



“Determinants of Dividend Policy and its impact on Shareholders Wealth Creation of Selected Banking Companies in India”.

1. Mr. Jaydev Vithlani (Author) 2. Dr. Kamini Shah (Co-Author)

2. Research Scholar Professor & Dean Department of Business Studies Department of Business Studies

Sardar Patel University Sardar Patel University

Abstract:

Dividend policy remains a critical area of corporate finance, particularly in the context of emerging markets where economic volatility and financial market inefficiencies influence corporate decision-making. This study examines the relationship between dividend payout ratios and shareholder wealth creation in banking sector of India, analyzing data from a diverse range of industries. By employing panel data analysis and regression techniques, the study investigates whether higher dividend payouts contribute to enhanced shareholder returns or if retained earnings serve as a more effective driver of value in these markets. The findings provide practical implication for policymakers, investors, and corporate managers in formulating dividend strategies that balance short-term investor satisfaction with long-term value maximization.

Keywords: Dividend payout ratio, shareholders' wealth, market capitalization Introduction

Dividend policy is a critical aspect of corporate financial management, representing a balance between retaining earnings for future growth and distributing profits to shareholders as dividends. This study investigates the impact of dividend payout ratios on wealth creation, with a particular focus on the banking sector. As one of the most pivotal components of the financial system, banks not only act as intermediaries of capital but also serve as key drivers of economic development. Their financial decisions, including dividend policies, significantly influence investor confidence and wealth accumulation. The primary objective of this research is to examine the relationship between dividend payout ratios and wealth creation among selected banking companies, and how these financial practices shape shareholder value in the context of the Indian banking sector.

This study focuses on a comparative analysis of five public sector banks and five private sector banks in India, which represent the two dominant categories of banking institutions in the country. Public sector banks, owned and operated by the government, often prioritize financial inclusion and social welfare objectives. Conversely, private sector banks, driven by profit motives, focus on efficiency, innovation, and competitiveness. These differences in operational philosophies make the comparison of their dividend payout policies particularly compelling. The research evaluates how these divergent approaches to dividend distribution affect wealth creation for shareholders, with the aim of uncovering significant patterns and trends.

The choice of the banking sector for this study is based on its dual role as a capital allocator and a wealth generator. Dividend policies in this sector are influenced by a range of factors, including profitability, regulatory requirements, market conditions, and growth opportunities. Furthermore, the banking sector is highly regulated, with norms prescribed by the Reserve Bank of India (RBI) governing capital adequacy and profit distribution. These regulations play a vital role in shaping dividend policies and highlight the importance of studying this sector to understand its unique dynamics.

Objectives of the study

The primary objective of this study is to examine the relationship between dividend payout ratios and wealth creation in the Indian banking sector, focusing on both public sector and private sector banks. By analyzing the financial performance and dividend policies of five public sector banks and five private sector banks, the study seeks to uncover the extent to which dividend decisions influence shareholder wealth. Specifically, it aims to assess how variations in dividend payout strategies impact critical indicators such as earnings per share (EPS), market capitalization, and overall shareholder returns.

Review of literature

The relationship between dividend payout policies and wealth creation has been extensively studied in corporate finance, with researchers exploring the implications of dividend decisions across various industries and contexts. Lintner (1956) laid the foundation for understanding corporate dividend behavior, introducing a model that highlights the importance of stable and predictable dividends in enhancing shareholder value. Following this, Gordon (1959) and Miller and Modigliani (1961) debated the significance of dividends in determining firm valuation, with the latter proposing the irrelevance theory under ideal market conditions, a hypothesis that has since been revisited and tested in diverse settings. Baker and Powell (1999) investigated managerial perspectives on dividend policy and found that managers often view dividends as a signal of firm stability and profitability, aligning with signalling theory. In the banking sector, Khan et al. (2011) examined the determinants of dividend policy and reported that profitability, liquidity, and firm size significantly influence payout ratios, with implications for shareholder wealth creation.

Further, Kumar and Sujit (2018) explored the impact of dividend payout on stock price volatility, finding a negative correlation that underscores the stabilizing effect of consistent dividend payments. This aligns with findings by Baskin (1989), who argued that higher dividends reduce uncertainty and attract risk-averse investors, thus contributing to stock price stability. Studies focusing on the Indian context, such as those by Reddy (2002) and Pandey (2001), revealed that dividend payout policies in Indian firms are heavily influenced by market expectations and regulatory frameworks, particularly in sectors like banking, which operate under stringent oversight. Al-Malkawi et al. (2010) conducted a comparative analysis of dividend policies in emerging markets and found that firms with higher payout ratios often demonstrate greater financial discipline, contributing positively to shareholder wealth.

In the context of the banking sector specifically, Karpavičius (2014) analyzed dividend smoothing behavior and reported that banks prioritize consistent payouts to signal financial health, especially during periods of economic uncertainty. Similarly, Benartzi et al. (1997) found that changes in dividend policies are closely monitored by investors as an indicator of future earnings prospects, reinforcing the importance of stable payout strategies. For public sector banks, Gupta and Banga (2010) emphasized the role of government ownership in shaping dividend policies, highlighting how such institutions often prioritize stakeholder welfare over profit maximization, a trend less evident in private banks. In contrast, research by Ahmed and Javid (2009) on private banks indicated that dividend payouts are more closely tied to profitability and growth opportunities, reflecting a shareholder-centric approach.

More recent studies, such as those by Mehta (2020) and Bhatia and Yadav (2021), have examined the role of corporate governance in influencing dividend policies. They observed that firms with robust governance frameworks are more likely to adopt transparent and shareholder friendly dividend strategies, which enhance trust and wealth creation. Supporting this, Aivazian et al. (2003) demonstrated that firms with higher institutional ownership tend to maintain stable dividend payouts, reflecting a commitment to shareholder value. Additionally, Subramaniam and Devi (2022) highlighted the role of financial performance indicators like return on equity (ROE) and earnings per share (EPS) in determining dividend policies, particularly in the highly regulated banking sector. Finally, Jensen's (1986) free cash flow theory remains relevant, as studies like those by Adjaoud and Ben-Amar (2010) argue that distributing excess cash as dividends can mitigate agency problems and enhance shareholder wealth.

Methodologies

This study employs a purposive sampling method to select the top five banking companies from both the public sector and private sector in India, based on their market capitalization as of 31st March 2024. Market

capitalization is chosen as the criterion for sampling because it reflects the relative size and market value of the companies, ensuring the inclusion of industry leaders that significantly influence shareholder wealth. The primary focus of the research is to analyze the dividend payout ratios of these selected banks for the financial year 2023-24. Dividend payout ratio, a key metric that reflects the proportion of net earnings distributed to shareholders in the form of dividends, is used to assess the relationship between dividend policies and wealth creation. Data for the study is collected from audited financial statements, annual reports, and other publicly available disclosures of the selected banks. The analysis involves comparing the dividend payout strategies of public sector and private sector banks to identify patterns, trends, and potential disparities. This comparative approach enables a deeper understanding of how institutional frameworks, governance structures, and operational objectives influence dividend decisions and their implications for shareholder wealth. Statistical tools and techniques are employed to derive meaningful findings and establish the relationship between dividend payouts and wealth creation, contributing to the broader discourse on corporate financial management in the Indian banking sector.

Data Analysis and Interpretation

The table -1 below provides an overview of the top private and public sector banks in India, based on market capitalization as of March 2024. This table also includes the dividend payout ratios for the financial year 2023-24, which reflect the proportion of profits distributed as dividends to shareholders. The selection is based on banks with the highest market capitalization in their respective sectors, their financial strategies, shareholder rewards, and operational size. Public sector banks tend to have more conservative payout policies due to their social obligations, while private sector banks might show higher payout ratios reflecting their focus on profitability and shareholder value.

Table – 1 Market Capitalization and Dividend Payout Ratio of Top five Public Sector and Top five Private Sector

Sr.No.	Name	Market Capitalization (as on 31 st March 2024) (Rs. In Cr.)	Dividend Payout Ratio (%) (2023-24)
Private Sector Banks			
1	HDFC Bank	1425692.81	15.25
2	ICICI Bank	949870.87	11.76
3	Kotak Mah. Bank	358654.97	1.35
4	Axis Bank	356026.51	1.09
5	IDBI Bank	87664.28	15.90
Public Sector Banks			
1	State Bank of India	768231.41	14.09
2	Bank of Baroda	134052.39	14.25
3	Punjab National Bank	124307.58	4.78
4	Indian Overseas Bank	105928.99	0.00
5	Union Bank (I)	98435.85	13.28

Private Sector Banks:

- **HDFC Bank:** With the highest market capitalization among private sector banks, HDFC Bank has a solid dividend payout ratio of 15.25% for FY 2023-24. This reflects its robust profitability and focus on rewarding its shareholders.
- **ICICI Bank:** ICICI Bank follows with a market cap of ₹949,870.87 crore, offering a slightly lower dividend payout of 11.76%, which still indicates a strong commitment to shareholder returns.
- **Kotak Mahindra Bank:** Despite its relatively smaller market capitalization of ₹358,654.97 crore, Kotak Mahindra Bank has a low dividend payout ratio of just 1.35%, highlighting a more conservative approach to distributing profits.
- **Axis Bank:** Axis Bank, with a market capitalization of ₹356,026.51 crore, also shows a modest dividend payout ratio of 1.09%, focusing more on reinvestment for growth.
- **IDBI Bank:** IDBI Bank, though having a smaller market capitalization of ₹87,664.28 crore, offers the highest dividend payout ratio among private banks at 15.90%, demonstrating its focus on capital distribution.

Public Sector Banks:

- **State Bank of India (SBI):** SBI, the largest public sector bank, has a market capitalization of ₹768,231.41 crore and offers a dividend payout ratio of 14.09%, reflecting its financial stability and shareholder-oriented policies.
- **Bank of Baroda:** With a market capitalization of ₹134,052.39 crore, Bank of Baroda maintains a competitive dividend payout ratio of 14.25%.
- **Punjab National Bank (PNB):** PNB has a lower payout ratio of 4.78% despite its significant market capitalization of ₹124,307.58 crore, reflecting its conservative approach to dividend distribution.
- **Indian Overseas Bank (IOB):** Indian Overseas Bank, with a market cap of ₹105,928.99 crore, offers no dividend payout in FY 2023-24, possibly due to financial restructuring or reinvestment strategies.
- **Union Bank of India:** Union Bank of India rounds out the list with a market capitalization of ₹98,435.85 crore and a dividend payout ratio of 13.28%, showing its commitment to maintaining shareholder returns while focusing on growth.

The contrast in dividend payout ratios between public and private sector banks provides an interesting finding related to their financial management practices. Public sector banks tend to be more cautious in their dividend policies, which could be influenced by their larger social responsibilities and government oversight. In contrast, private sector banks like HDFC and ICICI have a greater flexibility in terms of dividend payouts, often distributing a larger share of profits to shareholders to enhance their appeal to investors.

Impact of Dividend Payout Ratio on Market Capitalization in Banking Sector

The relationship between dividend payout ratios and market capitalization has been a subject of extensive research in financial management, particularly within the banking sector. The dividend payout ratio (DPR) represents the portion of a company's earnings distributed to shareholders in the form of dividends. In the banking sector, this metric is often used by investors to gauge the financial health and shareholder value creation of a bank.

Null Hypothesis (H_0) = There is no significant impact of Dividend Payout Ratio on Market Capitalization of banking sector

Alternate Hypothesis (H_1) = There is significant impact of Dividend Payout Ratio on Market Capitalization of banking sector

Results of the Regression Analysis

Table – 2 Regression Statistics

Multiple R	0.35
R Square	0.12
Adjusted R Square	0.01
Standard Error	457063.02
Observations	10.00

Table – 3 ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1.00	227377927924.43	227377927924.43	1.09	0.33
Residual	8.00	1671252863267.90	208906607908.49		
Total	9.00	1898630791192.33			

Table - 4 Coefficient

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	218059.06	257893.80	0.85	0.42
Dividend Payout Ratio	24284.56	23277.28	1.04	0.33

The results of the regression analysis suggest that there is no significant impact of the Dividend Payout Ratio (DPR) on the Market Capitalization of the banking sector. The Multiple R value of 0.35 indicates a weak positive correlation between the variables, but this is not strong enough to conclude a meaningful relationship. The R Square value of 0.12 and Adjusted R Square value of 0.01 suggest that only a small proportion (12%) of the variation in market capitalization can be explained by changes in the dividend payout ratio. The Standard Error of 457,063.02 further indicates considerable variability in the data, which adds to the uncertainty of the relationship. The ANOVA results show a F-statistic of 1.09, which is low, and the Significance F value of 0.33 is much higher than the typical significance level (0.05), suggesting that the regression model is not statistically significant. In addition, the coefficient for the Dividend Payout Ratio is 24,284.56, with a p-value of 0.33, which is above the significance threshold of 0.05, further supporting the conclusion that the dividend payout ratio does not significantly affect market capitalization. These results lead to the acceptance of the null hypothesis (H₀), indicating that there is no significant impact of the Dividend Payout Ratio on the Market Capitalization of the banking sector. This aligns with findings in previous research, such as the work of Fama and French (1998), which suggests that dividend payouts in the banking sector may not always have a direct influence on market valuation.

Conclusion

The study examining the impact of Dividend Payout Ratio (DPR) on Market Capitalization in the banking sector has revealed important findings related to the relationship between these two variables. Based on the regression analysis and ANOVA results, it can be concluded that there is no significant impact of the Dividend Payout Ratio on the Market Capitalization of banks. The low R-square value of 0.12 and the high p-value of

0.33 in the regression coefficients suggest that changes in the dividend payout policy do not significantly affect the market capitalization of the banks in this study. The lack of statistical significance (with a p-value higher than 0.05) further supports the acceptance of the null hypothesis, indicating that the dividend payout policy might not be a critical factor influencing the market value of banking institutions.

These findings align with the Modigliani-Miller theorem (1961), which argues that, in perfect markets, dividend payouts do not influence a company's overall market value. However, this study contrasts with some other research, such as that by Miller and Rock (1985), which suggests that dividends may signal a firm's future prospects, thereby influencing market perceptions and stock prices. The discrepancy could be attributed to the specific characteristics

of the banking sector, which often operates under stringent regulatory frameworks and government oversight, leading to less sensitivity to dividend changes. Additionally, as observed in Fama and French (1998) and Grullon and Michaely (2002), banks may not always exhibit the same market behaviors as non-financial firms, due to their unique operational and financial structures.

In contrast to private sector banks, which may have more flexibility to adapt their dividend policies, public sector banks often face constraints in their payout decisions due to government regulations and socio-economic obligations. This difference in operational context could explain the limited impact of dividend payout ratios on the market capitalization of both public and private sector banks.

References

1. Aivazian, V., Booth, L., & Cleary, S. (2003). Do emerging market firms follow different dividend policies from U.S. firms? *Journal of Financial Research*, 26(3), 371-387.
2. Ahmed, H., & Javid, A. Y. (2009). Dynamics and determinants of dividend policy in Pakistan: Evidence from Karachi Stock Exchange. *International Research Journal of Finance and Economics*, 25, 148-171.
3. Al-Malkawi, H.-A. N., Rafferty, M., & Pillai, R. (2010). Dividend policy: A review of theories and empirical evidence. *International Bulletin of Business Administration*, 9, 171-200.
4. Baker, H. K., & Powell, G. E. (1999). How corporate managers view dividend policy. *Quarterly Journal of Business and Economics*, 38(2), 17-35.
5. Baskin, J. (1989). Dividend policy and the volatility of common stocks. *Journal of Portfolio Management*, 15(3), 19-25.
6. Benartzi, S., Michaely, R., & Thaler, R. (1997). Do changes in dividends signal the future or the past? *Journal of Finance*, 52(3), 1007-1034.
7. Bhatia, A., & Yadav, R. (2021). The role of corporate governance in dividend policy decisions: Evidence from India. *Corporate Governance: An International Review*, 29(1), 79-96.
8. Gordon, M. J. (1959). Dividends, earnings, and stock prices. *Review of Economics and Statistics*, 41(2), 99-105.
9. Gupta, P., & Banga, C. (2010). The determinants of dividend policy: A study of Indian banking sector. *International Research Journal of Finance and Economics*, 40, 134-144.
10. Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance, and takeovers. *American Economic Review*, 76(2), 323-329.
11. Karpavičius, S. (2014). Dividend smoothing: Evidence from the US banking sector. *Journal of Corporate Finance*, 25, 540-556.
12. Khan, T., Naz, H., & Gul, S. (2011). Factors influencing dividend policy of commercial banks in Pakistan. *International Research Journal of Finance and Economics*, 77, 67-77.
13. Kumar, N., & Sujit, K. (2018). Dividend policy and stock price volatility: Evidence from India. *Global Business Review*, 19(3), 1-16.

14. Mehta, A. (2020). Impact of corporate governance on dividend policy: Evidence from Indian banks. *Asian Journal of Management Studies*, 5(2), 122-136.
15. Miller, M., & Modigliani, F. (1961). Dividend policy, growth, and the valuation of shares. *Journal of Business*, 34(4), 411-433.
16. Pandey, I. M. (2001). Corporate dividend policy and behavior: The Malaysian experience. *Asia Pacific Journal of Management*, 18(1), 81-103.
17. Reddy, Y. S. (2002). Dividend policy of Indian corporate firms: An analysis of trends and determinants. *Journal of Finance and Economics*, 10(2), 57-73.
18. Subramaniam, V., & Devi, S. (2022). Determinants of dividend policy in the Indian banking sector. *Journal of Financial Studies*, 35(4), 232-247.