after tax of selected companies, an inference may be derived that a high proportion of the profit has been declared as dividend without consideration of ploughback is true in
many cases. The aggregate figures for ten companies in Annexure III show that there is an inverse relationship to profitability and dividend paid out.

As a relevant point, it may be noted that on the aggregate the higher dividend pay-out ratios in years of depressed profitability is a result of the more well-managed and profitable companies maintaining their dividends while the loss-making companies had the effect of lowering the Profit After Tax (PAT) figures. If the accounts of loss-making companies are eliminated from the aggregate PAT figures, then the pay-out ratios for the profit-making companies would be lower.

The figures would indicate that with increase in profitability, the ratio of profits distributed as dividends did not increase and in fact went down drastically resulting in 70 per cent of the post-tax profits being retained in a good year (such as 1983-84) by profit-making companies.
It may be noted that those companies which made losses in 1980-81 and 1981-82 joined the league of profit-making companies in 1983-84 and also declared dividends. It is also to be noted that it is a matter of business prudence that in a year of prosperity a higher dividend policy has to be pursued especially in the context of depressed or nil dividend in years of stress.

The question as to whether developmental expenditure has or has not taken place may be seen from another angle. From an examination of the flow of funds for selected companies, one may compare the figures for capital accumulation with adjusted cash flow which show that in years where the borrowing has come down the reduction in borrowings has been adjusted against the net internal cash generation.

It will be seen that the whole of internally generated resources have been utilised in development expenditure.

An examination of the figures of dividends as a percentage of share capital will show that for
almost all the tea companies the dividend declaration had declined during the years of low profitability. The fact that dividend declaration showed a sudden spurt in 1983-84 and 1984-85 was due to another reason, besides increase in price realisation of tea and, therefore, profitability, some tea companies decided to change their accounting year in these years from their past accounting period which ended on December 31, every year.

The change in accounting year by tea companies had been necessitated for coinciding the accounting year ending with the period of disposal of the season's crop as well as for alleviating cash flow problem.

The dividend declaration by tea companies would not appear to be very high if viewed against the total of shareholders' funds.

But the position would be different when reckoned in relation to share capital. A reasonable premise
could be that less than one-third of the profits is distributed as dividends in more prosperous years. This, as a percentage of share capital, would seem to be high because of the comparatively low capitalisation of tea in relation to other industries.

It may be noted that for a good section of the industry at the time of Indianisation of sterling tea companies capitalisation was done on the basis of valuation approved by Reserve Bank of India which in almost all cases was lower than the real value of assets, with consequent under-capitalisation. According to the Reserve Bank of India guidelines, valuation of the Indian properties of Sterling tea companies was on the basis of the book-value of net assets. In certain cases, where revaluation of these properties had been done, such value was not considered at all.

While this may have effectively reduced repatriation of substantial foreign exchange on Indianisation, it
had resulted in an understatement of capital structure of tea companies. Secondly, even the values so arrived at were allocated by Reserve Bank of India between share capital and loans which were repatriable to the foreign owners over a five year period. This had the effect of further reducing the share capital base of the Indianised companies.

If a fair picture of capitalisation of tea companies were to be made, then one would have to go by the market value of the properties of tea companies.

A study of the dividend policy of Mcleod Russel (India) Ltd conducted through their Annual Report, publications and personal interviews, shows that prior to 1976 when the company was wholly owned by non residents in the UK dividend paid was found to be sometimes disproportionate to the amount of earnings made. In one year, in 1975 a dividend of 105% was paid to the shareholders. Dividend was
67% in 1977 and thereafter fell to 20% in the following two years.

The study of Mcleod Russel is a representative study of sterling tea companies and this indicates that the dividend policy of these companies during the time they were fully owned by non residents in the UK, were primarily governed by protection of interest of the foreign investors by means of remittance of dividend to the extent possible. However, with the gradual induction of Indian shareholders from mid 70's and Indian participation in management, long term interests of the company were also being looked after and it seems that a balanced ratio between dividend distribution and retention gradually emerged in these companies.

An effort has been made to bring this out in the attached analysis in Annexure III. As stated in Chapter V each industry has its own peculiarities and the dividend policy to be adopted based on a balanced judgement after considering these factors.
In the tea industry, the pay-back period is rather long and the fact of fluctuations in its fortunes cannot be disputed even while accepting the turn for the better in its prosperity for the better part of the eighties. Against the backdrop of these realities, it will be debatable if the returns for the tea industry can be considered pretty healthy, even if one consciously ignores the fact of under-capitalisation.

The tea industry has to clear the backlog in modernisation of factory facilities. Field practices have to be improved. Energy conservation measures have to be introduced. It will also have to clear the backlog in labour housing, which is a statutory obligation. All these will necessitate fairly substantial outlays.

It has also to be borne in mind that the tea industry is not entitled to the benefit of depreciation for its main asset, tea bushes.
Dividend policy for sterling tea companies seems to be the outcome of the factors peculiar to tea industry and particularly these group of companies as discussed above.