Pragmatic considerations and the need to protect the interest of different groups having stakes in the survival and growth of corporations are the genesis of legal pronouncements in a country. The legal considerations behind dividend decisions that we have analysed in the previous chapter may be viewed from that angle. The history of the development of corporate laws and those relating to taxation also shows that charges are brought about much later than a point of time when the need is felt. The legacy of the British rulers and the unwritten bondage between the British Laws and their Indian counterparts also sometimes explain some of the traditional approaches to corporate problems including problems concerning dividend policies. Needless to say, court pronouncements, delivered mostly to explain legal provisions and sometimes to fill in some gaps, generally adhere to the legal avenues, although at times there are seemingly some noteworthy deviations.

Naturally, legal considerations mentioned in the earlier chapter, may not cover all the determinants of a firm's dividend decisions. The next step, therefore, in this study, should be an examination of the variables stressed in the different theoretical dividend models which seek to explain the relation between a firm's valuation and its dividend decisions or other relevant considerations. After discussing the models, we may identify the major determinants of dividend policy.
Dividend Models

In this section, we may note the basic features of some well-known models of corporate dividend behaviour. We may start with the seminal work of John Lintner.

John Lintner - According to Lintner, firms are more concerned about the proportion of earnings to be declared as dividend rather than proportion of earnings to be retained, and firms ultimately try to reach the target payout ratio. A steady progression in the rates of dividend is preferred by the stockholders. The following model suggested by Lintner is based on the supposition that the current dividend is a function of net current earnings after tax and lagged dividend.

\[
D_t = a + b_1 P_t + b_2 D_{t-1} + U_t
\]

where 
- \(D_t\) = Current dividend
- \(P_t\) = Current earnings after tax
- \(D_{t-1}\) = Dividend in period \(t-1\)
- \(b_1 = c \cdot r, b_2 = (1-c)\)
- \(c\) = Adjustment rate
- \(r\) = Target payout rate where \(c > 0\) and \(r < 1\)
- \(U_t\) = Error term

According to Lintner, target payout ratio \(r\) and adjustment rate \(c\) more or less consciously and rationally reflect
a large number of relevant factors which are "the growth prospect of the industry and more importantly, growth earnings prospects of the particular company, the average cyclical movement of investment opportunities, working capital requirements and internal fund flows, the relative importance attached by management to longer term capital gains as compared with current dividend income for its stockholders and management's views of its stockholder's preference between reasonably stable or fluctuating dividend rates, and its judgement of the size and importance of any premium the market might put on stability or stable growth in the dividend rate as such, the normal payouts and speed of adjustment of competitive companies or those whose securities were close substitutes investmentwise, the financial strength of the company, its access to the capital market on favourable terms, company policies with respect to the use of outside debt and new equity issues, management's confidence in the soundness of earnings figures as reported by its accounting department, and its confidence in its budgets and projections of future sales, profit and so on".

It may reasonably be doubted whether these two parameters (r & C) are so versatile as can cover the impact of all the relevant factors when the period under consideration is large and uncertainty regarding profits of a company prevails.
Researchers* have rather tried to include specifically some explanatory variables affecting dividend policy in the expression of Lintner's model for better decision making. The explanatory powers of the variables have been tested in relation to dividend payment. The important variables which have been considered and their theoretical relationship with dividend may be briefly examined as under.

The first of such variable is future investment demand for fixed assets & inventories. It is inversely related to a firm's dividend payment. If firms decide to finance investment requirements from internal sources, such decision may impose some restrictions on the payment of dividend. Hence investment demand may also be a function of dividend model -

\[ D_t = a + b_1 P_t + b_2 D_{t-1} + b_3 ID_t + U_t \]

where \[ ID_t = \Delta FA_t + \Delta IN_t \]
\[ \Delta FA_t = FA_t - FA_{t-1} \]
\[ \Delta IN_t = IN_t - IN_{t-1} \]
\[ ID_t = \text{Investment Demand in period } t \]
\[ FA_t \& FA_{t-1} = \text{Net fixed asset in period } t \& t-1 \]
\[ IN_t \& IN_{t-1} = \text{Inventories in period } t \& t-1 \]


(2) Krishnamurty and Shastry - Investment and financing in the corporate sector in India.
Next, Flow of Net Debt may be considered. Funds required for investment needs and dividend payment of a company may be higher than its own created funds. In such a situation flow of net debt is expected to be positively related to dividend payment, lower rate of dividends requiring lesser amount of borrowing and vice versa in a given investment requirement. Hence flow of net debt may be a function in the dividend model.

(iii) \[ D_t = a + b_1 P_t + b_2 D_{t-1} + b_3 FND_t + U_t \]

where \( FND_t = ND_t - ND_{t-1} \) = Flow of net debt

\[ ND_t = TL_t - CA_t \]

\( TL_t = \) Total liability both short-term & long-term in period \( t \)

\( CA_t = \) Current assets in period \( t \)

The third variable that may be listed is interest payment. Sometimes, financial institutions (IFCI, IDBI etc.) impose some restrictions on dividend payment, the amount or time of dividend payment. If the amount of interest payment rises then it may reduce the payment of dividend due to restrictions imposed by loan agreements or adverse liquidity position. Hence interest payment is also a function in dividend model.

(iv) \[ D_t = a + b_1 P_t + b_2 D_{t-1} + b_3 I_t + U_t \]

where \( I_t = \) Total interest payment.
Share price changes may be the next variable. In finance literature there are a number of evidences to show the impact of dividends on the market price of the shares. If the price of the shares of a company does not rise as per expectation, the company may take a decision to increase the rate of dividend, particularly if it needs to raise fresh capital in near future. Generally, to avoid shortrun bias in price changes, share price in a given year is used as a ratio of the average price of the preceding two years, and such ratio is taken as explanatory variable to analyse the impact of behaviour of share price on the dividend decision.

(v) \( D_t = a + b_1 P_t + b_2 D_{t-1} + b_3 S^*_t + U_t \)

where \( S^*_t = \frac{S_{SP}^*}{S_{SP}^*} = \) share price in period \( t \) as a ratio of average price of the precedings two years.

\( S_{SP}^* = \frac{(S_{SP}^*_{t-1} + S_{SP}^*_{t-2})}{2} \)

\( S_{SP}^* , S_{SP}^*_{t-1} \& S_{SP}^*_{t-2} = \) average of high and low price of share in periods \( t , t-1 \& t-2 \).

Liquidity condition of the company is expected to have positive relationship with dividend payment. A company may have sufficiently large amount of distributable profit but owing to lack of liquidity it may not be able to pay higher amount of dividend. A comfortable liquidity position of the company would permit it to increase its dividend payment without disturbing working capital position.
Ratio of current assets to current liabilities is taken as one of the explanatory variable.

\[ \text{Lt} = \text{Ratio of current assets to current liabilities in period } t \]

Brittain J.A. - Brittain uses cash flow as an explanatory variable in the Lintner model. Cash flow (net current earnings after tax plus depreciation) is a better measurement of company's capacity to pay dividend than the traditional current ratio. According to Bellemose, D.H. cash flow is considered to be a workable approximation to present true earnings which is the ultimate basis of ability to pay dividend - The model may be represented in one of the following ways -

(i) When cash flow is taken as explanatory variable with lagged dividend -

\[ D_t = a + b_1 C_t + b_2 D_{t-1} + U_t \]

Where, \( C_t \) = Cash flow in period \( t \)

(ii) When depreciation is used with current earnings after tax as explanatory variable with lagged dividend -

\[ D_t = a + b_1 P_t + b_2 D_{t-1} + b_3 A_t + U_t \]

Where, \( A_t \) = Depreciation in period \( t \)
P.G. Darling - Lagged profit instead of lagged dividend is suggested by Darling as an explanatory variable in Lintner's model. According to Darling, companies are reluctant to make immediate and full adjustment of dividend to rising or falling profits. Instead, they will tend to follow a 'stabilisation policy of moving only partly towards the level of dividend that would be appropriate if profits remained constant over a substantial period of time. This reluctance or inertia factor is viewed as a tendency to cling to past profits, \( P_{t-1} \) in determining current dividend. In his opinion lagged dividend has no direct influence on the dividend decision in the long run. He also adds some independent variables like depreciation and amortization recoveries \( (A_t) \) which are sources of fund and changes of sales over previous two years \( (\Delta S_{-2}) \).

His hypothesis is that dividend will tend to vary directly with current profits, past profits, and inversely with persistent changes in the level of sales -

\[
D_t = a + b_1 P_t + b_2 P_{t-1} + b_3 A_t + b_4 \Delta S_{-2} + u_t
\]

S.P. Dobrovolsky - According to him with a given level of net income, an increase (decline) in retained earnings means a decline (increase) in dividends by exactly the same amount. Hence dividend decision will be affected by the same factors such as current profitability, continuity of dividend policies, rate of operating asset expansion etc. which
influence retained income. Generally, management becomes reluctant to change the dividend policy which is taken as basis for the current year. His findings suggest that dividend is negatively and significantly associated with operating assets expansion as measured by growth of operating assets, including net current earnings after tax and lagged dividend as other explanatory variables. His model is different from the others in as much as. The variables in his model are expressed as rates rather than as absolute amounts.

\[ D_t = a + b_1 Y_t + b_2 D_{t-1} + b_3 A_t + u_t \]

Where

- \( D_t \) = Total amount of equity dividend in period \( t \) as percentage of average net worth in period \( t \)
- \( Y_t \) or \( P_t \) = Net current earnings after tax in period \( t \) as percentage of average net worth in period \( t \)
- \( D_{t-1} \) = Total amount of equity dividend in period \( t-1 \) as percentage of net worth in period \( t-1 \)
- \( A_t \) = Operating asset expansion in period \( t \) as percentage of operating assets in the beginning of the year.

Bolten S.E. - His model is based on the key variables suggested by Lintner. According to him, increase in dividends would be less than the increase in earnings owing to the
speed of adjustment. His model may be described as follows:

\[ D_{t+1} = D_t + a \left( P^* - \frac{D_t}{E_t} \right) E_t \]

Where \( D_{t+1} \) = Dividend amount under consideration

\( D_t \) = Prevailing dividend

\( \frac{D_t}{E_t} \) = Prevailing payout ratio,

\( P^* \) = Target payout ratio.

\( E_t \) = Latest earning per share

\( a \) = Adjustment cushion

B. Graham & Dodd (Traditional Position) - Stock market reacts favourably to liberal dividend policy. The basic valuation model

\[ P = m \left( D + \frac{E}{3} \right). \]

Under this model in the valuation of shares the weight attached to dividend is equal to four times the weight attached to retained earnings. This weight has been given on the basis of their subjective judgement and not according to any objective empirical findings.

Now, if \( E \) is replaced by \( D+R \)

Then \( P = m(D + \frac{D+R}{3}) = m \frac{4D}{3} + \frac{mR}{3} \)

Where \( P \) = Market price per share

\( D \) = Dividend per share

\( E \) = Earnings per share

\( m \) = a multiplier.
This traditional position cites the evidence that high payout ratios go hand in hand with high price earning ratios and low payout ratios go hand in hand with low price earning ratios. This evidence is reliable on the point that -

(i) The dividend payout ratio tends to be high because firms normally maintain or reduce only slightly the dividend per share even when earnings are temporarily depressed.

(ii) The price earning ratio is high because a temporary decline in earnings does not have significant impact on share price.

(iii) In the risky firm, the dividend payout ratio tends to be low and management tends to be conservative.

(iv) In highly risky firm, investors are, in general, risk averse.

Such inferences are not always justified. Under this model stock market places considerably more weight on dividends than on retained earnings.

Walter model - This model is based on the argument that dividend policy affects the value of the firm. The assumptions are as follows:

(i) All investments of the firm are financed only through retained earnings.
(ii) Cost of capital and return on the firm's investment remain constant.

(iii) All earnings are either reinvested internally or distributed as dividend.

(iv) The firm has a long and infinite life.

(v) There is no change in earnings and dividend. The values of earnings and dividend may be changed in the model to determine results, but any given value of earnings and dividend are assumed to remain constant in determining a given value.

\[ p = \frac{D + r/k (E-D)}{K} \]

Where
- \( p \) = Market price per equity share
- \( D \) = Dividend per share
- \( E \) = Earnings per share
- \( r \) = Return on investment
- \( K \) = Cost of capital or market capitalisation rate

It is found according to this model -

(i) that when the rate of return exceeds the cost of capital \((r > k)\), the price per share increases as the dividend payout ratio decreases,

(ii) that when \( r = k \), the price per share does not vary with the changes in dividend payout ratio,
(iii) that when \( r < k \), the price per share increases as the dividend payout ratio increases.

Though this model shows the relationship which partially affects the market value of shares, assumptions under this model have a limited sense in the real world. The model also does not consider different other variables and effects of risk on the value of the firm which indicates that results of this model are doubtful though it is a useful tool to show the effects of dividend policy under varying profitability assumptions.

**Gordon's Model** - It is a very popular model according to which dividend policy of a firm affects its value under certain assumptions which may be stated as follows:

(i) The firm is an all equity firm (just like Walters model, it assumes that there is no external financing).

(ii) Internal rate of return \( r \) and cost of capital or the capitalisation rate, \( k \), are constant.

(iii) The firm has an infinite or perpetual life.

(iv) Tax does not exist.

(v) The retention ratio, \( b \), once decided upon is constant. Thus growth rate, \( g = br \), is also constant.

(vi) Cost of capital, \( k \), is greater than the growth rate,
\[ P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \ldots + \frac{D_k}{(1+k)^k} = \sum_{t=1}^{\infty} \frac{D_t}{(1+k)^t} \]

Simplified version.

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

Where \( P \) = Price of the share

\( E \) = Earnings per share

\( b \) = Retention Ratio i.e., percentage of earnings retained

\( k \) = Cost of capital or capitalisation rate

\( b_r \) = \( g \) = Growth rate in \( r \)

\( r \) = Rate of return on investment

Under this model when \( r = k \), dividend policy has no effect on the value of the firm. When \( r < k \), the firm should distribute all earnings. When \( r > k \), the firm should retain earnings so long as the value of \( b \) does not exceed \( k/r \).

Assumptions under this model are more or less the same as under Walter's model. Hence this model suffers from the same defects.

**M.M. Hypothesis** - Under this model, dividend policy has no effect on the value of the firm. The assumptions of this model may be listed as follows:

1. Capital market is perfect and investors are rational implying that information is freely available without cost. Transactions are instantaneous and costless. Securities
are divisible and shareholders would like to maximise their wealth remaining indifferent between dividend and share price appreciation.

(2) All investors are certain about the future investments and profits of the firm (M M drop this assumption later).

(3) A world of no taxes - (between dividend & capital gain).

(4) A given investment policy of the firm not subject to change.

(5) Risk of uncertainty does not exist.

\[ P_0 = \frac{1}{1+k}(D_1 + P_1) \]

Where \( P_0 \) = Market price per share at time 0
\( K \) = Cost of capital or capitalisation rate( = r)
\( D_1 \) = Dividend per share at time 1
\( P_1 \) = Market price per share at time 1

\[ V = nP_o = \frac{n(D_1+P_1)}{1+k} \]

Where \( n \) = number of shares
If \( m \) = new shares issued

\[ nP_o = \frac{(n+m)P_1-I+E}{1+k} \]

Where \( E \) = earnings of the firm for the period
\( I \) = Total new investments during period 1.
M M have the view that the value of a firm depends solely on its earnings power and it is not influenced by the manner in which its earnings are split between dividends and retained earnings. This view is referred to as 'dividend irrelevance' theorem.

This theorem is severely criticised for the very simplistic assumptions under which it works. According to its critics, dividends do matter because uncertainty characterises the future, the capital market is imperfect and existence of tax can not be wished away.

Levy & Sarnat - To examine the impact of dividends on share prices, the following regression equation has been applied by Levy & Sarnat, empirically, to cross-sections of common stock -

\[ P_i = a + b_1D_i + b_2(E_i - D_i) + u_i \]

Where - 
- \( P_i \) = the price of the ith company's share
- \( D_i \) = the dividend per share of the ith company
- \( E_i - D_i \) = the retained earnings of the ith company's share
- \( u_i \) = an error term

Empirical study reveals that, by using above regression equation, \( b_1 > b_2 \), and therefore, it was concluded that cash dividends are systematically preferred to retained earnings, that is in real life situation dividend policy is relevant.
But I, Friend & M. Puckett have raised serious matters regarding the imperfections of such empirical results. According to them where $b_1 > b_2$, firms could clearly increase their market value by increasing dividend payout ratio until $b_1 = b_2$. This is necessary condition to reach its optimal dividend policy. Hence empirical studies which find $b_1$ significantly higher than $b_2$ indicate that a permanent state of disequilibrium exists in the market or it is inadequate model which does not include all possible variables. In their opinion, without considering all variables, if we consider risk variable only, then results will be negative correlation between payout ratio and risk, rather than investors preference for dividend.

**Tax Effect: Imperfect Capital Market** - In a case of no tax system (or no tax differentials) - A dollar of capital gains or a dollar of dividends are of equal value. In case of tax differentials system - Greater value will be attached to low dividend payouts which leads to the conclusion that lowest dividend payout namely zero, will be optimal dividend policy.

\[
W = (1 - T_p) - q(T_p - T_g)
\]

Where $W =$ amount received by shareholders after payment of all taxes,

$T_p =$ the personal tax rate

$T_g =$ the capital gains tax rate ($T_g < T_p$) = dividend payout ratio.
In real life capital markets are not perfect. Numerous factors are often neglected which must be given consideration when setting a firm's dividend policy. When both taxes and uncertainty are considered, the optimal dividend policy i.e. payout ratio typically lies between zero & one. In such a situation it is clear that dividend policy remains one of the most difficult financial decisions facing the firm.

\[ \bar{Y} = E(1-T_p) + E \left( \frac{T_p - T_g}{1 - T_g} \right) \sigma_Y \]

Where \(\bar{Y}\) = Expected value of after tax income of the shareholders

\(E\) = Reported earnings per share (EPS)

\(\sigma_Y\) = Standard deviation of \(Y\)

\(\sigma_Y'^n\) = Maximum standard deviation of earnings per share when all earnings are retained.

**Dividend Growth Model** - Gordon and others developed and refined a mathematically rigorous model that assumes that future dividends are the sole determinant of the intrinsic value of shares. This model may be written as:

\[ \text{Intrinsic Value} = \frac{\text{dividend curr}}{CR_{\text{norm}} - (CR_{\text{Act.}})(\% \text{ RE})} \]

Where dividend curr = Current dividends in dollars (annual basis)

\(CR_{\text{norm}}\) = Capitalisation rate demanded by the market for a stock of this type.
\( \text{C R Act} = \text{Actual capitalisation rate on the firm's current earnings (provided they are relatively normal) and current market price.} \)

\( \% \text{RE} = \text{Percentage of future earnings the corporation is likely to retain.} \)

\[
\text{Growth factor} = (\text{C R Act.})(\% \text{RE})
\]

The dividend growth model shows the value of a share of stock as the stocks' current dividend divided by the excess of demanded profits over the rate of growth in the dividend.

\[
\text{Intrinsic Value} = \frac{\text{Current dividend}}{\text{demanded after tax profit} - \text{dividend growth}}
\]

**Residual Dividend Policy** - Funds required for investment may come from borrowing, retained earnings and sale of stock. The dividend policy which is based on the theory that internal financing is cheaper than external financing is referred to as the Residual Dividend Policy. First, management has to decide the proportions of new investment to be financed by borrowings and by equity capital which depends upon the financial market conditions and target debt levels set by management. In such a case the following situation may arise.

(i) Pure residual dividend policy - If equity investment \( (I^e_t) \) equals or exceeds earnings \( (E_t) \), then dividends will be zero, and if \( I^e_t \) is less than \( E_t \) then dividend will be \( D_t = E_t - I^e_t \).
(ii) Fixed dividend payout ratio - Under this approach, a constant proportion \((Q_t)\) of earnings is declared as dividend. This can be expressed as \(D_t = E_t \times Q_t\).

(iii) Smoothed residual dividend policy - Under this approach a stable pattern is maintained. Dividends over a long run equals earnings minus equity investment. (Dividends are zero if, on average, equity investment exceeds earnings).

Various dividend models developed by noted theoreticians have been briefly described with stress on their distinctive features. Undoubtedly, the list is, by no means, exhaustive. A large number of variables have been considered including those which have featured in a number of models as common factors. Admittedly, quite a few of the variables are of more theoretical rather than practical usefulness. We may now consider some of the factors that receive consideration while dividend decisions are taken in practice. They may be studied under two broad heads, external and internal.

A. **External Factors**:

**General State of Economy** - Uncertainty and more so apprehensions about future economic and business conditions, steep price rise due to inflation and political decision regarding industrial policy may lead the management to retain all or part of profits earned to maintain stock and other assets in future.
State of Capital Market - In case of easy accessibility to the capital market where firms find no difficulties in raising funds from capital market, management may have no problem to declare dividend at a high rate to maintain the confidence of existing shareholders and to attract the prospective investors. In the situation of financial turmoil and stiffer terms made by the financial institutions to lend money, management must plough back sizeable amount of profits which means following a conservative dividend policy.

State Regulations - Management have to take dividend decision within the overall legal framework and restrictions which may prescribe rules through Companies Act to regulate pattern and mode of income distribution. The legal rules and some legal cases act as boundaries within which management is to take decision regarding how much to be paid as dividend, how much to be transferred to reserve, how past reserve should be utilised, how the capital profits should be dealt with and so on.

Tax Policy - Sometimes tax policy of the Government affects dividend decision. Sometimes the Government allows tax incentives on larger amounts of earnings retained and additional tax burden is levied on higher dividend payouts in order to help formation of capital in the country. Such situations act as inducement to retain greater amount of firm's income and niggardly approach to dividend policy.
B. Internal Factors

**Existing Pattern of Dividend Policy** - Sometimes a company follows a policy of paying dividend every year. It will then pay a certain amount of dividend irrespective of the fluctuations in the level of its earnings. Even in the year when net loss is reported dividend will be declared from past earnings or capital profits (gains) if permissible. Such policy may be called stable dividend policy or policy of regular dividend.

If the firm does not have the policy of regular dividend or a policy of stock dividend, greater amount of earnings may be retained by it in many of the years.

**Firm's Investment Opportunities** - Dividend policy is affected by the firm's investment opportunities. If the firm has highly profitable investment opportunities, it requires funds to accept those investment proposals. Extra funds may be available by retaining greater portion or full amount of earnings of the firm. It is also the opinion of some theoreticians that firm can declare dividend and the required funds for accepting investment proposals may be raised externally by issuing new Shares, Debentures etc. But in most of the cases, where a company needs funds for investment, the management generally decides to retain earnings to avoid inconvenience as well as flotation costs relating to new issues or arrangements for loan.
Desires of Shareholders - Legally directors have the sole authority to take final decision in every important policy making including dividend policy. But they are appointed by the shareholders who are the owners of the company. Therefore, stockholders attitudes and desires should be given due importance. There may be stockholders who are interested in dividend for maintaining economic status, or avoiding risk or for better investment opportunities outside the firm and other group of stockholder may prefer larger return in future in the form of capital gain to reduce their tax burden. Management have to take dividend decision after considering the investors' attitude though sometimes conflict arises when a firm has a number of potential investment proposals which require large amounts of funds and at the same-time its stockholders have strong preference for dividend.

Liquidity Position of the Firm and Its Fund Requirements
Company may have sufficient earnings to declare dividend but it may not have sufficient cash to pay dividends because dividend payments involve cash outflow. Hence financial manager should assess cash position of the firm. Better cash position helps to take high payout policy.

On the other hand, management can not declare dividend though its cash position is sound if it needs cash to repay short term or long term loan on the basis of their agreement and requires higher amount of working capital for purchasing raw materials, assets replacement, day to day business
transactions, future contingencies etc.

Access to Capital Market or External Financing - Generally a reputed firm which has high and stable earnings will have easy access to capital market and hence it can follow liberal dividend policy. On the other hand the firm which has a tight liquidity position and which also is unable to raise funds due to limited access to capital market, adopts low dividend payout ratio. Firms which depend heavily on financial institutions for procuring funds, declare a minimum dividend so that they can remain on the "eligible" list of these institutions.

Control - Existing management group or body of shareholders try to maintain control over the affairs of the company. For this reason, sometimes management employs dividend policy as an effective instrument to maintain its position of command and control. Where the managements can not or does not wish to purchase new shares, they may be reluctant to issue new shares and consequently smaller amount of dividend payout policy is adopted by retaining higher amount of earnings for raising funds required for potential investment proposals. Management may lose its existing control by new issue of equity. Under such circumstances present owners desire to maintain control by withholding dividend payment so that need to raise money by issue of new shares does not arise.

Nature of the Business - Dividend policy is affected by
the nature of the business of the firm. If the nature of the business is such that it is affected by business cycle, the firm follows a conservative dividend policy. Where as firms which are engaged in public utility service or manufacturing staple products, income is not much affected by cyclical economic conditions they can follow a liberal dividend policy.

**Age of the Company** - Age of the company affects the dividend decision. Young and growing firms which require capital for expansion of activities and have generally minimum access to capital market, follows conservative dividend policy to plough back larger earnings.

Old and established companies which have no further expansion programmes and have sufficient amount of reserves and surplus at their command and also easy access to capital market, can follow a high payout policy.

**Other Important Factors** - Net current earnings after tax, cash flow and amount of depreciation. Change in the volume of sales over past two years, condition for interest payments etc. affect the dividend policy. Some psychological factors affect the dividend policy. The same investors' attitude and assessment of risk, future profit, relation between the level of interest rate and equity price, the trend of earning per share and its relationship to the growth in national income, possible changes in the level of price earning ratio, stock market index etc. also affect dividend policy.
A brief survey of the dividend theories and models as has been outlined in this chapter, has thrown up a large number of factors/variables which in some measure have been believed by one or more theoreticians to have influenced dividend decisions. They include the most simple and widely used terms like current year's profit, lagged profits, immediately preceding years' dividend, cash-flows generated, need for funds to finance investment in fixed assets or inventories etc. Again there are variables like change in sales over the past two years, depreciation on fixed assets, ratio of current year's share prices to the average of past two years share prices, operating leverage, financial leverage and a host of other such variables which, simple logic would not rate as ones having direct connection with dividend decisions. However, considering the theoretical importance of all the variables studied and the practical ratings they have been able to achieve in different empirical studies, some variables have been selected which will be described in the next chapter which will deal with establishing linear relation between dividend and the variables selected through OLS (ordinary least square equation) the simple and multiple variants.