

Dividend distribution policy for listed companies

1.0 Objective

1.1 This Memorandum seeks to place a proposal to formulate a dividend distribution policy for listed companies in accordance with the extant provisions of the Companies Act, 2013 and SEBI regulations.

2.0 Background

2.1 Under Section 2(35) of the Companies Act, 2013, "Dividend" includes any interim dividend. In common parlance, "dividend" means the profit of a company, which is not retained in the business and is distributed among the shareholders in proportion to the amount paid-up on the shares held by them. In case of listed companies, Section 24 of the Companies Act, 2013 confers on SEBI, the power of administration of the provisions pertaining to non-payment of dividend.

2.2 Sometimes, the investors raise their concerns against companies that are not distributing their extra profits among the shareholders. The companies should analyse if they have reinvestment opportunities where they can plough back their profits in their business. The need to have a 'dividend distribution policy' arises because this aids investors in identifying stocks that match with their investment objectives.

2.3 According to information available, only a few countries like Brazil, Chile, Venezuela Columbia and Greece have made it mandatory to pay dividends to shareholders depending upon size of profits. Mandatory dividend rules entail pros and cons. On one hand, they protect the cash flow rights of minority shareholders, on the other, they distort investment plans.

3.0 Legal provisions regarding dividend:

3.1 The following are the major provisions enacted by SEBI on dividend:

- a. The Issue of Capital and Disclosure Regulations, 2009 require issuers to disclose their dividend policy as well as the rates of dividends, if any, paid by the issuer in respect of each class of shares for each of the five financial

years immediately preceding the issue of the offer document. The Regulations also provide that the requirement of promoters' contribution is not required in the case of a further public offer, inter-alia if the issuer has a track record of dividend payment for at least immediately preceding three years.

- b. The mode of payment of dividend by listed companies is covered under regulation 12 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR). Other related provisions of the LODR are:
 - i. Regulation 29 - companies to intimate the stock exchanges prior to declaration of dividend.
 - ii. Regulation 42(3) - a listed entity shall recommend or declare all dividend and/or cash bonuses at least five working days before the record date.
 - iii. Regulation 43 - a listed entity shall declare and disclose the dividend on per share basis only and that it shall not forfeit unclaimed dividends before the claim becomes barred by law.

3.2 The following are the major provisions of the Companies Act, 2013 regarding dividend:

- a. Section 51 permits companies to pay dividends pro-rata, in proportion to the amount paid-up on each share when all shares are not uniformly paid up.
- b. Section 123 (1)(a) provides inter-alia that no dividend paid by a company except out of the profits for that financial year or for any previous financial years.
- c. Section 123(6) prohibits a company violating provisions as regards repayment of deposits from declaring dividend on its equity shares, as long as such failure continues.
- d. In accordance with Section 134(3)(k), Board of directors must state in the Directors' Report the amount of dividend, if any, which it recommends to be paid.

3.3 The following are some major conditions of the Companies (Declaration and Payment of Dividend) Rules, 2014 (Rule 3) regarding declaration of dividend out of surplus in the absence of adequacy or absence of profits in any year:

- a. The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year:
- b. The total amount to be drawn from such accumulated profits shall not exceed 1/10th of the sum of its paid-up share capital and free reserves
- c. The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
- d. The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

4.0 Conclusion

To sum up, the focus of legislation is in respect of the circumstances in which a company is eligible to distribute dividends but casts no obligation to announce as to when a company may declare dividend. Some listed companies in India have on their own formulated dividend distribution policies, but it is not mandatory under any regulation. There is a need that the companies should declare their policies on distribution of dividend so that the investor may know as to when and how much dividend they may expect.

5.0 Proposal

5.1A dividend distribution policy may be formulated, by listed companies and disclosed in their Annual Reports as well as on their websites. At the minimum, such policy may include:

- a. The circumstances under which their shareholders can or cannot expect dividend;
- b. The financial parameters that will be considered while declaring dividends;
- c. Internal and external factors that would be considered for declaration of dividend;
- d. Policy as to how the retained earnings will be utilized.
- e. Provisions in regard to various classes of shares.

When the company proposes to declare dividend on the basis of parameters other than what is mentioned in such policy or proposes to change its dividend distribution policy, the same along with the rationale shall be disclosed.

To begin with it will be made applicable for top 500 listed companies based on market capitalization.

5.2 It is proposed to insert a new clause 43A in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, incorporating the proposal at 5.1 above.

5.3 The Board is requested to consider and approve the proposals contained in paras 5.1 and 5.2 above and authorize the Chairman to make the necessary consequential changes to give effect to the decision.