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An Empirical Investigation of Corporate Dividend Policy based on Walter and Gordon Model of Selected 10 IT Companies of India

Sharadchandra Narendrabhai Solanki (M. Com, M. Phil, DTLP, GSET) Assistant Professor Government Arts and Commerce College, Vanthali, Dist. Junagadh

Abstract
This study attempts basically to measure the Dividend policy of the IT Sector taking selected 10 IT companies like Tata Consultancy Services, Infosys, Wipro, HCL Technologies and Tech Mahindra Ltd., Mphasis Ltd., Oracle Financial Services Ltd., Mintree Ltd., Polaris Ltd., Hexaware Technologies Ltd., for the period 2010-11 to 2014-15. In order to achieve our goal we have measured the dividend policy and their impact on the share price as per Walter and Gordon Model. Dividend Model is an important tool for Evaluating the Share Price. On the other hand Walter and Gordon propagated a theory which supposed that investment policy and dividend policy of a company are interlinked and significantly affects price of its shares; it is an indication of the Payout power of the Company. Walter and Gordon Model which is based on analysis of Earning and Payout Ratio of different IT Sector of India. In the present study researcher has applied statistical tools like Two-way ANOVA. It concludes that both the models reveals the impact of dividend payout in the value of share compare to other respected aspect of the study.

Key Words: Dividend, Share Price, Dividend Policy, Earning per Share.

1. Introduction
A dividend is a payment made by a corporation to its shareholders, usually as a distribution of profits. When a corporation earns a profit or surplus, it can either re-invest it in the business (called retained earnings), or it can distribute it to shareholders.

Dividend Policy
Dividend policy is concerned with financial policies regarding paying cash dividend in the present or paying an increased dividend at a later stage. Whether to issue dividends and what amount, is determined mainly on the basis of the company’s inappropriate profit (excess cash) and influenced by the company’s long-term earning power.

Factors Affecting Dividend Policy
The boards of directors of a company have the sole right to declare dividend and decide the quantum of dividend. In addition to legal restrictions, there are many factors affecting the dividend policy of a company such as Preference of Shareholders, Current Year’s Earnings, Past Dividends, Management Control Motive, Liquidity Position, Future Financial Requirements, and Access to Capital Market, Contractual Restrictions, Taxation Policy, Inflation, Stability of Earnings and Legal Restrictions.

Dividend Policy and Share Prices
Financial management having major three functions, one of them is dividend policy. Dividend policy has to be formulated on the light of impact the decision about dividend is likely to have on shareholders wealth. Dividend payment shall be determined such that it leads to maximization of shareholders wealth. There are various dividend relevance theories as per different share valuation model.
A. Traditional Position:
According to the traditional position expounded by Graham Benjamin and David L. Dodd, stock market places considerable weight age on dividends than on retained earnings. They have propagated that the stock market is highly responsive to liberal dividend rather than conservative dividend. They have found that value of shares of a company is affected by dividend payments four times as that of retained earnings. This can be evident from their version of equation in which E is replaced by (D + R).

B. Walter's Model of Dividend Relevance:
James E. Walter has presented a model in 1963, which explains the relevance of dividend for valuation of shares or maximization of shareholders wealth. According to Walter, investment policy of a company cannot be alienated from its dividend policy and both are interlinked. An appropriate dividend policy favorably affects the company’s value. The key argument in support of the relevance proposition of Walter's model is the relationship between return on firm's investment or its internal risk of return (r) and its cost of capital or required rate (k). The firm would have an optimum dividend policy, which will be determined by the relationship of r and k.

Share Valuation Formula Walter put forward the following share valuation formula: \[ P = \frac{D}{k} + \frac{[r - (E-D)/k]}{k} \]
Where, \( P \) = Price per share \( D \) = Dividend per share \( E \) = Earnings per share \( r \) = Rate of return on investments \( k \) = Cost of capital

The above equation may alternatively be written as: \( P = \frac{[D + (E-D)/k]}{k} \).

C. Gordon's Model of Dividend Relevance:
Gordon's Model is based on the principle that dividend payment is relevant to value of company. According to Myron J. Gordon, dividends are highly relevant and dividend policy significantly affects value of firm. This theory is based on compounded relationship between dividend policy and market value of shares of a company.

D. Gordon's Model versus Walter's Model:
Gordon's model contends that dividend policy of the firm is relevant and the investors put a positive premium on current incomes/dividends. He argues that dividend policy affects the value of shares even in a situation in which the return on investment of a firm is equal to the required/capitalization rate (i.e., \( r = ke \)). Walter's model is of the view that the investors are indifferent between dividends and retention.

2. Review of Literature

Black (1976) in his study concluded with the following question: “What should the corporation do about dividend policy? We don’t know”. A number of factors have been identified in previous empirical studies to influence the dividend policy decisions of the firm. Profits have long been regarded as the primary indicator of the firm’s capacity to pay dividends.

Lasfer, M. Ameziane (1996), “Taxes and Dividends: The UK Evidence”, 20 in his test of the simultaneous effect of corporation and personal income taxes on the dividend policy of a sample of UK listed companies showed that taxation affects both the payout and ex-day returns. Furthermore, he contended that tax exhaustion reduces the level of dividends paid by firms while a lower tax burden on dividends in the hands of shareholders appears to encourage firms to pay higher dividends. Lasfer (1996) however found no evidence of a tax-induced dividend clientele effect. This is consistent with the proposition that firms’ dividend policy is affected by its shareholders’ tax position.

Dahliquist and Robertson (2001), “Direct Foreign Ownership, Institutional Investors and Firm Characteristics”, 59 define this phenomenon with respect to the motivation of foreign ownership as an institutional bias on dividend policy in oppose to a foreign investor bias. It therefore follows that in general institutional investors prefer capital gains, reinvestment and low dividends rather than high dividends. However, it is known that pension funds have revealed preference for consistently high dividend paying firms.
Grullon et al. (2003), “Dividends, Share Repurchases, and the Substitution Hypothesis”, put forward a compelling argument against the view that dividend changes signal future profitability. They found that when controlling for non-linear patterns in the behaviour of earnings, dividend changes contain no information about future earnings changes.

3. Statement of Problem
Income earned in the form of dividend is highly uncertain. Those shareholder lies in the low income want to take dividend on the basis of liberal dividend policy. It is a policy of distributing a major part of its earnings to its shareholders as dividend and retains a minimum amount as retained earnings. Thus, the ratio of dividend distribution is very large as compared to retained earnings. The rate of dividend or the amount of dividend is not fixed. It varies according to earnings. The higher is the profit, the higher will be the rate of dividend. Majority of investors fall under the low income slab. Hence, those companies following a liberal dividend policy earn the goodwill of investors, which will have a positive impact on market price of their shares.

4. Objectives of the Study
The objectives of the study are as under:
   i) To identify the factors that may cause dividend policy to be important.
   ii) To know why dividend payments generally reflect the business risk of the firm.
   iii) To study performance evaluation of selected IT Companies by using Gordon Model and as per Walter Model.
   iv) To examine the stock market reaction to dividend policy.
   v) To give suggestion to sample companies for better performance.

5. Period of the Study
In the present study period of the study includes five finance years commencing from 2010-2011 to 2014-2015.

6. Data Collection
This study mainly based on secondary data. The data mainly collect from published annual report of Selected IT Companies. Other information related to Selected IT companies will be collected from website, manuals, books, and journals, periodicals published by the companies, stock exchange, news paper and various other sites.

7. Sample of the Study
The total numbers of Companies listed in India Stock Market are Universe of the study. The total numbers of BSE companies are the population of the study. But due to constraint of time and money at this stage researcher has chosen top five companies based on Market Capitalization as on 20/07/2016. Sample of the study includes Tata Consultancy Services, Infosys, Wipro, HCL Technologies and Tech Mahindra Ltd. Mphasis Ltd., Orale Financial Services Ltd., Mintree Ltd., Polaris Ltd., Hexaware Technologies Ltd.

8. Hypothesis of the Study
For the present study the researcher will be formulated two Hypotheses i.e. Null Hypothesis and Alternative Hypothesis. Both Hypotheses are tested with the help of statistical tools. The statements of Hypotheses are as under:

H₀: Hypotheses
H₀: H₁: There is no significance difference between the share Price as per Walter Model and share price as per Gordon Model of selected 10 IT Companies during the study period.

H₁: Hypotheses
H₁: H₁: There is significance difference between the share Price as per Walter Model and share price as per Gordon Model of selected 10 IT Companies during the study period.
9. Data Analysis & Interpretation

In the present study researcher computed following Valuation of share as per Dividend Model during the study period.

Table No. 1

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>SS</th>
<th>DF</th>
<th>MS</th>
<th>F</th>
<th>F Crit</th>
</tr>
</thead>
<tbody>
<tr>
<td>SS Between Rows</td>
<td>74060.47</td>
<td>4</td>
<td>18515.12</td>
<td>2.8918</td>
<td>2.6335</td>
</tr>
<tr>
<td>SS Between Columns</td>
<td>2438291.86</td>
<td>9</td>
<td>270921.32</td>
<td>42.3142</td>
<td>2.1526</td>
</tr>
<tr>
<td>Error</td>
<td>230493.99</td>
<td>36</td>
<td>6402.61</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2742846.33</td>
<td>49</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: Computed by Researcher)

Above mention table no. 1 represent two – way ANOVA for the Share Price as Per Walter Model of 10 Selected IT Companies during the study period. As per table since computed value of F at 5% significance level between rows (2.8918) is higher than critical/ table value (2.6335), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the share price as per Walter Model during the study period. The results are not as per expectation.

But since computed value of F at 5% significance level between columns (42.3142) is higher than critical value (2.1526), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the Share Price as per the Walter Model between the selected 10 IT companies. The results are not as per expectation.

Table No. 2

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>SS</th>
<th>DF</th>
<th>MS</th>
<th>F</th>
<th>F Crit</th>
</tr>
</thead>
<tbody>
<tr>
<td>SS Between Rows</td>
<td>51430.08</td>
<td>4</td>
<td>12857.52</td>
<td>7.8291</td>
<td>2.6335</td>
</tr>
<tr>
<td>SS Between Columns</td>
<td>786491.30</td>
<td>9</td>
<td>87387.92</td>
<td>53.2119</td>
<td>2.1526</td>
</tr>
<tr>
<td>Error</td>
<td>59121.46</td>
<td>36</td>
<td>1642.26</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>897042.80</td>
<td>49</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: Computed by Researcher)

Above mention table no. 2 represent two – way ANOVA for the Share Price as Per Gordon Model of 10 Selected IT Companies during the study period. As per table since computed value of F at 5% significance level between rows (7.8291) is higher than critical/ table value (2.6335), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the share price as per Gordon model during the study period. The results are not as per expectation.

But since computed value of F at 5% significance level between columns (53.2119) is higher than critical value (2.1526), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the Share Price as per the Gordon model between the selected 10 IT companies. The results are not as per expectation.

Table No. 3

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>SS</th>
<th>DF</th>
<th>MS</th>
<th>F</th>
<th>F Crit</th>
</tr>
</thead>
<tbody>
<tr>
<td>SS Between Rows</td>
<td>131531.4</td>
<td>4</td>
<td>32882.86</td>
<td>4.4255</td>
<td>2.6335</td>
</tr>
<tr>
<td>SS Between Columns</td>
<td>2102920.0</td>
<td>9</td>
<td>233657.70</td>
<td>31.4469</td>
<td>2.1526</td>
</tr>
<tr>
<td>Error</td>
<td>267488.5</td>
<td>36</td>
<td>7430.24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2501940.0</td>
<td>49</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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(Source: Computed by Researcher)

Above mention table no. 3 represent Two Way ANOVA for the Share Price as Per Book Value of 10 Selected IT Companies during the study period. As per table since computed value of F at 5% significance level between rows (4.4255) is higher than critical/ table value (2.6335), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the share price as per Book Value per Share during the study period. The results are not as per expectation.

But since computed value of F at 5% significance level between columns (31.4469) is higher than critical value (2.1526), null hypothesis has been rejected and alternative hypothesis has been accepted. It shows that there is significant difference in the Share Price as per the Book Value per Share between the selected 10 IT companies. The results are not as per expectation.

Table No. 4

<table>
<thead>
<tr>
<th>Companies</th>
<th>Rank of Walter</th>
<th>Rank of Gordon</th>
<th>Rank of BV</th>
<th>Total</th>
<th>Average</th>
<th>Final Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>TCS Ltd.</td>
<td>6</td>
<td>2</td>
<td>6</td>
<td>14</td>
<td>4.67</td>
<td>6</td>
</tr>
<tr>
<td>Infosys Ltd.</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>5</td>
<td>1.67</td>
<td>1</td>
</tr>
<tr>
<td>Wipro Ltd.</td>
<td>8</td>
<td>7</td>
<td>8</td>
<td>23</td>
<td>7.67</td>
<td>8</td>
</tr>
<tr>
<td>HCL Technologies Ltd.</td>
<td>7</td>
<td>6</td>
<td>7</td>
<td>20</td>
<td>6.67</td>
<td>7</td>
</tr>
<tr>
<td>Tech Mahindra Ltd.</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>11</td>
<td>3.67</td>
<td>2</td>
</tr>
<tr>
<td>Mphasis Ltd.</td>
<td>5</td>
<td>3</td>
<td>5</td>
<td>13</td>
<td>4.33</td>
<td>5</td>
</tr>
<tr>
<td>Oracle Financial Services Ltd.</td>
<td>1</td>
<td>10</td>
<td>1</td>
<td>12</td>
<td>4.00</td>
<td>3.5</td>
</tr>
<tr>
<td>Mindtree Ltd.</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>12</td>
<td>4.00</td>
<td>3.5</td>
</tr>
<tr>
<td>Polaris Ltd.</td>
<td>9</td>
<td>8</td>
<td>9</td>
<td>26</td>
<td>8.67</td>
<td>9</td>
</tr>
<tr>
<td>Hexaware Technologies Ltd.</td>
<td>10</td>
<td>9</td>
<td>10</td>
<td>29</td>
<td>9.67</td>
<td>10</td>
</tr>
</tbody>
</table>

(Source: Computed by Researcher)

Above table no. 4 Ranking of 10 Selected IT Companies as per Walter, Gordon Model and as Per Book Value basis during the study period. Walter Model, Gordon Model includes EPS, DPS, Growth Rate, Required Rate of Return, Return on Assets, etc. Researcher has been tried to measure performance by giving ultimate or final rank to sampled companies. Based on table it was found that Infosys Ltd. stood at first position which followed by Tech Mahindra Ltd., Oracle Financial Services Ltd., Mintree Ltd., Mphasis Ltd., TCS Ltd., HCL Technologies Ltd., Wipro Ltd., Polaris Ltd. Among sampled companies during the study period. Furthermore it was also found that Hexaware Technologies Ltd. companies registered lowest rank among sampled companies during the period under review.

10. Finding of the Study

1) Oracle Financial Ltd having highest average share price as per Walter Model with Rs.794.86 among all Selected Companies during the study period. Whereas Hexaware Technologies Ltd. has lowest share price as per Walter Model with Rs. 31.99 among all Selected Companies during the study period. But higher Covariance can be seen in TCS Ltd (38.13%), Second Tech Mahindra Ltd. (34.21%) and lower Covariance in Mphasis Ltd. (12.27%).

2) Infosys Ltd having highest average share price as per Gordon Model with Rs.489.97 among all Selected Companies during the study period. Hexaware Technologies Ltd. has lowest share price as per Gordon Model with Rs. 32.53 among all Selected Companies during the study period. But higher covariance can be seen in Oracle Financial Services Ltd (223.61%), second Mindtree Ltd. (59.57%) and lower covariance in Hexaware Technologies Ltd. (13.88%).
11. Conclusion
At last researcher founds that Dividend announcements/policy affects significant impact on share prices of companies. Hence, researcher should accept the theory of Walter and Gordon’s i.e. prices of shares are significantly affected by dividend announcements/policy. Walter model reveals payout and Retention ration among the companies and which may have favorable impact on the share price of the company. While Gordon model shows dividends are highly relevant and dividend policy significantly affects value of the companies.

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Sharadchandra Narendra bhai Solanki
(M. Com, M. Phil, DTLP, GSET)
Assistant Professor
Government Arts and Commerce College,
Vanthali, Dist. Junagadh