Ch 5 - DIVIDEND DECISION (Chart- 5.1)

BASIC FORMULAS

- Dividend Per Share (DPS) = $\frac{\text{Total Equity dividend}}{\text{No. of Equity Shares}}$
- Dividend Rate(%) = $\frac{\text{Dividend Per Share}}{\text{Face Value per share}}$
- Dividend Yield (%) = $\frac{\text{Dividend Per Share}}{\text{Market price per share}}$
- Payout Ratio (%) = $\frac{\text{Dividend Per Share}}{\text{Earnings per share}}$
- Retention Ratio (b) = 100 – Payout Ratio, (or) $\frac{\text{Retained Earning}}{\text{Residual Earnings}}$

SWAPNIL PATNI'S CLASSES

Ch 5 - DIVIDEND DECISION (Chart- 5.2)

APPROACHES TO DIVIDEND POLICY

1 Water's Approach

Theoretical Market Value of Equity Share= $\frac{D + (E - D) \times \frac{R}{Ke}}{Ke}$

Where, D = Dividend per share
E = Earning per share
Ke = Cost of Equity Capital
R = Internal rate of Return

2 Gordon's Model

$P = \frac{D_1}{Ke-g}$ (with growth) $P = \frac{D_1}{Ke}$ (without growth)

Where, P = Theoretical share Price
g = Growth Rate
D_1 = Dividend of Next Year
Ke = Cost of Equity capital

Conclusion: If R > Ke — Payout of Dividend should be Minimum
If R < Ke — Payout of Dividend should be maximum &
If R = Ke — Dividend payout can be anywhere between 0-100%

3 Modigliani & Miller's Approach (MM Hypothesis)

1) Dividend Not Paid
$P_1 = P_0(1+Ke)$

2) Dividend Paid
a] $P_1 = P_0(1+Ke)-D_1$
b] $P_0 = \frac{P_1+D_1}{1+Ke}$

3) Change in No. of Shares
$\Delta n = \frac{I-(E-D)}{P1}$

4) Market Value of Next Year
$MV_1 = n_1 \times p_1$

Where, P_1 = Price of Next Year
P_0 = Price of Current Year
Ke = Cost of Equity
D_1 = Dividend of Next Year / Expected Dividend
I = Investment
E = Earnings / Profit of the Firm
n_1 = Existing no. of shares + New no. of shares

4 Lintner's Model

$D_1 = D_0 + [(EPS \times \text{Target Payout}) - D_0] \times Af$

Where, D_1 = Dividend of period 1
D_0 = Dividend of Period 0
EPS = Earning per share
Af = Adjustment Factor

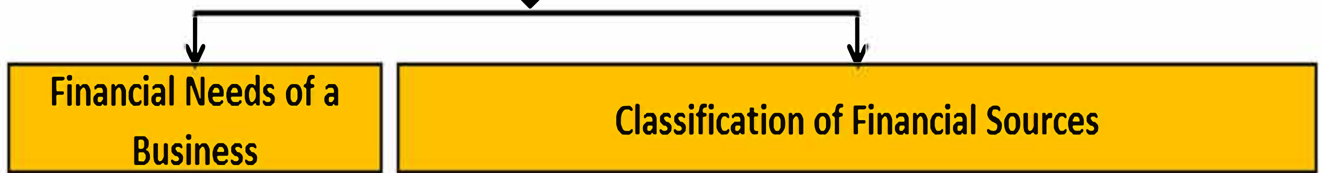
5 Traditional or Graham & Dodd Model

$P = m \left[D + \frac{E}{3} \right]$

Where, P = Market Price
m = Multiplier
D = Dividend per share
E = Earning per share

CA INTERMEDIATE All India Rankers of Nov 2018.
Studied LAW From CA Ankita Patni

Ch 6 :- Types of Financing (Chart 6.1)



Financial Needs of a Business

i) Long-term financial needs

Such needs generally refer to those requirements of funds which are for a period exceeding 5-10 yrs.

ii) Medium-term financial needs:

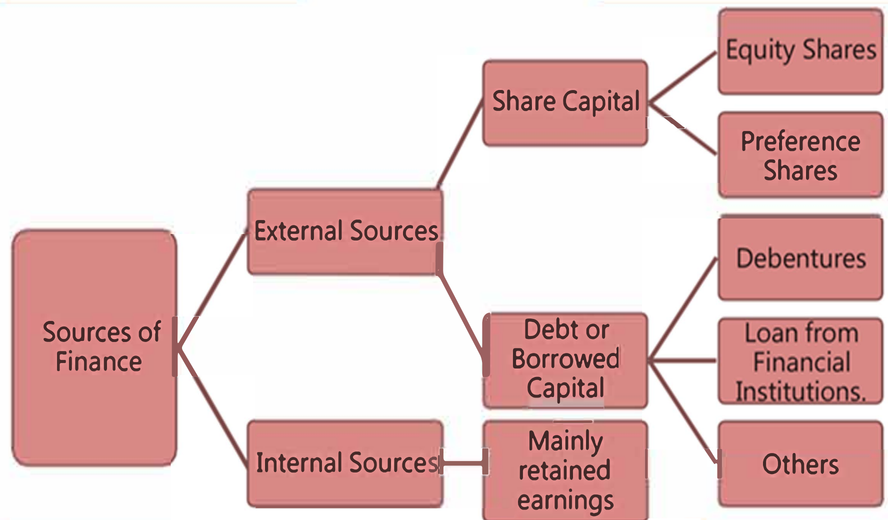
Such requirements refer to those funds which are required for a period exceeding 1 yr but not exceeding 5 yrs

iii) Short- term financial needs

Such type of financial needs arises to finance current assets such as stock, debtors, cash, etc. Investment in these assets is known as meeting of working capital requirements of concern

Classification of Financial Sources

i) Based on basic Sources



ii) Based on Maturity of repayment period

Long Term	Medium Term	Short Term
1) Share capital or Eq sh 2) Preference shares 3) Retained earnings 4) Debentures/Bonds of different types 5) Loans from FI 6) Loans from State Financial Corporations 7) Loans from commercial banks 8) Venture cap. funding 9) Asset securitization 10) International financing like Euro-issues, Foreign currency loans	1) Preference shares 2) Debentures/Bonds 3) Public deposits/ fixed deposits for duration of 3 yrs 4) Medium term loans from Commercial banks, Financial Institutions, State Financial Corporations 5) Lease financing/ Hire-Purchase financing 6) External commercial borrowings 7) Euro-issues 8) FC bonds	1) Trade credit 2) Accrued expenses and deferred income. 3) Short term loans like Working Capital Loans from Commercial banks 4) Fixed deposits for a period of 1 year or less 5) Advances received from customers. Various short-term provisions

Ch 6 :- Types of Financing (Chart 6.2)

Long Term Sources of Finance

I) Owners Capital or Equity Capital

a) Characteristics

1) Source of permanent capital
2) owners of company as they undertake highest risk
3) Eq. SH entitled to dividends. dividend payable to them is an appropriation of profits & not a charge against profits.
4) In event of winding up, ordinary shareholders can exercise their claim on assets after claims of other suppliers of capital have been met
5) There can be various types of equity shares like New issue, Rights issue, Bonus Shares, Sweat Equity

b) Advantages of raising funds by issue of equity shares

1) permanent source of finance
2) company has no liability for cash outflows associated with its redemption.
3) helps further borrowing powers of co.
4) company is not obliged legally to pay dividends
5) company can make further issue of share capital by making a right issue

c) Disadvantages of raising funds by issue of equity shares

i) cost of ordinary shares is higher
ii) Investors find ordinary shares riskier
ii) issue of new eq. shares reduces EPS & ownership and control of existing SH.

II) Preference Share Capital

a) Characteristics

1) can be raised through a public issue of shares
2) Such shares are normally cumulative
3) rate of dividend on is normally higher
4) carry a stipulation of period & funds have to be repaid at end of a stipulated period.
5) It is a hybrid form of financing which imbibes within itself some characteristics of eq. capital & some attributes of debt capital
6) Cumulative Convertible Pref. Shares may also be offered
7) It may be redeemed at a pre decided future date or at earlier stage inter alia out of profits of company

b) Various types of Preference shares

Type of Pref. Shares	Salient Features
i) Cumulative	Arrear Dividend will accumulative
ii) Non-cumulative	No right to arrear dividend
iii) Redeemable	Redemption should be done
iv) Participating	Participate in surplus of firm
v) Non- Participating	Over fixed rate of Dividend
vi) Convertible	Option of Convert into eq. Shares

c) Advantages

i) No dilution in EPS on enlarged capital base
ii) Non-payment of pref. dividends does not force company into liquidity.
iii) No risk of takeover, as they don't have voting rights
iv) can be redeemed after a specified period.

d) Disadvantage

i) preference dividend is not tax deductible & so does not provide a tax shield to co.
ii) Preference dividends are cumulative in nature. although these dividends may be omitted, they shall need to be paid later