DIVIDEND POLICY DECISIONS – A CASE STUDY OF RELIANCE INDUSTRIES LIMITED (RIL)

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The test for any company, from the perspective of its shareholders, is the sustained price performance of its equity share. Market share, size of business, competitive advantage, profit numbers, and all other parameters are important, but at the end of the day, shareholders may judge a company primarily on the basis of the returns earned on their equity investments. Viewed from this perspective, the decision on the dividend policy is an important financial decision for any listed company. It determines the amount of net profits that a company would distribute amongst its shareholders, and the amount ploughed back / retained, into the business. The present paper examines the dividend policy of India's largest public listed company, Reliance Industries Limited (RIL). Evidently, it would prefer the decision which has a favorable/salutary effect on the wealth of shareholders. Irrespective of conflicting opinions in literature, regarding the impact of dividend on the valuation of a firm/wealth of shareholders, the broad consensus and evidence seems to be in the favor of relevance of dividend policy. Amongst other findings on RIL's dividend policy aspects, a notable one is the pursuance of a stable dividend policy by RIL, for the period under reference.

INTRODUCTION

RIL saw its inception in 1963, by one of India's greatest entrepreneurs, Shri Dhirubhai Ambani. Starting off as a small textile manufacturing unit, it was incorporated in 1973 and the name confirmed as RIL in 1985. RIL is the largest private-sector enterprise in India in terms of revenues, profits, net worth, assets and market capitalization. The company has overseas operations in more than 100 countries.

The performance of RIL equity shares has been attractive over a period of time to all investors. In the 1980s and early 1990s, RIL raised significant equity financing for its projects, through several offerings. RIL's long-term share price performance has been

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amongst the best in the country. The Bombay Stock Exchange listed RIL shares in January 1978, after the company's offer for sale of 2.82 million shares. In the succeeding 23 years, RIL's turnover has grown 418 times, and its net profit has grown nearly 1,000 times. Reflecting this growth, the value of RIL shares has increased exponentially. (Source: RIL annual report, 2002)

An original investor of 100 shares in the maiden public offering, and who subscribed to every rights issue of equity shares and convertible debentures, would have invested Rs. 46,379. By 2002, that investment would have fetched him 2,174 shares (a multiplication of holding by more than 20 times), including 1,310 bonus shares, valued at Rs. 7,60,900 at the average market price in April 2001, with a total dividend of Rs.79,270. This translates into a rate of return of 29% per annum, compounded for 23 years. For an investor who subscribed to 100 shares in the maiden offering, and then did not subscribe to any of the subsequent issues, an original investment of Rs. 1,000 would result in a holding of 512 shares (including 412 bonus shares), valued at Rs. 1,79,200, at the average price in April 2001. This investment would also have generated Rs. 24,765 as dividends over this period, resulting in a total compounded annual rate of return of a rather staggering 44% per annum. (Source: RIL annual report, 2002).

RIL lays down the following values that drive its overall dividend policy – understanding of the market and timing of market entry; benchmarking against global competition; focusing on profitable growth; financial discipline; and, constant striving for management excellence.

For better exposition, this paper has been divided into seven sections. Section I lays down the objective, rationale, scope and methodology of the paper. Section II contains a brief literature review concerning dividend decisions and the resultant company valuations. Section III is concerned with determining the dividend payout ratios of RIL. Determinants of dividend policy and whether RIL has preference to pursue stable dividend policy constitutes the subject matter of section IV. Section V examines the impact of dividend policy on its share price. Company's valuation from the point of view of potential buyers is discussed in section VI. Analysis and findings are enumerated in Section VII. Concluding observations are listed in section VIII.

Section I

Objective, Rationale, Scope and Methodology

The objective of the paper is to have a comprehensive analysis of the dividend policy, dividend decisions and practices followed by RIL over the past ten years (2001-2010) through a study of its financial results and performance. The study has academic as well as practical significance. It would provide insight into the practices the company has adopted related to its dividend policy for its shareholders, and the efforts undertaken to ensure wealth maximization of its shareholders. The scope of the study is limited to the ten year period 2001-2010.

Research Methodology

Research methodology adopted in the present study to analyze financial statement of RIL is as follows:

Secondary Data and Analysis: Most of the analysis has been carried out based on secondary data. Secondary data sources includes annual reports of the company, management presentations to investors, research reports related to company, company press releases, websites of Bombay stock exchange and National stock exchange, and online databases – Capitaline and ISI Emerging Markets.

Data Analysis: Financial ratios are used extensively for this study. The key financial ratios have been computed for all major aspects of dividend decisions. For example, dividend payout ratio is the main ratio to understand dividend payment and earnings retention. The relevant data in terms of dividend on equity (face value), EPS, DPS and retention per share have also been computed. These ratios are computed on a year-to-year basis for RIL. The impact of the dividend policy of RIL on its share price has also been examined. To study the trends and implications, data has been divided into two sets. First set consists of years 2001-2005, designated as phase I and second set consists of years 2006-2010, designated as phase II. The rationale for phase II with effect from 2006 stems from the fact that the corporate governance clause has been mandated by SEBI, from April 1, 2006.* Means for both these sets and for the entire data set are calculated to

* The Securities Exchange Board of India (SEBI) had initially mandated the adherence of clause 49 of corporate governance (for all listed companies) from April 1, 2004. However, there were modifications made to clause 49, based on the recommendations of the Narayan Murthy committee on corporate governance. The modified clause 49 came into effect from January 1, 2006 and all listed companies were mandated to adhere to clause 49 with effect from April 1, 2006. (*Source:* The official website of SEBI: http://www.sebi.gov.in/)