An Analysis on Dividends as a Liability or an Asset for the Company

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Introduction

A Company according to Sec 2(68) is "a company means a company incorporated under this Act or under any previous company law." "A company by being incorporated has a separate identity of its own and is also known as an artificial person, which means it has its own rights, duties, obligations and has the ability to own its own property and also can sue and be sued in its name."

Dividend is the term used to describe that part of the company's earnings that is given to the shareholders. The term originates from the Latin word, "dividendum"[2] that is an item to be split. Dividends and the impact on investors evaluation of a company is a matter debated for quite some time now. To maintain and stock price growth and return on capital to the Investors are very crucial for a company's financial performance. The shareholders are paid dividends at the closing of the financial year, which is March 31st in India. Nevertheless, companies are allowed to issue dividends to the shareholders, referred to as Interim

1* Student, CMR University, School of Legal Studies.

2 Dividend", Douglas Harper, Online Etymology Dictionary, November 12th, 2001

dividend,[3] even during the fiscal year. A dividend is paid to a shareholder based on the shares one holds, known as the per-share basis. For instance, John owns 100 shares in a company and the Company proposes a dividend of 30 rupees for each share, then John will receive 3000 rupees as dividend. Dividends are often paid to recompense the shareholders for their contribution in the business. However, Companies are not required to pay dividends to shareholders, but stable and sizeable dividends frequently draw new investors and further raising value of shares and subsequently the company's worth. It's a matter of concern for both investors and the management of the company to be aware of the dividend policy as its equally important to both of them. It's regarded by the investors as a dependable income source and a performance indicator. As it has an impact on the stock value and investment decisions, the management pays special attention while crafting their policy on dividends. The ability of the management increases the shareholders profits which can be attained through a thorough understanding of the structure of dividend policy, which is yet another metric for measuring the success of the management.

The company in the incorporation stage requires capital to begin with, hence this can be done by investors and moving forward they float shares once the company is established and then they raise capital either through debt or equity. There are two possible ways in which the capital borrowed is paid off, i.e. through interest, the firm has to pay

[3] Section 2(35), Companies Act, 2013

interest regardless of whether it makes profits or makes losses and the second being dividend which is paid proportionately according to amount of profits made to the shareholders. Equity share capital often is referred to as the cornerstone or backbone of any organization, as most of the business carried on by the companies is through this capital.

Significance of the Study

Often a dividend is regarded as a reward to the shareholder for the amount invested in the company which helps raising capital of the company and run the business. The research paper tries to under what is the basis on which dividend policy is decided along with an understanding of the different types of dividends and the views of shareholders while investing in a company. The paper tries to analyze the viewpoint of whether dividends are an asset or liability to a company which has remained a question unanswered.

Review Of Literature

This part of the paper aids us in understanding the perspectives of earlier studies on the topic. In light of the fact that individuals prefer dividends as there are taxes, by explaining the significance of dividend policy, by “Brennon and Thakor.” “Baker and Wulgar” state that they have undertaken a survey as to the views of experts with respect to the dividend policy and company value. Illiyas Sharif and Adnan Ali, in their work have outlined different kind of dividends, the reasoning why the companies choose to issue dividends. The work by C.S Siddhartha Batik, describes the process involved in the issuance of dividends as well as the way in which banking companies distribute their dividends. The research conducted by Kevin Chiang and George Frankfurter,[4] explains the reason why a dividend exists and how it emerged. According to Michael Brennan and Anjana Takur they have conceptualized shareholders profit seeking behaviour whether they prefer to receive dividends or not. In Mike Roberts research, the importance of a company to pay dividend has been analyzed and outlined and why it's considered as the need of the hour. Miller and Rock in their study laid down that giving dividends provides investors confidence that the firm has opportunities of growth and development and that it has adequate financial resources.

The review of above-mentioned literature has helped the researcher to analyze whether a dividend is considered as an asset or liability.

Objectives Of The Study

- To analyze the need for a payment of dividend and the factors affecting the policy of dividends.
- To analyze the various theories based on which dividend policies are framed.

[4] The Perception of Dividends by the Institutional investor, Kevin Chiang and George Frankfurter

- To understand the different types of dividends given by companies to its shareholders.
- To examine the procedure and payment of dividends.
- To analyze the companies views on dividend as an asset or liability.

Scope And Limitations

The scope of the topic is voluminous and hence the scope of this paper is limited to only companies views on dividends through secondary research in trying to understand the views of whether the companies view dividends as an asset or liability.

The Need For Payment Of Dividends And Factors Influencing The Dividend Policy

It's often a question that has been left unanswered as to why do companies pay dividends, as it’s not an obligation as such. How and what a company’s dividend policy indicates to a layman about the company is also another thought that strikes any individual's mind.
There are many companies that do not offer dividends to its shareholders, such as Amazon, Google etc. most often we see that established large companies do not offer dividends, which is due to the fact that they are in a fast-growing phase and choose to spend their profits on further development and investing to earn more profits, than

distributing them to the shareholders. There are various theories which envisage the need for payment of a dividend. They are as below:

Signaling Theory: this concept is based on the principle that the companies that pay dividends are more attractive and persuade potential investors to invest in the company, as they show a positive outlook on the future of the company which also in turn receives an immediate cash inflow to the company. Most managers tend to follow this theory by comparing firms that pay dividends against those who do not.[5] The cash flow signaling model works based on managers having access to important investment opportunities and information, hence the investors tend to respond favorably as managers express this by paying out dividends. Dividends are also an indicator of a company's consistent income. The management hence, is of a notion that by paying out dividends expresses their conviction in the future success of the company. [6]

Agency Theory: According to this theory, a different possible and alternate answer for dividends payment is the division of ownership and management. It's based on the notion that the managerial level

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[5] Jai cheng li, Analysis on Reasons Why Companies Pay Dividends, Advances in Economics, Business and Management Research, volume 118, International Conference on Management Science and Industrial Economy (MSIE 2019) last visted on 26 November 2020

[6] IBID AT 4

might put their own interest ahead of investors' benefit. Managers might choose to invest in undertakings with a negative NPV, which in turn reduces value. For managers, engaging in such activities is made simpler by the enormous cash flow, and the cost of tracking and bonding is termed as agency costs. Therefore, dividends are utilized in lessening the free cash flow and in assisting the business in preventing managers from abuse of corporate resources. Hence, its proven that dividends help in safeguarding large scale cash reserves as well as from bad managerial conduct, who might use the retained profits for unethical purposes. Therefore, dividends are a key financial instrument for lowering agency costs.[7]

In view of the investors, if the stocks one holds also provide dividends, investors are more likely to purchase them and invest in such companies. It's more appealing to the investors when firms pay dividends to invest in them. Dividends are looked at as an indication of a strong management and a profitable business which is doing well. Since such businesses are of minimal risk, investors choose to invest in Dividend paying companies. They also come with a huge market value, as a result of which there is an increased demand raising the stock prices of such companies. There is a strong correlation between share prices and the issuance of dividends. The earning of a company considerably rises with the issuance of dividends.

[7] IBID AT 4

Factors Affecting Dividend Policy

Dividends as already explained are the profits or earnings that a company earns and a part of which are issued in the form of dividends to those who invest in the company. The directors must decide how much of the earnings must be distributed and how much must be kept in the company as a fund for the development and emergencies that might arise ahead. A crucial element of a managerial level's role is the distribution of the earnings amongst the shareholders. Dividend policy thus, involves determining an appropriate dividend policy to be allocated to the company's investors and shareholders by the board. When it comes to the impact on the share price of the company, the goodwill as well as the growth of the company, a company's dividend policy has a major impact. The shareholders income grows as the prices of the shares increase.

A company's dividend policy is influenced by a variety of factors, which include:

Earning's Size: The profits that a firm earns, determine the dividend policy. It's not just the dividend size but also the sort of profit. It's also consistent dividend policy that a firm looks at.

Shareholder's Interests: The management must adhere to a strategy that serves the interest of both the shareholders as well as the company.

Liquidity Status: While deciding the policy on dividends, the company must take into account the company's status with regard to its liquidity. A company's cash reserves are affected through their dividend policy and payments. Its best to avoid payment of dividends through cash for a budding business, as they have an imperative need for funds.

Stability of Profits: A company may adopt a flexible policy when the earnings the company earns are consistent and makes a substantial growth.

Trade Cycle: The company generates more revenue when the country the business exists in is facing an inflation situation. As a result of which the company is in a position to pay out more dividends and when in need of cash inflow, it can obtain it from others at a reasonable rate of interest.

Ideology of the Management: By issuing new shares the company's structure is altered, most companies employ internal funds to support the expansion. Hence, there is a chance that the income of the current members might vary when such debentures are raised for the purpose of the expansion.

Former Dividend Rates: If it's an already established company, the dividend policy and rates are determined based on rate of dividends paid in the past years. The company would benefit from maintaining consistency in its dividend payout, therefore as a result the directors need to be aware of the previous dividend rates that have been paid out in the past.

Market Policies: The policies of the competitors in the market are also a major influencing factor as the shareholders may choose to invest their money in those competing companies if they are providing with a dividend better and higher. As a result of which the companies while determining its policy on dividends alongside evaluating and analyzing the dividend policies of the competitors of the market.

Types Of Dividends The Companies Pay To Its Shareholders

A dividend may be broadly be classified into two types, which is one based on the mode of payment and second being the time within which the dividend is paid.

Further the dividends paid based on the payment time can be classified into two types, interim and final dividend.

Interim Dividend: this form of dividend maybe paid maybe paid any point throughout the fiscal year, which may be issued based on either past or present years earnings. A firm cannot issue an interim dividend unless its specifically mentioned in the Articles of Association of the company. Apart from one difference the interim dividend type is largely the same as that of the final dividend that being, a company can call for a decision to not pay dividends and after such a declaration it's not bound to pay the interim dividend.

Final Dividend: This form of dividend is issued at the conclusion of the fiscal year, on the completion of the books of accounts for that year. The declaration is done during the final annual meeting of the company. Its determined based on the latest fiscal year, however, it can be based on the profit reserves from the past years. These dividends are not modifiable unlike the interim dividends. It's viewed at as a debt owed by the company towards its shareholders. Therefore, the company is obliged to pay a dividend if declared one.

Dividends are differentiated based on the mode of payment which are as below:

Cash Dividend: the most widely known dividend is a cash dividend, where the dividend is directly credited to the shareholders bank which is commonly adopted by most companies. These dividends are paid on the basis of each share the shareholder owns. Suppose, a company A earns 2 lakhs, it can declare that 20000 will be paid out as dividends which will further be divided to the shareholders at 20 rupees as the value for each share they own. If a shareholder owns 100 shares in that company, then he will get paid 2000 rupees as dividend. According to the Companies Act 2013, the only permitted type of dividend distribution is a cash dividend.[8] Nevertheless, some companies the bonus share method for issuance of dividends.

Stock Dividend: The company through this type of dividend offers the existing shareholders freshly issued stocks. [9]The shares given are proportionate to the shares that are already owned by the shareholder. The shareholder for instance, holding 100 shares of a company A, may receive an extra share for every 100 shares he holds. While the company issues new stocks it must be less than 25% of the company's current share capital. This is a strategy utilized by a company that intends to reduce the share capital, by doing so the although the number increases the total value remains constant. That is for instance, if a Company A issues 1o0 additional shares through stock dividends along with the preexisting shares of 1000, at share price 20, the total number of shares issued rises to 11o0, but company overall value remains at 20000.

Property Dividend: This kind of dividend is another type of non-financial dividend, which is when the company issues actual assets of

[8] Section 123(5), Companies Act, 2013

[9] Effect of Dividend Policy on Stock Prices", Ilyas Sharif and Adnan Ali, International Journal on Business and Management, August 31, 2020

the company to the shareholders. [10]These are tangible assets that are paid out as a dividend. For instance, if Company A is manufactures laptops, it can distribute these laptops as part of its dividends, with the increase in the product value to the amount of shares held by the shareholder. Currently, it's been rarely followed by companies however, corporations with limited number of shareholders are the ones who are adopting this form of dividend policy.

Scrip Dividend: This form of dividend is often adopted by a company when it does have money or intends to spend its earnings in any other way, as it's a form a future payment to the shareholder as a promissory note.[11] Companies that intend to issue dividends to their shareholders, while using the earnings to expand their business adopt such strategy.[12] For instance, if a Company A has earned a profit of 20 lakhs which and has not issued dividends yet, and wants to utilize this money to build a new building while rewarding its shareholder, can adopt scrip dividend policy.

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[10] Dividend Payout Characteristics of UK Property Companies", Joseph T Ooi,

Journal on Real Estate Portfolio

Management, June 13, 2020

[11] "What is a Scrip dividend", Barclays.Co. Uk

[12] "Scrip Dividend and Share Buy-Back Strategies Based on Volatility", Angel

Huerga and Carlos Rodriguez,

12th International Conference on Operations Management, 14th July 2018

Liquidating Dividends: This form of dividend is paid when a company is under liquidation and is in the stage of winding up. It's often issued post the settlement of all other debts and liabilities. When such a dividend is declared, the whole company's equity capital rather than merely profits, is used to make the payment. Furthermore, this type of a dividend can only be issued when a company ends up being profitable instead of becoming insolvent.

Dividend Declaration And Procedure For Payment Of Dividends

The procedure for the payment of dividend has been laid down in Section 123 of the Companies Act of 2013. In section 124 of the Act, the unpaid dividends which were to be paid, the procedure for that has been specified. The procedures as per the Act are as below:

Sources from which dividend is paid: the sources through which a company pays off its shareholders dividends from largely two sources, the earnings of the company and funds from the government. With regards to the earnings, it pays off from either the current fiscal year earnings or from the past years reserves which were created to previous years profits. When there is a guarantee given by the State or the Central Government, the dividends may also be paid through using the money given by the Government.

Reserves: According to the Companies Act, a dividend cannot be issued until the company sets aside some portion of the profit which the board considers necessary for profits. The Act also specifies that a company may pay dividends through already existent procedure outlined in the Articles of Association of the company. Also, the Act states that it can make use of only its free reserves to pay its dividends.

Mode Of Payment: A dividend generally maybe only paid in cash, in accordance with Section 123 of the Companies Act, there is no other payment option available. Based on the preferences of the shareholders, the cash dividend may be issued and transferred through a check, warrant, or any other digital method of payment.

Prohibition: No dividends may be issued by companies that are in conflict with Section 73 and 74 of Companies Act 0f 2013, as long as the conflicts persists.

Unpaid Dividends: Its termed as an unpaid dividend when its unpaid before thirty days after being declared, which often happens when a company fails to identify particular shareholders information or have access to some shareholders. The company must create a separate account and deposit such an amount of unpaid dividends into those accounts. Following which the company has 90 days to prepare a record of all those shareholders who haven't received their payments, together with their information. As a result of which, the amount is moved to the investors Education Fund which will be available for subsequent claim by shareholders included in the list.

The procedure for payment of Dividends are as follows:

Board Meeting: At the completion of every financial year, the company's board conducts a meeting in which alongside all the other important happening discussed, the declaration of dividend and the decision of what part of the shareholders will be paid a dividend is decided.

Report Of The Director: The Directors meeting must be reported and detailing the company's intention about the issuance of the dividends to the shareholders. The amount must also be stated if the board decides to issue dividends.

Annual General Meeting: When the annual general meeting takes place in the company, its when the dividend is officially and formally declared. This declaration will only be valid if the required number of shareholders are present to make it official. Dividend payments may be lowered at the discretion of the shareholders. If a majority of them approve, the decision on dividends is approved.

Creation Of a Special Account: Upon the approval, a special account must be opened where the amount declared as dividend must be transferred.

Credit of Total Amount Payable to Dividend Account: The amount which is to be paid as dividend must be deposited into the account created to distribute the dividends to qualifying shareholders before 5 days after the declaration of the dividend.

Dividend Distribution: A list of who are entitled to receive a dividend is prepared, together with the amount that each shareholder is entitled to be paid, based on which each of them will receive dividends according to the agreed plan with the bank. The process described in Section 124 must be followed, if the payment is not made by 30 days following the declaration of dividend.

Companies View On Dividends Asset Or Liability

Significance of Dividends for Companies

As we already have noted before payment of a dividend is not compulsory and it's at the discretion of the company whether or not to pay it. By not paying dividends the company can use its earnings for the development of their business. While most industry Giants like Apple, Microsoft, JP Morgan etc. have always paid dividends to their shareholders but whereas companies such as Facebook Google etc. have never done so.[13] This raises a question of why a company would

[13] Why Do Companies Pay Dividends?", CliffCore.com, July 7th, 2020.

choose to have it as an asset rather than looking at it as a liability, as payment of dividends has its own pros and cons and that many companies don't pay dividends are more profitable than those who don't.

In a nutshell, earning a dividend implies the satisfaction and content of shareholders. According to a survey conducted by Louisiana State University, majority of investors chose to invest in a company that offers stable dividends. [14]They may be largely classified into 3 major types, those who wanted dividends for one's own personal financial safety, second being those who chose dividends since it's raised the value of the shares, and thirdly those who chose to have both. According to the survey results, older and more experienced investors constituted the majority of the first type, whereas the younger group who were budding investors were dominated in the second type.

It might be a quiet complex and difficult to decide whether to pay dividends or not. Both paying and not paying of dividends comes with its own pros and cons. Some companies employ alternative strategies to compensate their shareholders which include, offering bonus shares, share buybacks, and sometimes at high prices.[15] These other approaches may also have advantages for the business, as bonus issues

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[14] The Perception of Dividends by Professional Investors", Kevin Chiang and George Frankfurter, Managerial Finance Journal, January 2006.

[15] Why Do Companies Pay Dividends?", Mike Roberts, RetireOnDividends.com, August 2019

decrease the company's equity capital, whereas share repurchases might assist companies in ownership consolidation.

Organizations that are new tend to be significantly lesser than established and experienced to payout dividends. Mostly, the newer companies must devote their profits in order to grow, thus need greater cash reserves. On the contrary bigger companies are far steadier and rise at a slightly lower pace. Due to which they require lesser investment, and hence they can choose to pay dividends to shareholders.

View Of Companies Of Dividend As An Asset

The sense of stability and among the shareholders, is by far the most important reason why most companies choose to pay dividends. Investors while investing attribute stability and development to regular dividend payouts. As a result of which more investors invest and the value will also rise of the shares. The purpose of a dividend is to make the company more appealing to them and please them, and on the other hand it will also attract more investors. Tax savings are another perk issuing dividends. In accordance with 2020 budget statement, it was declared that henceforth dividend income will be taxed on the shareholder.[16] The dividend distribution Tax is repealed. This implies

[16] Dividend Income Becomes Taxable in Receiver's Hand, DDT Abolished", Preeti Motiani, Economic Times,
February 2nd, 2020

that the companies will have more cash reserves than earlier, and as a result of which the companies with larger cash reserves have the ability to pay more amount of dividends which will be a bonus for the shareholders as well.

View Of Companies Of Dividend As A Liability

As pointed out earlier, the justification against dividends is that by not paying out dividends they end up having more cashflow, which may be used for the company's growth and expansion. Since, growth may lead to a considerably greater increase in the worth of company, many newer businesses choose to not pay out dividends. These companies may utilize these earning on buying new equipment or other resources necessary for the company to be a market leader. The shareholders may benefit from this strategy which induces capital instead of getting paid dividends, as they can dispose their investment and make a larger gain than they could from dividend returns.[17] Given that the gains from such a strategy are more, the shareholders might actually choose this method. The increased risks associated with this approach, are due to the fact that growth is not assured by reinvesting the earnings.

Findings, Recommendations And Conclusion

[17] How and Why Companies Pay Dividend", Investopedia, May 18th 2020.

On thorough research, it can be concluded that in the first place, the companies believe that dividend is viewed by them as an asset as opposed to a liability. The fundamental justification is that it's required to pay interest on the debt money without any liability. However, when it comes to dividend payments this is not applicable, as the amount that the company chooses to pay its shareholders is entirely upon them. The fact that equity share capital accounts for more than 70% of the capital formation hence, can generate a fortune without having to repay the money means that it can be regarded as an asset. In order to run a company, it requires capital hence, it may be considered as an asset as the earnings that company pays as dividends is substantially lower than that of the interest that a company may have to pay as interest for the debt borrowed. In addition, the investors will contribute greater amounts to equity share capital, due to strong dividends, as a result the companies will have far more capital to expand in the coming years. Therefore, investors gain from both trading as well as from the dividend amount. A good amount of dividend will also make sure that companies are in a stable financial condition, which will further attract investors. Dividends are hence, regarded as a liability only for budding firms as they are more in need of capital. Nonetheless, a large number consider dividends as an asset having an added advantage to the company.

I believe, that companies must pay dividends to shareholders as it may easily boost the worth of shares and also stabilizes the business and gives faith of the continuance of business in future years. Nevertheless, companies should pay according to their abilities and not more than what is required. Another key requirement for any business is to maintain a consistent working capital. But in my opinion, the companies can now afford to issue greater amount of dividends than they were able to do when DDT, i.e dividend distribution tax was banned. Moreover, the companies need to issue dividends only when they have made a standing in the market and have generated a substantial profit margin.

On the whole when a company provides for dividends to its shareholders, it benefits the company and attracts more investors. This must be done stably and in a consistent manner. Although not compulsory, it benefits the company and rather than being a liability its most often look at as an asset as investors look at companies that pay dividends on a continuous basis as a future prospect and the value of shares also increases. Management hence, take immense efforts into designing the right kind of dividend policies in order to make profitable gains by attracting more investors and alongside satisfying the current shareholders.