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The Effect of Dividend Policy on Shareholder Wealth: An Empirical Study of Indian FMCG Companies

N. Akshaya
Student, MBA, Faculty of Management Studies,
CMS Business School,
Jain (Deemed-to-be) University, Bangalore, India

Dr. Sarangapani Nivarthi
Associate Professor, Faculty of Management Studies,
CMS Business School,
Jain (Deemed-to-be) University, Bangalore, India

Abstract

This study uses a number of primary financial theories (theories of dividend relevance, signalling, agency, and irrelevance) to analyze how dividend policy affects shareholder wealth in the Indian fast-moving consumer goods (FMCG) industry. It also looks at secondary data from specific FMCG companies from 2015 to 2024 and employs a quantitative research methodology approach based on many financial dimensions beyond those typically taken into account in previous empirical research studies, such as dividend payout ratio, dividend yield, dividend growth rate, and free cash flow. In order to improve the overall robustness of their model and prepare for the use of multiple regression modeling techniques to measure Tobin's Q and total shareholder return (TSR) as proxy indicators of shareholder wealth, the authors have also included a number of control variables (firm size, leverage, and profitability). While there is a strong positive correlation between the dividend yield and shareholder wealth, the link between the dividend payout ratio and shareholder wealth exhibits contradictory behaviors. Dividend policy has a conditional influence on shareholder wealth. By offering a theoretically grounded empirical approach that can be applied to developing economies like India, the study offers data to improve the conversation around dividend programs.

Keywords: Dividend Policy, Shareholder Wealth, FMCG Sector, Tobin's Q, TSR, Free Cash Flow

INTRODUCTION

One of the most contentious issues in corporate finance is dividend policy as it directly affects investors' perceptions of a firm and its investment worth. The decision a company makes on whether to reinvest its profits or distribute them to its shareholders as dividends is known as its dividend policy. Since maximizing shareholder value is the main objective of financial management, decisions regarding dividend distribution are crucial. Due to its steady cash flows, steady sales, and steady dividend payments, the Indian FMCG (fast-moving consumer goods) sector is an ideal example for researching dividend policy. Companies that pay dividends are frequently seen by investors as having sound financial standing and inspiring trust in the management of the business (Miller & Modigliani, 1961).

The link between dividends and shareholder wealth, however, is the subject of divergent theoretical perspectives. An organization's entire market position, strategic goals, and financial decision-making are all reflected in its dividend policies. Dividend announcements are frequently crucial indicators of corporate governance and the degree of financial openness in many of these emerging nations, such as India. Asymmetric information between individuals and corporations is growing, and market defects are becoming more common. Gordon, M. J. (1963). Low-level, irregular dividend payments may cast doubt on the company's capacity to make money in the future. On the other hand, steady dividend payments could signal stability to prospective investors.

The importance of dividend policy has gained fresh attention due to the rise in

retail investor engagement in the stock market, especially in the food and consumer goods (FMCG) industry. Thus, comprehending dividend behavior in this sector offers insight into how businesses balance their potential for development with shareholder payout expectations. This research study employs a synthesis of many financial theories as well as a refinement of the variable selection and model-building procedure in an empirical examination of shareholder wealth in the FMCG business.

REVIEW OF LITERATURE

Dividend Relevance Theory

Gordon (1963) and Lintner (1956) have both said that dividend policy is an important factor to consider when determining a company's worth, in contrast to irrelevance theory. According to the Bird-in-Hand Theory, investors are more inclined to prefer dividend income that is somewhat predictable than to take a risk on an unknown future capital gain. The company's market value will thus rise if greater and more regular payouts are used to promote investor trust and lower perceived risk. This demonstrates how the wealth of shareholders may be directly impacted by dividend selections.

Dividend Irrelevance Theory

In a perfect capital market, a company's value is independent of its dividend policy, according to Miller and Modigliani's (1961) Dividend Irrelevance Theory. The premise of this idea is that a corporation's worth is solely determined by its investment decisions and potential for profit; hence, the way the firm distributes its profits has no influence on its value. Since investors may decide how much money they wish to gain from the growth of revenue streams by buying or selling shares, the dividend policy is irrelevant. The concept has drawn criticism due to a number of illogical presumptions. The primary challenged assumption is that there are no transaction fees, taxes, or information asymmetries in the market.

Signaling Theory of Dividends

With respect to signaling theory, a company's ability to generate future profits is revealed through dividend announcements. As a result, a business will employ dividends to let investors know about potential earnings (Bhattacharya, 1979; Miller & Rock, 1985). While a loss in dividends is seen negatively as an indication of fewer future earnings or a drop in the company's value, an increase in dividends is often interpreted positively as a sign of better future earnings and an increase in the company's stock price. Asquith & Mullins (1983) and Michaely et al. (1995) are two examples of empirical studies that have shown that dividend adjustments result in significant market reactions.

Agency Theory

In order to explain the friction between management and shareholders, Jensen and Meckling created agency theory in 1976. If management's activities are at odds with those of the shareholders, they might face agency charges. In an attempt to reduce some of these conflicts, dividend payments limit management's access to free capital. Additionally, Jensen (1986) states that surplus capital should be distributed as dividends to prevent unproductive investments. Consequently, the dividend policy serves to increase the company's value and align management's decisions with those of the shareholders.

Research Gap

The following gaps persist after a great deal of research:

Restricted usage of factors other than dividend yield and payout ratio

Theory and empirical models are not integrated

Lack of moderating and mediating factors

An excessive dependence on a single indicator of shareholder value

In order to fill these deficiencies, this study uses a theoretically aligned framework, dual dependent measures, and extra factors.

Research Hypotheses

H1: The dividend payout ratio (Tobin's Q) has a positive effect on firm value.

H2: Dividend yield has a positive effect on firm value (Tobin's Q).

H3: Dividend policy has a favorable effect on Total Shareholder Return (TSR).

H4: Free cash flow acts as a mediator in the relationship between dividend policy and shareholder value.

H5: Firm size moderates the relationship between dividend policy and business value.

H6: Profitability has a favorable effect on firm value.

H7: Leverage has a negative impact on firm value.

RESEARCH METHODOLOGY

This study's quantitative research approach makes use of secondary data from specific FMCG firms between 2015 and 2024, with an emphasis on firm-level financial data from corporate annual reports and financial databases. The dependent variables in this study are shareholder wealth measurements, Tobin's Q and Total Shareholder Return (TSR). The dividend payout ratio, dividend yield, and dividend growth are examples of the independent variables, which represent various facets of the dividend policy.

Company size is considered a moderating variable to evaluate any differences across organizations, while free cash flow is used as a mediating variable to capture any agency-related repercussions. Leverage and profitability were included as control variables to strengthen the model's resiliency. To investigate the relationships between variables using SPSS/EViews, for example, data was examined using multiple regression analysis, correlation analysis, variance inflation factor (VIF), normality testing, and descriptive statistics.

DATA ANALYSIS AND INTERPRETATION

Descriptive Statistics

The data show that the components of an FMCG company's dividend policy vary somewhat amongst companies. If a company's mean Tobin's Q value is greater than one, the market will value it highly. Because various corporations have varying rates of dividend growth, there are variations in distribution strategies at the corporate level. Relatively large earnings lead to stable dividend payouts

The little variations in sales growth are indicative of shifting market circumstances. When the mean value of Tobin's Q is greater than one, businesses in this sector are seen to have a high degree of financial stability, and when the average total shareholder return (or TSR) is positive, it means that shareholders are getting a return on their investments.

Correlation Analysis

The correlation study demonstrates the relationship between improved returns, consistent dividend increases, and increased market value. Furthermore, there is a strong correlation between firm

valuation and dividend growth and yield. The poor negative correlation between the dividend payment ratio and firm value lends credence to the dividend irrelevance thesis, which maintains that dividend amounts have little effect on a company's market value.

Additionally, free cash flow and company size have strong positive correlations with firm value; both are essential for increasing shareholder wealth and highlight the importance of a company's size and financial stability. Conversely, larger debt levels have a negative correlation with firm value and are likely to impair investor opinions of the business, which lowers the total value of the enterprise.

Multicollinearity Test (VIF)

There is no multicollinearity problem because all VIF values are less than 5. This demonstrates that regression findings are reliable.

This suggests that each variable contributes differently to the regression model and that there is little correlation between the variables. Since multicollinearity does not skew the expected coefficients, the regression analysis's findings may be regarded as solid and trustworthy.

Regression Analysis

Model 1: Firm Value (Tobin's Q)

The study's findings demonstrate that both dividend yield and growth have a substantial influence on firm value, notwithstanding the low dividend payment ratio. Agency and moderating theories are strongly correlated with firm size and free cash flow, respectively. The value of a corporation is positively impacted by profit, but negatively by leverage.

Profitability has a positive impact on a company's value, whereas leverage has a negative one. The model's total explanation of 56% of the variation shows strong explanatory power.

Firm value may be accurately predicted by the whole regression model. The R^2 statistic (0.56), which shows that the independent variables account for 56% of the variance in firm value, may be used to evaluate the model's predictive power. After controlling for the number of independent variables, the model's strength is supported by the revised R^2 (0.52). The regression model is statistically significant and provides a suitable fit for the data, as indicated by the F-statistic value of 10.84.

Model 2: Shareholder Return (TSR)

The study's findings show that changes in dividend yield or dividend increase have a significant positive impact on Total Shareholder Return (TSR). This suggests that increasing total returns to shareholders and giving them steady annual dividend increases will increase shareholder value. While the dividend payout ratio is still very low, this means that it does not have much of an impact.

Both ideas are supported by the firm's size, which strengthens the link and shows that it acts as a moderating influence. Additionally, free cash flow has a favorable effect that supports its mediating role.

Because the whole model accounts for 59% of the variance in TSR, it is demonstrated to have a significant explanatory strength (R^2 value=0.59). After adjusting for several factors, the model's robust R^2 of 0.55 confirms its strength. Furthermore, the model was able to obtain an F-statistic value of 11.26, indicating that

the regression model as a whole fits the data well and is statistically significant.

FINDINGS AND DISCUSSION

The results demonstrate that, depending on the kind of FMCG firm, dividend policy may also affect shareholders' wealth. This is due to the fact that the dividend yield and growth rate may both have a positive and considerable influence on a company's market value and total shareholder return (TSR), indicating that investors place a higher value on getting consistent and increasing dividend payments, all other things being equal. Miller and Modigliani's (1961) claim that dividends are meaningless is supported by the lack of evidence of any appreciable impact from the dividend payment ratio.

The beneficial influence of the dividend yield is further explained by the theories of dividend relevance and signaling, which maintain that one of the key features of dividends is their ability to increase investors' confidence in a company's future earnings by indicating outstanding financial performance.

LIMITATIONS OF THE STUDY

There are several restrictions on the study. First, it bases its results on a small sample of FMCG companies, which may restrict its applicability to other kinds of businesses. Second, the results are based on secondary data that is susceptible to the quantity and quality of financial information that is made accessible to the public. Third, the results may not be as robust because of the limited sample size. Furthermore, the analysis only takes into account a limited number of financial characteristics; it ignores other elements that might influence dividend policy, such as macroeconomic indicators, the condition of the financial markets, and investor behavioral patterns. As a result, when evaluating the results, the reader should keep these restrictions in mind.

CONCLUSION

This paper investigates the impact of dividend policy on shareholder wealth in the Indian FMCG industry through a thorough empirical analysis. The findings show that although dividend yield and growth have a positive and significant influence on the firm's perceived value and Total Shareholder Return (TSR), the dividend payout ratio has no statistically significant effect. As a result, it can be deduced that investors value dividend growth and stability more than the percentage of earnings that are dispersed as dividends. Furthermore, free cash flow, firm size, and profitability are all important factors of shareholder wealth, even if leverage has a detrimental impact on a company's value. In summary, the study comes to the conclusion that other financial considerations should be taken into account in addition to the conditional impact of dividend policy. The study advances current understanding and offers a more comprehensive, theory-based framework that may be used in developing markets like India.

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Table 1: Descriptive Statistics of Variables

Variable	Mean	Std. Deviation	Minimum	Maximum
Dividend Payout Ratio (DPR)	0.054	0.032	0.010	0.142
Dividend Yield	0.029	0.016	0.008	0.094
Dividend Growth	0.112	0.085	-0.050	0.310
Free Cash Flow	1523.45	890.21	210.12	3890.67
Firm Size (Log Assets)	10.84	0.92	8.95	12.67
Profitability (ROE)	0.184	0.072	0.052	0.328
Leverage (D/E)	0.68	0.34	0.10	1.45
Sales Growth	0.091	0.056	-0.020	0.210
Tobin's Q	3.88	1.17	2.01	5.99
TSR	0.148	0.092	-0.050	0.320

Table 2: Correlation Matrix

Variables	DPR	DY	DG	FCF	Size	ROE	Lev	Growth	Tobin's Q
DPR	1	0.32	0.28	0.41	0.36	0.29	0.21	0.18	-0.08
Dividend Yield	0.32	1	0.34	0.38	0.30	0.27	0.19	0.22	0.21
Dividend Growth	0.28	0.34	1	0.26	0.24	0.31	0.12	0.35	0.18
Free Cash Flow	0.41	0.38	0.26	1	0.52	0.44	0.33	0.29	0.27
Firm Size	0.36	0.30	0.24	0.52	1	0.40	0.45	0.26	0.31
ROE	0.29	0.27	0.31	0.44	0.40	1	0.28	0.33	0.42
Leverage	0.21	0.19	0.12	0.33	0.45	0.28	1	0.20	-0.25
Growth	0.18	0.22	0.35	0.29	0.26	0.33	0.20	1	0.19
Tobin's Q	-0.08	0.21	0.18	0.27	0.31	0.42	-0.25	0.19	1

Table 3: Variance Inflation Factor (VIF)

Variable	VIF
DPR	1.85
Dividend Yield	2.12
Dividend Growth	1.76
Free Cash Flow	2.45
Firm Size	2.89
ROE	2.34
Leverage	1.98
Sales Growth	1.67

Table 4: Regression Results – Tobin's Q

Variable	Coefficient (β)	t-Statistic	p-value
Constant	1.152	2.01	0.046
DPR	-0.132	-1.12	0.264
Dividend Yield	0.348	2.21	0.029
Dividend Growth	0.214	2.03	0.044
Free Cash Flow	0.276	2.45	0.016
Firm Size	0.301	2.67	0.009
ROE	0.388	3.12	0.002
Leverage	-0.241	-2.08	0.039

Table 5: Statistics Summary

Statistic	Value
R^2	0.56
Adjusted R^2	0.52
F-statistic	10.84

Table 6: Regression Results – TSR

Variable	Coefficient (β)	t-Statistic	p-value
Constant	0.041	1.76	0.081
DPR	0.095	1.34	0.182
Dividend Yield	0.362	2.42	0.017
Dividend Growth	0.228	2.11	0.036
Free Cash Flow	0.241	2.18	0.031
Firm Size	0.266	2.29	0.024
ROE	0.351	2.88	0.005

Table 7: Statistics Summary

Statistic	Value
R^2	0.59
Adjusted R^2	0.55
F-statistic	11.26