Welcome to this module that

is a part of the Course title

financial management in Semester 6.

The title of the unit is

Unit 1 dividend policy.

The module name is models related to

investment and dividend decisions.

Walters model.

Dividend decisions is one of the most

important financial management decisions.

The decision to be taken here

is out of the earnings.

How much is to be given to the

shareholders in the form of

dividends and how much is to

be retained by the company.

As retained earnings,

the payment of dividend can

have two opposing effects.

One when you give dividends,

definitely it increases

the prices of the shares, but at the same time there is a reduction in the funds available for investment. Due to which there is a reduction in the expected rate of expected growth rate of the form and thereby the share prices decline. Therefore, it is very important to have an optimal dividend policy that is to maintain or to balance a or to strike a balance between the current dividends and the future growth rate. That is the retained earnings. There are conflicting theories regarding the dividend decisions and its impact on the value of the form. These theories can be classified into two schools or groups, namely relevant theories and irrelevant theories.

Relevant theories say argue that relevant theories argue that there is an impact of the dividend decisions on the value of the form. There are two relevant theories that is 1 Walters model an second Gordon's model. In this module we would cover the Walters model. The learning outcome of this module would be at the end of the module. You will be able to understand the relevancy of current cash dividends in establishing a positive impact on the value of the form as per the Walters model. James Walter has proposed a model of share valuation that supports the view that the dividend policy of an enterprise has an impact on the value of the enterprise. The model proposal,

a relationship between one the return on forms investment or also called as the internal rate of return. And its cost of capital, also called us the required rate of return or the minimum rate of return. The model also divides forms into three groups based on. The relationship between the return on investment and the cost of capital. These three groups are first growth forms, second normal forms and 3rd declining forms. As for the Walters model, when the return on investment is more than the cost of capital, such kind of a form would be called as a growth form. Second, when the return on investment is equal to the cost of capital, this kind of this kind of a form

would be called a normal form. And the third classification is when the return on investment is less than the cost of capital. That is the declining form. As for the Walters model, depending on these relationship between R&K. For each of these forms, the optimal dividend ratio is given as follows. For growth forms, when dividend payout ratio is 0%, that means out of the earnings you give nothing as dividends. You keep full 100% as retained earnings in that case. The film's value would be maximum. Whereas for normal forms it makes no difference whether you retain the full earnings as retained earnings or you distribute the earnings in the form of dividends.

The third case, that is the declining forms. The Walters model suggests that if you have. A dividend payout ratio of 100%, that is, when the value of the form wouldn't maximized. There are some assumptions to the Walters model. They are all profitable. Investments are financed through retained earnings, which is internal financing, which means external sources like dead or fresh equity are not issued. The second assumption is the firm's return on investment and cost of capital are constant. The third assumption would be all earnings are either distributed as dividends or reinvest reinvested internally immediately. That means 100% payout or 100% retention.

Big inning earnings and

dividends never change.

That is,

EPS and EPS may be changed in

the model just to determine

its affective share price,

but any given changes in EPS

and DPS remain constant forever.

EPS and DPS would mean earnings per

share and dividend per share respectively.

The form has an in finite that

is a perpetual life.

Coming to the Walters model Formula,

Walter has given the following

formula for determining the market

price or value of the share.

According to this Formula,

P stands for price per equity share.

That is nothing but value of

the share in the market.

D stands for dividend per share.

R stands for rate of return on investment. KE stands for cost of capital. E stands for earnings per share and E --D stands for retained earnings per share. That means out of the earnings when dividends are subtracted, what you would have is the retained earnings. What does model is better understood with an illustration? The following form information is available in respect of a form. You are required to show the effect of dividend payment on the market price using the Walters model. There are three cases which are provided. That is, when dividend payout ratio is zero percent. When dividend payout ratio is 50%, that means 50% is retained. An when dividend payout ratio is 100%. That means zero percent is retained.

Earnings per share is given as rupees 40, an cost of capital is given as 10%. He let me assume the rate of investment. Again. There are three cases given here. First, when the rate of investment is 13%, when the rate of investment is 10% and the third case that is 8%. Let's look at the first case. That is for a growth form where the return on investment is higher than the cost of capital. That is the return on investment is 13%, which is higher than the cost of capital that is 10%. In these three cases, given where case one, the dividend payout ratio is 0%. That means the company retains 100% of its earnings and does not give anything in the form of dividends to its shareholders.

Similarly, case two,

when dividend payout ratio is 50%, which means only 50% of the earnings are given as dividends. The rest 50% is kept as retained earnings. Case 3 is when dividend payout ratio is 100%. That would mean that the whole earnings that is owned by the form would be given in the form of dividends to its shareholders and the retention would be 0% for a growth form. Given these three cases, you would notice that when the form when the values are Subs. When the values are substituted. The share price is maximum in case of case one. That is when the dividend payout ratio is 0%, which means when you retain 100% of your earnings for a given, your if it's a growth form,

then the share value would be maximum that is rupees 520 as compared to rupees 460 and rupees 400 in the other two cases. Similarly, considering for a normal form, that is where R is equal to K, which means the return on investment is equal to the cost of capital of the form that is, return on investment is also 10% and the cost of capital is also 10%. That means the cost that you pay for the funds that you have invested is equal to the return that you're getting on the same investment. You're also given. You're also taking all the three cases. Case one when dividend payout ratio is 02, case 3. When dividend payout ratio is 100%, you would notice that for a normal form, irrespective of the dividend payout ratio. This would remain 400.

That means the dividend decision do not impact. Do not have any impact on the value of the share when. The return on investment is equal to the cost of capital. The third case would be the case for a declining form. For a declining form, that is when the return on investment is lesser than the cost of capital. That is, given your as 8%, which is lesser than 10%. You would notice that for case three, that is, when dividend payout ratio is 100% and the company does not retain anything in the business, the company gives full of its earnings to its shareholders in the form of dividends. That is, when the share price

In the previous two cases that this case one and case 2IN case of a declining form, the share price is rupees 320 and rupees 360. The interpretation and conclusion of voters model would be given that there are three types of forms, growth forms, normal forms and declining forms. For growth forms, the market price or value of the share would decline. With the increase in dividend per share, so to have an optimal dividend policy or to have the maximum share price or to have the maximum value of share the optimum dividend payout ratio would be 0%. In case of a normal form where the market price or value would be stable if the dividend per share increases, this would mean that there is no optimum dividend payout ratio and the dividend decisions would not have

is maximum that is at at 400.

any impact on the value of the form. The third case, that is the declining forms, the market price or the value of the form would increase when the dividend would also increase. Therefore, the optimum dividend payout ratio for declining forms would be 100%. That means the company should not retain anything in the business. It should give full of its earnings to its shareholders in the form of dividends. These are some of the references for your further reading. Thank you.