# Dividend Decissions



→ Dividend decission effect the shareholders wealth

- Yes → Theories of relevance
  - (i) Walter Model
  - (ii) Gordan's Model
- No → Theories of irrelevance
  - (i) Modigliani & Miller's Model.

(i) → Walter's Approach :-

Company has earned profit.

Two choices for declaring that profit.

- Dividend → Ke.
- Retain in business → R.

Therefore we conclude

$R > Ke$ → Retain

$R < Ke$ → Declare dividend

$R = Ke$ → Distribution or retain.

$$P_0 = \frac{D + r/ke\,(E - D)}{ke}$$

$P_0$ = Value of shareholders / market price of a share

$D$ = Dividend per share

$R$ = IRR of new projects

$ke$ = Return shareholder expects if he invest outside.

$E$ = Earnings per share

$E - D$ = Retained earnings

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→ Gordon Approach:-

$$P_0 = \frac{E(1-b)}{K_e - br} \qquad G = BXR.$$

$P_0$ = Market price of a share
$E$ = Earnings per share
$b$ = retention ratio, $(1-b)$ = Dividend payout ratio
$K_e$ = Required rate of return
$r$ = Return from Investement.

→ Modigliani miller Approach:-

(i) Market price of the share

$$P_0 = \frac{P_1 + D_1}{1+K_e}$$

(ii) No. of shares to be issued for investment

$$mP_1 = I - (E - nd_1)$$

$m$ = no. of shares to be issued, $P_1$ = Price of share at the time of issue, $E$ = Earnings, $E - nD_1$ = retained Earnings.

(iii) Value of the company ⇒

$$nP_0 = \frac{P_1(n+m) - I + E}{1+K_e}$$

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→ Right issue :-

(a)

Theoritical Right value (X) = $\frac{\text{Market price before right } (M) \times \text{No. of shares before right } (N) + \text{No. of right shares } (R) \times \text{subscription price of right } (S)}{\text{No. of R.}}$

(b) Right value :- R.V = No. of (M − X)

R = No. of right shares

S = subscription price of right.