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# THE THEORY OF DIVIDENDS AND ITS EVOLUTION

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***Abstract.*** *The article reviews the main theories of dividend policy and their applicability in practice. In particular, classical theories such as Modigliani-Miller theory, tax preference theory, signalling theory, Lintner's model and agency theory are considered. Based on the analysis, conclusions and suggestions are drawn.*

***Keywords:*** *dividend, dividend payments, dividend policy, theory of dividends, Modigliani-Miller theory, tax preference theory, signalling theory, Lintner's model, agency theory.*

**Introduction.** There is a great deal of scholarly interest in dividend-related decisions around the world. In particular, to effectively organise dividend policy and increase the investment attractiveness of joint-stock companies, many scientific studies have been conducted in world practice, such as studying the advantages and disadvantages, evaluating the factors affecting the amount of dividends paid, classifying dividends, studying the types of dividend payments and determining the reasons for buying the company's shares. However, there are different interpretations of dividend policy in the world, different views on its impact on the investment attractiveness of companies, and some issues related to the formation of an optimal dividend policy are still not fully resolved.

For this purpose it is necessary to ensure the implementation of such urgent tasks as making optimal decisions on the management of financial resources through the effective organisation of dividend policy in joint-stock companies, the wide use of modern tools to strengthen the financial supply, the introduction of management strategies in investment decisions and the effective organisation of privatisation practices.

The theoretical and methodological bases of the organisation of the dividend policy in joint-stock companies, its economic content its impact on the value of the company and its attractiveness for investment are studied in the scientific researches of several domestic and foreign economists. These scientists have expressed different opinions on the study of some aspects of this problem, but the existence of several problems in the optimisation of dividend policy in joint-stock companies of our republic requires more in-depth study both from the theoretical and practical point of view.

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**Research Methodology.** In this article, methods such as scientific abstraction, selective analysis, comparative analysis, observation, analysis and synthesis are used in the analysis of dividend policy in the financial management system of companies.

**Analysis and results.** From a scientific perspective, it is evident that certain aspects of dividend policy characteristics remain unexplored despite the initial studies conducted in this field during the first half of the previous century[1]. This is characterised by the fact that several alternative theories related to dividend policy are compatible with each other, but most of them are fundamentally different. The main conceptual difference in views lies in different interpretations of the role and importance of dividend policy at the firm level. For instance, economists M. Miller and F. Modigliani, who made significant contributions to the development of the field of corporate finance, argue that "dividend policy has no impact on the value of the company"[2]. Conversely, M. Gordon and J. Lintner emphasise the importance of dividend policy in their studies and its impact on the size of total shareholder wealth. Investors generally prefer to receive dividends rather than wait for future income in exchange for the share price, seeking to eliminate or minimise financial risk[3].

As a result of our research, we can divide the main theories of dividend policy into two groups. The first group includes the theories that deny the importance of dividends, while the second group includes the theories that confirm the importance of dividends (Table 1).

**Table 1**

**Main theories of dividend policy[4]**

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[1] Black F., Scholes M.S. The effects of dividend yield and dividend policy on common stock prices and returns // Journal of Financial Economics. 1974. Vol. 1. Iss. 1. P. 1–22.
DeAngelo H., DeAngelo L., Stulz R. Dividend policy and the earned/contributed capital mix: a test of the life-cycle theory // Journal of Financial Economics. 2006. No 81. P. 227–254.
Denis D.J., Osobov I. Why do firms pay dividends? International evidence on the determinants of dividend policy // Journal of Financial Economics. 2008. Vol. 89. Iss. 1. P. 62–82.
Fama E., French K. Disappearing dividends: changing firm characteristics or lower propensity to pay? // Journal of Financial Economics. 2001. No 60. P. 3–43.
Miller M.H., Rock K. Dividend Policy Under Asymmetric Information // The Journal of Finance. 1985. No 40. P. 1031–1051.

[2] M.H. Miller, F. Modigliani, Dividend Policy, Growth and the Valuation of Shares // The Journal of Business. 1961. № 34. P. 411–433.

[3] M. J. Gordon, Dividends, Earnings, and Stock Prices // The Review of Economics and Statistics. Vol. 41, No. 2, Part 1 (May, 1959), pp. 99-105. John Lintner, Distribution of Incomes of Corporations Among Dividens, Retained Earnings, and Taxes // The American Economic Review, Vol. 46, No. 2, Papers and Proceedings of the Sixty-eighthAnnual Meeting of the American Economic Association. (May, 1956), pp. 97-113.

[4] Sherkuzieva, N. A. Increasing investment attractiveness by optimizing the dividend policy in joint-stock companies: дис. Diss. Dissertation abstract written for PhD degree in economics.-Tashkent, 2021.-B. 21.

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| | Name of the theory | Founders of the theory | Main idea |
|---|---|---|---|
| **Theories that ignore the importance of dividends** | Dividend irrelevance theory | F. Modigliani M.H. Miller | The founders of the theory argued that dividend policy did not affect the market value of the company or the financial health of the owners. |
| | Tax preference theories | R. Litzenberger, K. Ramaswamy | Dividend policy is often used as a means of minimising tax payments on current and future income for owners. Therefore, it is important to minimise dividend payments and maximise reinvestment of profits. |
| **Theories supporting the importance of dividends** | Dividend preference theory or "Bird-In-The-Hand" theory | M. Gordon J. Lintner | Investors generally prefer to receive profits from the current period in the form of dividends rather than reinvesting them. |
| | The Information Content of Dividends (Signalling) Hypothesis | S.Ross | Dividends are a means of informing investors about a company's prospects and financial health. |
| | Clientele Effects of Dividends Hypothesis | M. Brennan | Investors' expectations determine a company's dividend policy. In turn, investors choose a company based on its dividend policy. |

The most important of them are listed in Table 1, we will focus on the main characteristics of these theories below.

**1. The theory of irrelevance of dividends. The founders of the theory are F. Modigliani, M. Miller.** The founders of this theory believe that "the value of the company depends only on its income and entrepreneurial risk. A dividend policy means that the main part of profit should be used as a source of financing the most profitable investment projects, and dividends should be paid to the owners of ordinary shares on a residual principle. Also according to this theory, in a perfectly competitive market (ideal capital market), dividend policy does not affect the price of the company's equity or the cost of its capital, i.e. it is considered unimportant"[5]. It should also be noted that this theory is one of the first theories of dividend policy, it was created in 1961. It should also be noted that the founders of the theory made a great contribution to the study of dividend policy.

**2. Dividend preferences or the " bird-in-hand" theory. The founders of the theory are M. Gordon, J. Lintner.** This theory contradicts the previous theory, whose founders believe that the dividend policy type has a significant impact on the total wealth of shareholders. According to this theory, investors prefer to receive dividend income in the current period rather than waiting for future capital gains. As the amount of dividends paid indicates the stability of a company and the advisability of investing in it, shareholders are content with lower returns on invested capital. This, in turn, leads to an increase in the market value of the company. Therefore, a company can enhance the wealth of its shareholders by increasing the share of profits allocated to dividends[6],[7].

**3. The tax preference theory The founders of the theory are R. Litzenberger and K. Ramaswamy.** According to this theory, shareholders prefer income from the capitalisation of value to dividend income. This is because dividend income is taxable, while capital gains tax is only payable on the sale of shares in a company. According to this theory, in some countries, the taxation of current income, typically in the form of dividends, is higher than the taxation of future income, taking into account the time value of money, tax rates, exemptions, and other factors. In such cases, the net income distribution policy should minimize dividend payments and maximize investment expenditure to save a significant amount on the owners' total income through taxes. If a country has a higher tax rate on capital income than on dividend income, then it is better to pay dividends to the shareholders[8].

**4. The signalling theory of dividends. The founder of the theory is S. Ross.** According to the authors, "large dividend payments "signal" to market participants

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[5] Merton H. Miller, Franco Modigliani. Dividend Policy, Growth and the Valuation of Shares // The Journal of Business, Vol. 34, No. 4 (Oct., 1961), pp. 411-433

[6] M. J. Gordon, Dividends, Earnings, and Stock Prices // The Review of Economics and Statistics, Vol. 41, No. 2, Part 1. May, 1959, p. 99-105.

[7] John Lintner. Distribution of Incomes of Corporations Among Dividens, Retained Earnings, and Taxes // The American Economic Review, Vol. 46, No. 2, Papers and Proceedings of the Sixty-eighth Annual Meeting of the American Economic Association. May, 1956, pp. 97-113.

[8] H. Robert Litzenberger, Krishna Ramaswamy. Effects of Personal Taxes and Dividends on Capital Asset Prices // Journal of Financial Economics, 1979, vol. 7, issue 2, p.163-195. http://www.sciencedirect.com/science/article/pii/0304-405X(79)90012-6

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about sufficient financial stability and high investment attractiveness of the company. In general, according to this theory, the size of dividends is considered to be an important factor in the market value of the stocks, and announcements of dividend increases cause the stock price to rise, while dividend decreases lead to a decrease in the market value of the stocks"[9]. In our opinion, in this theory, joint stock companies use all means to guide the financial management system.

**5. The theory of the "client effect". The founder of the theory is M. Brennan.** The main idea of this theory is as follows: "The dividend policy of the company should maximally take into account the expectations and wishes of shareholders and future investors. If the majority of shareholders want to receive the income of the current period, the dividend policy should be based on the direction of the company's profit for the consumption of the current period. If it is the other way round, i.e. if the majority of shareholders want to increase the market value of the stocks, then its capitalisation should have priority in the distribution of the company's profit. In this case, a group of shareholders who do not agree with such a dividend policy reinvest their capital in shares of other companies, which, in turn, leads to the same composition of shareholder clients"[10].

**Conclusion.** After studying general theories related to dividend policy, it was concluded that there is no one-size-fits-all approach that can be applied to all joint-stock companies. Depending on various factors and financial market conditions, companies may attempt to maintain or increase shareholder income by either withholding or paying dividends. Of course, we think that this is influenced by various objective and subjective, internal and external factors, as well as by the location of joint stock companies in a particular country.

The theory of dividend policy is a multifaceted one, and we can observe that when studying this topic, researchers to some extent pay attention to the study of the following issues as well. Such as,

- the role of dividend policy in corporate financial management;
- the impact of the dividend policy of joint stock companies on cash flow and market value of the stocks;
- the advantages and disadvantages of different types of dividend policies;
- financial and operational factors affecting the amount of dividends paid;

[9] S.A. Ross. The Determination of Financial Structure: The Incentive-Signaling Approach // Bell Journal of Economics and Management Science. 1977. № 8. P. 28-40.
[10] M.J. Brennan. Taxes, Market Valuation and Corporate Finance Polic // National Tax Journal. №23.1970. P. 417-427.

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- the difference between dividend policy and stock splits, reasons why a company repurchases its shares and the financial result of such actions, etc.

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2. DeAngelo H., DeAngelo L., Stulz R. Dividend policy and the earned/contributed capital mix: a test of the life-cycle theory // Journal of Financial Economics. 2006. No 81. P. 227–254.

3. Denis D.J., Osobov I. Why do firms pay dividends? International evidence on the determinants of dividend policy // Journal of Financial Economics. 2008. Vol. 89. Iss. 1. P. 62–82.

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10. H. Robert Litzenberger, Krishna Ramaswamy. Effects of Personal Taxes and Dividends on Capital Asset Prices // Journal of Financial Economics, 1979, vol. 7, issue 2, p.163-195. http://www.sciencedirect.com/science/article/pii/0304-405X(79)90012-6

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