Shareholders' Rights:

Dividend Policy is Divided Policy

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Conservative investors tend to park their funds in fixed-rate instruments, with a preference for deposits that earn a simple rate of interest and pay out returns only on maturity. Aggressive investors, on the other hand, prefer to invest in the share capital of listed companies, hoping to receive periodic returns in the form of dividends, with some capital appreciation over the year. For their part, companies must be careful about their dividend policy. They must retain a certain amount of cash to cope with possible downturns, while also offering attractive enough pay-outs to draw investors, who have various investment options.

Perhaps oddly, while the new Companies Act specifies a whole slew of policies related to disclosures, CSR, director appointment and remuneration, risk management, and so on, it does not require organisations to follow a specific dividend policy – something that would be of great benefit to investors. (However, it has eased the earlier requirement of having to transfer profits to reserves before paying out any dividend, and it has allowed firms to pay dividends on previous years' profits.) Neither do any of India's financial-sector regulators – the RBI and SEBI in particular – specifically address this area.

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However, the issue has now acquired some urgency, given a growing number of complaints from investors. Many large companies, including Whirlpool, First Source and HDIL, have failed to pay out dividends, despite sitting on huge piles of cash. Conversely, firms like Sun Pharma, BASF India and Bajaj Electronics are paying out dividends while making losses, and prior to its IPO, Indigo distributed hefty dividends to its promoters. In response to these developments, SEBI recently said that it might compel firms to disclose their dividend policy in the IPO prospectus, and SEBI's International Advisory Body has suggested possibly mandating a dividend distribution policy for all listed corporates.

Recent government interventions

In a recent memorandum, the Central government stated that central public sector enterprises (CPSEs) shall declare an annual dividend of 30 per cent of profit after tax (PAT), or 30 per cent of the government's equity, whichever is higher. (The earlier norm, established in 2004, was 20 per cent of PAT or 20 per cent of equity, but 30 per cent for CPSEs in the petroleum, chemical and infrastructure sectors.) According to the ministry there are huge variations in dividend pay-outs, with many CPSEs not adhering to the guidelines. Specifically on the banking sector, RBI Governor Raghuram Rajan recently said that the government should not

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interfere in the running of state-run banks, but he also argued that it might be necessary to privatise them to achieve this goal. He also suggested reducing dividend payments if a bank is less than healthy. All considered, it is worth considering entirely exempting PSU banks – many of whom are sitting on a pile of bad loans due to stalled projects – from paying dividends.

CSR versus dividend distribution...

Unique to India, the Companies Act mandates that firms spend at least 2 per cent of their pre-tax profit (averaged over three years) on specified CSR activities. In contrast, shareholders – who, by right, own the profits of the company – have no right to demand a dividend pay-out, but only to receive it when the Board declares it. The upshot is that, whether shareholders receive their share or not, the company has to spend on CSR.

...and how a dividend policy would help

The objective of a dividend policy is to ensure regular dividend income for shareholders, and long-term capital appreciation for all stakeholders. A well-articulated policy helps the company strike the right balance between the quantum of pay-outs and the amount of profit retained for various purposes. It is also something that management can refer to while recommending or declaring dividends. Good governance practices, in fact, demand a clear, consistent policy that specifies a basis for paying dividends. Arguably, companies might even consider moving a step further, to having a 'retention policy', whereby they need shareholder approval to retain cash, and must disclose how they plan to utilise the money.

Several companies, including Dabur, Infosys, ONGC, and HDFC Bank already have a dividend distribution policy posted on their website, but it is not mandatory for them to do so, and thus, there is no uniformity in policies. Ideally, though, all companies should have such a policy, which they should make available in the public domain – allowing investors to take more informed investment decisions. SEBI must take an immediate call on this, keeping in mind the broader interest of investors. ■

(The views expressed are personal)