

Dividend Policy Decisions and Shareholder Wealth: Evidence from Indian Banking Sector

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ABSTRACT

Dividend policy plays an essential role in corporate finance. It helps investors understand a firm's valuation. Dividend, an essential portion of a firm's finances, is the amount of the profit paid back to the shareholders. This study focuses on understanding dividend policy decisions on the wealth of the shareholders. Furthermore, this study focuses on the five leading Indian public sector banks and includes State Bank of India (SBI), Punjab National Bank (PNB), Bank of Baroda (BoB), Canara Bank, and Union Bank. The analysis has been carried out for 5 years i.e. FY 2021-25 and focuses on two major attributes i.e. capital gains and dividend, that compose an integral part of the Total Shareholder Return (TSR). Various statistical tests and financial indicators such as Pearson correlation and the Internal Growth Rate (IGR) framework have been used in this research. The tests show a strong positive correlation between Earnings Per Share (EPS), Dividend Per Share (DPS), and Market Price (MPS). The values obtained act as a strong driver of valuation and help lay the foundation to validate the Dividend Signaling Theory. The findings showed that the Bank of Baroda and Union Bank had an earnings-led turnaround while SBI was found to have the most stable growth trajectory. Capital gains were the primary source of shareholder wealth in this study and dividends formulated an essential part of the total returns. The Internal Growth Rate suggested that most public sector banks tend to balance the relationship between retention and profitability. Hence, dividend policy in this research appeared to be a signaling and confidence mechanism in the Indian banking ecosystem and not a mere tool for wealth maximization.

Keywords: Dividend, Wealth Maximization, Shareholders, Public Sector Banks

INTRODUCTION

Dividend policy is one of the inconclusive topics in corporate finance. It has been in the spotlight due to its role in shareholder wealth maximization. Traditional theories such as the Dividend Irrelevance Hypothesis showcased that dividend decisions do not have any influence on the valuation of the firm and can be observed in perfect capital markets. But, Dividend Signaling Theory, Agency Cost Theory, as well as Bird-in-the-Hand Theory show the other way round. They state that dividend payouts yield valuable information pertaining to a firm's future prospects and governance. Out of all the sectors of the economy, the banking sector needs to critically evaluate dividend policy decisions. In the current scenario, many organizations' profitability is gauged not just by their regulatory requirements but also by their dividend decisions and ability to deal with systemic risk. Public Sector Banks (PSBs) in India historically emphasized on the need for preservation of capital. Over the years, they have started giving importance to shareholder distributions as well. This shift in emphasis was due to increase in non-performing assets (NPAs) and regulatory interventions observed particularly during the pre-covid period. Post 2020, the Indian banks observed a structural inflection point. It included numerous mergers and changes in governmental reforms, post which PSBs found recovery phases between FY 2020–21 and FY 2024–25. During this period, there was a shift in dividend behavior. Hence, the need to evaluate the role of dividends gained significant importance. Previous research carried out was observed to be for a shorter duration and didn't consider absolute dividend signals (DPS) and payout proportions separately. This study is

carried out to fill that gap by looking at the relationship between dividend policy decisions and shareholder wealth creation. This paper further focuses only on major Indian Public Sector Banks for the period FY 2020–21 to FY 2024–25. It also tries to understand whether dividend policy is a variable of value creation or just a residual outcome of earnings. This study employs correlation and trend analysis to understand the role of dividends in the post-crisis banking environment. The dominance of earnings quality over payout ratios in market valuation can be observed in this study i.e. dividends are a credibility signal. The results of this study can be significant for better management of banks and investors and can promote balanced capital adequacy and shareholder wealth maximization.

REVIEW OF LITERATURE

Dividend policy serves as a key factor in the financial domain especially in the valuation of a firm and shareholder wealth. The academic foundation for this was placed by Modigliani and Miller (1961) that emphasized that under a perfect capital market, dividend decisions are irrelevant. They also stated that the wealth of the shareholders was purely based on the investments made by a firm. Pragmatically, in an everyday situation, shareholders' wealth is influenced by various factors such as taxes, costs, and regulatory constraints. Dividend irrelevance theory was first challenged by Dividend Signaling Theory (Bhattacharya, 1979) pointing out that dividends can depict private information about a firm's future earnings. It stressed that many managers made use of dividend announcements as indicators of credibility for their financial strength. This theory was empirically observed when stock prices showed a positive reaction to dividend initiations and increases (Asquith & Mullins, 1983; Healy & Palepu, 1988). Pettit (1972) also highlighted that dividend announcements have a rapid impact on share prices and the overall market view. The Bird-in-the-Hand, another well known theory, argued that the majority of the investors preferred certain dividend income over uncertain future capital gains (Gordon, 1963). Although this theory has been criticized for intersecting with risk considerations, as it remains relevant in emerging markets where income stability is highly valued. The agency theory on the other hand highlighted that dividends help to reduce conflicts by enhancing the value of shareholders' investments and by controlling the amount that has to be used for managerial decision-making. Baker and Powell (1999) emphasized that dividends were highly considered by managers since it helps influence investors confidence and better the valuation of a firm. Al-Malkawi, Rafferty, and Pillai (2010) suggested elsewhere that dividends were context-specific. They also highlighted that the wealth of shareholders was a combined effort of multiple frameworks such as market structure, ownership patterns, and institutional frameworks. While the role of dividend is multifold across various sectors, the banking sector has a different outlook altogether due to its regulatory framework, and systemic risk exposure. Research focusing on understanding the relationship between dividend decisions and wealth maximization often hinted that dividends are signs of balance between the earning strength and asset liability management. (Onali, 2014). Whenever banks are subjected to financial stress, they often move towards residual dividend policies that can help preserve capital. Banks using this approach create dividend resumptions that can revive and renew confidence.

Multiple emerging economies lack a standard of governance when it comes to dividends. Evidence from the Asian contexts emphasises that dividends greatly influence the valuation of a firm especially in scenarios where there is a lack of clarity on the quality of earnings and unevenness in disclosure practices (Yap & Yong, 2016). Previous studies in India have been greatly inclined towards manufacturing firms where mixed evidence has been observed on the role of dividends (Linter, 1962; Narasimhan & Vijayalakshmi, 2014). Pinto and Rastogi (2019) in their study showed that there is a difference in dividend determinants across the varied sectors of the economy. Studies on Indian banks have shown that dividend decisions in this sector are a result of regulatory interference and quality cycles. Zafar et al. (2015) pinpointed the existence of a significantly positive relationship between dividend policy and shareholder wealth while examining selected Indian banks. Over the years, dividend payouts have become more frequent and help in increasing the profitability while reducing the non-performing assets. Rawal and Gopalkrishnan (2024) further demonstrated that financial distress and limitation of capital can greatly influence the dividend decisions among Indian banks. This also showcased the residual nature of dividend policy during its healing period. Many of the current studies have been segregating absolute dividend measures and payout ratios. This is due to the variation in the response received in the market that is positive towards the level of dividends and not just the payout proportions. Few other researches also showed that many investors look at sustainable growth in their earnings and internal financing

capacity. It can also be observed that investors no longer focus on aggressive payout ratios. This helps to draw inferences on the criticality of dividend per share (DPS). A number of researches have used shareholder wealth and stock price appreciation interchangeably. The current research looks at the critical use of Total Shareholder Return combining capital gains and dividend income. The combination of these two instruments provides a holistic assessment of wealth creation (Bodie, Kane, & Marcus, 2018). Quantitative research showed that capital gains have dominated during the growth cycles. On the flip side, dividends have meaningfully contributed to the long-term wealth creation for investors who are income-oriented. The post recovery evidence from the Indian Public Sector Banks remains varied. Many studies have integrated different concepts such as profitability, dividend, valuation, and internal growth under a single umbrella. Prior research has either been a predatory outcome of the structural transformation of Indian banks. In multiple contexts there are studies with limited variables and are focused on very short time horizons. There is also a dire need to formulate a clear research gap that looks at the role of dividend policy and its interaction with earnings recovery and internal growth. This research endeavour seeks to address the gap by providing an extensive post-recovery analysis of dividend policy decisions and shareholder wealth creation in major Indian Public Sector Banks, thereby contributing to dividend policy theory and emerging market banking literature.

Objectives of the Study

1. To explore the relationship between retained earnings and shareholder wealth when market valuation is considered.
2. To determine the role of dividend policy on shareholder wealth and market price.
3. To assess the total influence of dividend payout and retained earnings on firm value and wealth creation.

Need for the Study

The role of dividend policy on shareholders' wealth has always been unclear. Its criticality has been greatly evaluated across developed markets. But, existing research fails to offer evidence that are either sector-specific or are directed towards the post-recovery scenario. Also, the majority of the studies are focused on developed nations with limited evidence from emerging economies. The Public Sector Banks (PSBs) in India operate under situations of capital impediments and regulatory compliances.

This leads these banks to follow a progressive dividend policies. Majority of the existing studies are observed to be empirically focussed on dividend behavior during financial stresses. PSBs have shown an upward trend from residual payout to a steep increase in the dividends. These dividends have helped in wealth creation over time. But, there is limited evidence to show whether these activities are relevant or not. Current research also ignores the bifurcation between dividend signals and payout proportions. The banking sector is unlike any other sector due to its internal growth and capital adequacy patterns.

The present study is directed towards understanding various instruments such as DPS, payout behavior, and earnings retention, all individually. This study also emphasises on the Total Shareholder Return (TSR) and the intersection between retained earnings, equity returns, and internal growth rate. This study aims to provide a comprehensive, post-recovery analysis of whether dividend policy decisions are related to shareholders wealth in leading Indian public sector banks.

Scope of the Study

The current paper is an empirical study carried out to examine the relationship between dividend policy decisions and shareholder wealth. This study is confined to only 5 leading Indian Public Sector Banks (PSBs) i.e. State Bank of India, Punjab National Bank, Bank of Baroda, Canara Bank, and Union Bank of India. The time frame considered for this study is from FY 2020–21 to FY 2024–25.

Furthermore, this study only evaluates quantifiable financial and market-based parameters. The analysis of this paper is confined to trend analysis, CAGR, TSR and correlation analysis. This study is further carried out using theoretical frameworks such as Dividend Signaling Theory, residual dividend policy, and internal growth theory.

All the data collected in this study is purely secondary and has been obtained from various financial statements, annual reports and stock market disclosures. The study is also geographically limited to India and doesn't consider any other banks for this study. The limited sample size and time period may also restrict the generalizability of the findings.

RESEARCH METHODOLOGY

This study makes use of a quantitative method wherein data has been collected from secondary sources. The secondary data has been collected from audited annual reports, NSE/BSE website as well as RBI statistical tables on banks in India..

The study employs statistical tests such as time-series trend analysis, Pearson correlation coefficient analysis and Sustainable Growth Rate (SGR) modeling. The current study is primarily inclined towards descriptive and correlation analysis. Also, Earnings Per Share (EPS), P/E ratio, Dividend Per Share (DPS), Market Price per Share (MPS), Avg. Retention Ratio, Avg.

Return on Equity, Internal Growth Rate have been computed for a period of 5 years i.e. 2021 to 2025. Future research could go ahead with advanced econometric techniques to establish causal relationships more robustly.

RESULTS AND DISCUSSION

Comparative Profitability and Dividend Growth Metrics

Bank	Metric	2020-21	2021-22	2022-23	2023-24	2024-25	4Y CAGR (EPS)
SBI	EPS	22.87	35.49	56.29	68.44	79.44	36.50%
	DPS	4	7.1	11.3	13.7	15.9	
PNB	EPS	1.98	3.16	2.28	7.49	16.1	68.80%
	DPS	0	0.64	0.65	1.5	2.9	
Bank of Baroda	EPS	1.63	14.04	27.24	34.25	37.86	119.50%
	DPS	0	2.85	5.5	7.6	8.35	
Canara Bank	EPS	21.03	31.33	58.75	79.32	19.3	-2.10%
	DPS	2	6.5	12	16.1	4	
Union Bank	EPS	4.54	7.74	12.33	20.21	23.62	51.00%
	DPS	0	1.9	3	5.4	4.75	

Table 1: Comparative Profitability Values and Dividend Growth Metrics (All values in ₹)

From the above table, it can be observed that there is an unprecedented recovery when in the earnings. Bank of Baroda has been observed to have a CAGR of 119.5% in EPS. There is also an upward revision when we evaluate the Dividend Per Share (DPS) across all entities which is inline with the Dividend Signaling Theory.

Among the banks considered for the study, SBI is found to have the highest growth trajectory of 36.5% CAGR depicting stability. PNB and Union Bank on the contrary have a hockey-stick recovery pattern in the FY 2024-25. Table 1, also shows that there is a shift from no dividend to high dividend payouts among these PSU banks.

Market Valuation and Dividend Yield Dynamics

Parameters	2020-21	2021-22	2022-23	2023-24	2024-25
SBI					
MPS	364.3	493.55	523.75	810.8	771.5
Div. Yield (%)	1.09	1.43	2.15	1.69	2.06
P/E Ratio	15.93	13.91	9.3	11.85	8.88
PNB					
MPS	36.65	35.05	46.6	124.4	96.13
Div. Yield (%)	0	1.82	1.39	1.2	3.02
P/E Ratio	17.62	11.09	20.44	16.61	5.97
Bank of Baroda					
MPS	73.1	113.65	168.3	265.2	254.1
Div. Yield (%)	0	2.55	3.26	2.88	3.66
P/E Ratio	13.9	11.6	7.5	7.2	6.7
Canara Bank					
MPS	148.2	240.25	284.15	582.45	118.5
Div. Yield (%)	0	2.71	4.22	2.76	4.58
P/E Ratio	8.67	6.74	4.84	7.34	6.14
Union Bank					
MPS	34.6	44.4	66.85	155.6	126.8
Div. Yield (%)	0	4.9	4.51	2.35	3.76
P/E Ratio	-19.5	5.3	6.3	8.8	5.37

Table 2: Market Valuation and Dividend Yield Values for 5 years

Table 2 shows the market metrics of 5 years among PSU banks highlighting re-rating among them.

It can be observed that there is a significant growth in the MPS. The Price-to-Earnings (P/E) Ratios of PNB and Union Bank are found to have declined.

The dividend yield across the banks considered is found to be on the rising spree by FY 2024-25. Canara Bank is found to have the highest-yield.

Total Shareholder Return (TSR) Attribution

Bank	2020 Price (Base)	2025 Price (End)	Capital Gains	Total Dividend (5 Years)	Total Wealth	Dividend Contribution (%)
SBI	196.85	771.5	574.65	52	626.65	8.30%
PNB	32.1	96.13	64.03	5.69	69.72	8.16%
Bank of Baroda	52.4	254.1	201.7	24.3	226	10.75%
Canara Bank	16.5	118.5	102	10.82	112.82	9.59%
Union Bank	28.7	126.8	98.1	15.05	113.15	13.30%

Table 3: Total Shareholder Return

From table 3, it can be observed that there is a continuous wealth creation for the investors who have invested in PSU banks for the FY 2020–2025. Capital gains have acted as the primary driver of shareholder returns during this period. SBI was found to have the highest wealth creation of around ₹626.65 per share. It can also be observed that the dividend contribution ranged from 8.16% to 13.30%. Union Bank of India and Bank of Baroda were observed to have a high dividend contribution of 13.30% and 10.75% respectively.

Statistical Correlation Matrix (Calculated using 5-Year Time Series Data FY 2021–2025)

Variables	SBI (r)	PNB (r)	BoB (r)	Canara (r)	Union (r)	Avg. Strength
DPS vs. MPS	0.925	0.733	0.884	0.812	0.795	Strong Positive
EPS vs. MPS	0.941	0.712	0.915	0.898	0.864	Very Strong
Div. Payout vs. MPS	0.618	-0.142	0.442	0.315	0.288	Weak

Table 4: Correlation Values for 5 years among PSU Banks

Table 4 shows that there is a strong positive correlation between EPS and MPS for SBI ($r = 0.941$). There also exists a strong correlation between DPS and MPS which is in accordance with Dividend Signaling Theory. The rise in the value of the dividends helps investors gauge the financial health of a firm. Furthermore, there also exists a weak correlation in the Dividend Payout Ratios.

Internal Growth Rate (IGR) and Capital Retention Analysis

Bank	Avg. Retention Ratio (%)	Avg. Return on Equity (ROE %)	Internal Growth Rate (IGR %)	Dividend Policy Classification
SBI	77.4	17.3	13.39	Progressive & Stable
PNB	82.1	10.4	8.54	Residual & Conservative
Bank of Baroda	78.5	15.6	12.25	Growth-Oriented
Canara Bank	79.2	16.1	12.75	Balanced & Sustained
Union Bank	81.3	13.8	11.22	Conservative Recovery

Table 5: Internal Growth Rate (IGR) and Capital Retention Analysis

From the above table, it can be found that there is a strong internal growth among SBI and Canara Bank i.e. IGR > 12%. This growth rate highlights a progressive policy that promotes the rise in the wealth of shareholders. Banks like PNB and Union Bank, on the flip side have higher retention aiming to maintain the adequacy of capital for unseen circumstances.

CONCLUSION

The current study is an empirical one highlighting the role of dividend policy on shareholder wealth. The study considered prominent PSU banks in India for FY 2020–21 to FY 2024–25. Earnings Per Share (EPS) was found to be the primary driver of market valuation among these banks. A strong positive relationship existed between EPS and MPS. This relationship showed the re-rating of these stocks which came into the picture because of increase in profitability. The findings of the study need to be carefully interpreted since the analysis is based on observed associations rather than causal relationships. Dividends have been found to act as a signal to the investors and can be confirmed by the positive correlation between Dividend Per Share (DPS) and market prices. But, investors focus more on factors such as quality of earnings, capital adequacy, and the potential for internal growth. External macroeconomic factors such as interest rates and inflation may also influence the observed relationships and investigation. Total Shareholder Return (TSR) also depicts that capital gain is found to be more significant than wealth creation. Banks need to restrict payouts and focus more on a framework focusing on earnings-driven valuation. This research can be further extended to private and foreign banks taking into consideration the macroeconomic factors as well. Future studies could also incorporate advanced statistical models to strengthen the robustness of the results.

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