Market wisdom
INVESTOR EMPOWERMENT SERIES
LESSON NO.13 • FROM THE HOUSE OF ASIT C. MEHTA INVESTMENTS

Dividend: What does it mean to investor?

Dividend is an important fruit that you get from the tree called investments. Several aspects of this concept need to be understood so that you not only get your dividend dues on time but also understand its importance in investment strategies. Dividends are income tax free in the hands of the recipient and hence are an important component of returns that you get from your investments.

The profit earned by the Company (after payment of Corporate Income-tax) can either be retained in the Company for its future financial needs or distributed to shareholders in the form of dividend. According to the Companies Act, 1956, after satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable profits of the company. Companies have to currently pay a tax of 12.5% on the amount that it distributes as dividend. Surcharge and education cess are charged separately. Therefore the shareholder does not pay any tax.

There is no legal binding on companies to declare and distribute dividends. Decisions regarding the amount and frequency of dividends are solely at the discretion of the board of directors. A shareholder does not have a say in the decision making process of declaring dividend, amount of dividend, etc. The dividend on equity shares is not fixed and may vary from year to year depending on the amount of profits available. Generally, dividends are paid annually. The dividend paid so is known as final dividend. Final dividend is distributed to share holders after the annual general meeting. However, there are companies which announce interim dividend with announcement of its interim results.

During 2004-05 Indian companies distributed Rs. 33,583 crores as dividend to its share holders. Amount so distributed for 2005-06 increased by 18.5% to Rs. 39,785 crores. In India, most public sector undertakings, banks and FMCG companies distribute generous dividend to its share holders. Over the last three years, all information technology players have also been generous in paying dividends. Reliance Industries is the largest private sector company in India in terms of total amount of dividend payment while in PSUs ONGC is the largest company in dividend payments.

Sometimes when a company announces dividends, some investors find it difficult to understand the amount of money that will be received as dividends. Dividend is always calculated on the face value of the share. In the case of stock certificates, face value is the par value of the share. If company declares 300% dividend it means company is going to pay 300 times the face value of one equity shares. For example, if TCS declares to distribute 300% as dividend, share holder will get Rs.3 per share for every share, as face value of the TCS share is Rs.1.Nowadays, since the face values of companies are often different, companies only declare a dividend as Rupees Per share. In that case one gets that amount per equity share irrespective of its face value or market value. So it is important to note whether the sum declared is Rupees Per share or percentage of face value. A declaration of Rs. 3 per Re 1 per share and Rs.3 per Rs 10 face value share is quite different!

Other Important point's investors must know regarding dividends.

The day on which the Board of Director's announces their intention to pay a dividend is known as Declaration Date. On this day, the company creates a liability on its books; it now owes the money to the shareholders. On the declaration date, the Board will also announce a date of record and a payment date.

Shareholders who are beneficial owners of the shares on a particular date are only entitled to dividends. This is known as record date. The list of beneficial owners is given by the Depositories to the Registrar of shares of the company in case the shares are dematerialized. Shareholders who are not registered as of this date will not receive the dividend.

The "ex dividend" date is set by the exchange where the stock is traded, several days before the date of record, so that all trades made on previous dates can be properly settled and the shareholder list on the date of record will accurately reflect the current owners. Purchasers buying before the ex-dividend date will receive the dividend. The stock is said to trade "cum dividend" (meaning "with dividend") on these dates. Purchasers buying on or after the ex-dividend date will not receive the dividend. The stock trades ex-dividend on these dates.

The facility to get credit clearing of dividend directly in shareholders designate bank account is known as Electronic Clearing Facility (ECS). The scheme was launched in March 2002 with 15 centers and selected group of bank is now offered at all centers where MICR clearing facility is available. The ECS facility also provides adequate protection against fraudulent interception and encashment of dividend warrant apart from eliminating loss of dividend warrants in transit. The ECS facility further eliminates burden of correspondence for revalidation/issuance of duplicate dividend warrants. Under the ECS facility, shareholder's bank will credit the dividend amount in the account on due date and indicate the credit entry as "ECS" in Bank Statement without issuing or handling paper instrument/warrant. This facility is free to the recipient.

Dividend Yield reflects the amount paid per share as a percentage of the share price in markets. For example if TCS were to declare Rs. 3 per share as interim dividend (on Rs. 1 face value share which is quoted on the market at Rs. 1000) the yield works out to 0.33% yield

In event cheque / credit entry is returned by the bank or postal authorities and not paid to the share holder within 30 days, then the amount should be deposited with the Unclaimed dividend account and withdrawal is possible only on production of adequate proof by the company. The money if still unclaimed moves to Investor Protection account of Government of India after 7 years.

Complain for non-receipt of dividend should first be made to the company. In event the company does not respond then complaint should be filed with the stock exchange. Non-payment of dividends could lead to prosecution of directors or responsible officers of the company by the Registrar of companies.

Normally the company managements keep in mind its business plans while deciding on the dividend policy. A very fast growing Company will require large resources and as such would tend to be conservative in dividend declaration since they will need to replenish the amount so declared at the same time the investor also need to deploy the amount received in their hand. On the other hand a largely profitable company without any Capital Expenditure Plan do not require to keep holding on to the earned money and may want to pass on to the shareholders to deal as they may deem fit.

Dividends, interim and final, are also used as surrogates by investing community to interpret the management's view of the future of the company. While investing in markets, it is necessary to study the dividend track record of the target company as it tells you many important things about the company without wasting too many words….

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