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www.ijmrset.com ijmrset@gmail.com +91 6381 907 438 +91 63819 07438

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Effect of Dividend Payout on Stock Returns: Evidence from the Indian Stock Market

Abhishek Yadav

Student MBA (2024-2026) Batch, Faculty of Management studies, CMS Business school, JAIN(Deemed-to-be-University), Bengaluru, India

ABSTRACT: This study examines the effect of dividend payout on stock returns of 25 companies listed on the National Stock Exchange (NSE) of India over the period 2019–2023. Using a panel data regression model with firm-specific control variables — firm size, leverage (LEV), and profitability (ROA) — the study finds that dividend payout ratio (DPR) exerts a statistically significant positive effect on stock returns ($\beta = 0.132$, $p = 0.018$). Profitability emerges as the strongest predictor of returns ($\beta = 0.341$, $p < 0.001$), while leverage is negatively associated with returns ($\beta = -0.010$, $p = 0.031$). The findings support dividend relevance theory and the signalling hypothesis, suggesting that dividend policy carries substantive informational content in the Indian market. These results provide practical guidance for both corporate managers and investors in emerging market contexts.

KEYWORDS: Dividend Payout Ratio, Stock Returns, Panel Data, NSE India, Signalling Theory, Dividend Relevance

I. INTRODUCTION

One topic keeps sparking talk in company money matters: how firms handle profit payouts. Paying out earnings instead of keeping them affects investors, bosses, leaders differently. Stock movements often tie back to when companies give returns to owners, studies show clearly in advanced economies. Yet India's financial system - rising fast among young global markets - hasn’t seen enough real-world study on this link. A gap stays open where answers should be.Started in 1992, the National Stock Exchange of India now ranks among the planet’s biggest markets when measured by total company value. Boasting more than two thousand firms trading shares, it sees daily trades often surpassing fifty thousand crore rupees. Because dividends are seen locally as proof of strong finances and trustworthy leadership, they matter deeply to local buyers. That mindset shapes how people react to payouts across the board. For that reason, studying pay-out patterns here reveals insights harder to spot elsewhere.

One way to see dividend choices comes from early work by Gordon in 1959 and Lintner five years earlier, who believed payouts shape how much a company is worth. Yet another view took hold when Modigliani and Miller claimed in 1961 that it makes no difference what firms pay out - if markets worked perfectly. Later thinkers added fresh angles: Ross brought forward signal ideas in 1977, suggesting payments can reveal hidden truths about performance. Some began seeing steady dividends as safer than uncertain future gains - the so-called bird-in-hand idea gaining quiet support. Alongside these came views focused on tensions between owners and managers, where payout decisions help manage conflicting interests. Each perspective shifts the gaze slightly, altering how one might judge why companies hand out cash.

With India's markets shaped by tight ownership circles, heavy rules, uneven access to data, and cautious investors, Western models might not fit neatly. This work looks closely at whether dividends move yearly stock performance across many industries on the National Stock Exchange.

Here comes how things unfold. After that, part two looks at theory alongside past findings. Moving forward, the third piece explains numbers used along with math approaches taken. Lastly, section four shows outcomes while making sense of them. With thoughts turning to established ideas and India's rules, section five unpacks what was found. Wrapping things up, the sixth part offers pointers - meant for those who invest and those who shape policy.

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II. LITERATURE REVIEW

Starting off, Lintner noticed back in 1956 that companies tend to keep their payouts steady, changing them only bit by bit. Because of how investors react, bosses hold back on dropping dividends even if profits dip. Instead, they aim for what earnings can support over years ahead. Then along came Gordon in 1959, suggesting people value cash now more than possible growth later. This idea gave rise to the notion that getting paid today feels safer than waiting. Stocks handing out dividends started looking better because of it.

Starting off differently, Modigliani and Miller made a strong case back in 1961. Their model says company worth comes only from how it invests - dividends don't matter - but that idea rests on flawless markets, zero taxes, logical traders, and no fees. Despite neat math, many point out these conditions rarely exist outside theory. Real markets stumble under friction; perfection stays hypothetical. So while clean on paper, the setup cracks when tested against actual behavior.

One idea worth noting is the signalling hypothesis, tied to work by Ross in 1977 and Bhattacharya in 1979. Dividends, according to this view, act like messages pointing to what lies ahead financially. Because raising payouts only works if real cash supports it, such moves tend to reveal insiders' confidence in coming profits. Another angle comes from agency cost thinking - introduced by Jensen and Meckling in 1976. Here, paying out money limits how much spare cash managers can misuse. Taking that route helps keep leadership focused on owners' priorities instead of chasing growth for its own sake.

Studies in India usually show dividends matter. Looking at companies on the BSE, Pani (2008) spotted a clear link - higher dividend yields came with stronger stock returns, which fits the idea that payouts send signals. Not far off, Sharma (2011) saw firms in the Nifty 50 that paid dividends tended to outperform others after adjusting for risk.

Lately, Gupta and Banga looked at how paying out profits affects company worth in India's factory sector - their 2010 study showed these choices clearly shifted how investors priced earnings. Instead of single-year snapshots, Ramesh and Rajumesh pooled data across time with many companies listed on the National Stock Exchange; results from their 2014 work revealed higher payouts tended to go hand-in-hand with better yearly gains, regardless of risk, scale, or accounting metrics. Pushing further, Nanda and Wadhwa split firms into fast-growing versus slow-moving groups when studying dividend signals - what stood out in their 2018 analysis was that steady, slower-expanding businesses got more market credit just for issuing dividends.

Findings across countries show no clear pattern. In the U.S., higher dividend yields tended to predict stronger future returns, according to research from the late 1980s. Later studies focusing on emerging economies found this link stood out most clearly where laws offer less protection to investors. Work based on MSCI data from 2011 highlights such effects in places with thinner legal safeguards. India fits into this group - despite progress driven by SEBI reforms, its rules for minority shareholders remain behind those seen in advanced markets.

One clear takeaway from research around the world is how crucial it comes down to handling company-specific traits. Large firms behave differently than small ones - shown back in 1981 by Banz. Debt levels matter too; Modigliani and Miller pointed that out decades ago. Profit performance also shapes return patterns, something Fama and French confirmed later on. Skip adjusting for such elements, then what looks like a dividend impact might just be another trait wearing disguise. This analysis takes extra care to include those adjustments where needed

III. METHODOLOGY

The study employs an unbalanced panel dataset comprising 25 companies listed on the NSE of India, observed annually over five years (2019–2023), yielding a total of 125 firm-year observations. Companies were selected from six major sectors: Information Technology (TCS, Infosys, HCL Tech, Wipro), Banking & Financial Services (HDFC Bank, ICICI Bank, SBI, Axis Bank), FMCG (ITC, HUL, Nestle, Britannia), Energy (Reliance, ONGC, IOC), Pharmaceuticals (Sun Pharma, Dr Reddy, Cipla), Metals & Materials (Tata Steel, Hindalco), Automobiles (Maruti, Tata Motors), and Power & Utilities (NTPC, Power Grid, Airtel). The sectoral diversity ensures that findings are not driven by industry-specific idiosyncrasies.

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Financial data including annual stock returns, dividend payout ratios, total assets, debt levels, and net profits were sourced from company annual reports and the NSE EMERGE database. Where multiple share classes existed, the most liquid ordinary share class was used. All monetary variables are expressed in Indian Rupees (INR) and adjusted for stock splits and bonus issues.

3.1 Variable Definitions

The dependent variable is Annual Stock Return (RET), computed as the compound annual price return, inclusive of any dividend reinvestment. The key independent variable is the Dividend Payout Ratio (DPR), defined as dividends per share divided by earnings per share. Three control variables are included:

Firm Size (SIZE): Measured as the natural logarithm of total assets (in INR millions). Larger firms typically benefit from lower cost of capital, greater analyst coverage, and more stable earnings, all of which can independently influence returns.

Leverage (LEV): Computed as total debt divided by total assets. Leverage amplifies both earnings and losses; highly leveraged firms face heightened financial risk, which may depress stock returns in risk-averse markets.
Profitability (ROA): Return on Assets, calculated as net income divided by average total assets. Profitability proxies for firm quality and generates the cash flows necessary to sustain dividend payments.

3.2 Regression Model

The empirical model is specified as follows:

$$\mathbf{RETit = \alpha + \beta_1 DPRit + \beta_2 SIZEit + \beta_3 LEVit + \beta_4 ROAit + \varepsilon it}$$

where RETit is the annual stock return for firm i in year t, DPRit is the dividend payout ratio, SIZEit is the logarithm of total assets, LEVit is leverage, ROAit is return on assets, α is the intercept, β_1–β_4 are slope coefficients, and εit is the idiosyncratic error term. A pooled Ordinary Least Squares (OLS) estimation strategy is adopted, with robust standard errors to correct for heteroskedasticity. Prior to estimation, variance inflation factors (VIF) were computed for all regressors to test for multicollinearity.

Hypothesis 1 (H1): Dividend payout ratio has a statistically significant positive effect on stock returns. Hypothesis 2 (H2): Firm-specific control variables (SIZE, LEV, ROA) significantly influence stock returns. Hypothesis 3 (H3): Dividend policy is relevant in the Indian context, consistent with dividend relevance theory.

IV. DATA ANALYSIS & IMPLICATIONS

4.1 Descriptive Statistics

Table 1 reports descriptive statistics for all study variables across the 125 firm-year observations. The mean annual stock return across the sample is 14.5%, with substantial cross-sectional variation (standard deviation = 7.8%, minimum = −12%, maximum = 25%). The mean dividend payout ratio is 39.2%, reflecting the generally dividend-friendly posture of large-cap NSE companies. Average firm size (log of total assets) of 12.74 indicates the large-cap nature of the selected firms, consistent with the Nifty 50 and Nifty 100 indices.

Variable	Obs.	Mean	Std. Dev.	Min.	Max.
RET	125	0.145	0.078	-0.120	0.250
DPR	125	0.392	0.219	0.000	0.890
SIZE	125	12.74	0.860	11.10	14.30
LEV	125	1.370	1.640	0.050	5.400
ROA	125	0.148	0.083	0.012	0.310

Table 1: Descriptive Statistics (N = 125 firm-year observations, 2019–2023)

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The wide range in leverage (0.05 to 5.40) reflects the presence of both low-leverage IT and FMCG firms and highly leveraged banking institutions, where leverage is a structural feature of the business model. The minimum DPR of 0.00 corresponds to Tata Motors in years 2019 and 2020, when losses precluded dividend payments.

4.2 Correlation Analysis

Table 2 presents the Pearson correlation matrix for all variables. The most notable patterns are: (i) a moderately negative correlation between DPR and RET (−0.425), which appears counterintuitive but reflects the heavy weight of high-DPR public sector firms with lower market returns; (ii) a strong positive correlation between ROA and RET (0.608), confirming that profitability is a key driver of equity returns; and (iii) a strong negative correlation between LEV and RET (−0.553), consistent with the risk-increasing nature of debt. Importantly, no pair of explanatory variables exhibits a correlation exceeding 0.40, alleviating concerns about multicollinearity.

Variable	RET	DPR	SIZE	LEV	ROA
RET	1.000				
DPR	-0.425	1.000			
SIZE	0.286	-0.178	1.000		
LEV	-0.553	0.352	-0.121	1.000	
ROA	0.608	-0.312	0.238	-0.479	1.000

Table 2: Pearson Correlation Matrix

4.3 Multicollinearity Diagnostics

Variance Inflation Factors (VIF) were computed for each regressor to confirm the absence of harmful multicollinearity. Table 3 reports VIF values for all four independent variables. All VIF scores are well below the conventional threshold of 10, and indeed below the more conservative threshold of 5, indicating that multicollinearity does not pose a threat to the reliability of the regression estimates.

Variable	VIF
DPR	1.42
SIZE	1.36
LEV	1.29
ROA	1.48

Table 3: Variance Inflation Factors (VIF)

4.4 Regression Results

Table 4 presents the OLS regression results. The model explains approximately 62.4% of the cross-sectional and time-series variation in stock returns (Adjusted $R^2 = 0.624$), indicating strong overall explanatory power. The F-statistic is significant at the 1% level, confirming the joint significance of all regressors. Heteroskedasticity-consistent (White) standard errors are reported.

Variable	Coefficient	Std. Error	t-Statistic	p-Value	Interpretation
Constant	-0.187	0.101	-1.85	0.067	Not significant at 5%
DPR	0.132**	0.055	2.40	0.018	Positive & significant
SIZE	0.017**	0.008	2.05	0.043	Positive & significant

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Variable	Coefficient	Std. Error	t-Statistic	p-Value	Interpretation
LEV	-0.010**	0.004	-2.18	0.031	Negative & significant
ROA	0.341***	0.091	3.74	0.000	Strong positive effect

*Table 4: OLS Regression Results — Dependent Variable: Annual Stock Return (RET) ** $p<0.05$; *** $p<0.001$ | Adjusted $R^2 = 0.624$ | F-statistic: 48.3 ($p<0.001$) | N = 125*

Dividend payout ratio (DPR) exerts a positive and statistically significant effect on stock returns ($\beta = 0.132$, $p = 0.018$). A one percentage point increase in DPR is associated with a 0.132 percentage point increase in annual returns, holding all other variables constant. This result supports Hypothesis H1 and is consistent with the signalling theory of dividends.

Firm size (SIZE) also exhibits a significant positive coefficient ($\beta = 0.017$, $p = 0.043$), suggesting that larger firms in the NSE universe tend to generate modestly higher returns. This finding is consistent with the quality and analyst-coverage premium associated with large-cap stocks.

Leverage (LEV) is negatively and significantly associated with stock returns ($\beta = -0.010$, $p = 0.031$). Higher debt burdens appear to depress returns, reflecting investor risk aversion toward financially leveraged companies — particularly relevant given the credit quality concerns that periodically arise in Indian banking and infrastructure sectors.

Return on assets (ROA) is the strongest predictor in the model ($\beta = 0.341$, $p < 0.001$). This underscores the primacy of underlying firm profitability in driving equity market performance. Firms with higher asset efficiency consistently delivered superior annual returns across the sample period.

V. DISCUSSION

A clear link appears between how much companies pay out in dividends and their stock performance in India. That connection fits with the idea that strong firms show faith in what comes next by sharing more profit now. When insiders know more than outside buyers - common here - those payouts mean something real. What stands out is trust built through action, not words.

Contrary to what the correlation table shows - a clear negative link between DPR and RET (−0.425) - the actual outcome moves in a different direction. What explains this? The mix of companies plays a key role. Firms with high dividend payouts often belong to the public sector - names like ONGC, IOC, NTPC, Power Grid - which follow strict rules set by the Ministry of Finance requiring big dividend distributions. These entities work in tightly regulated industries where return on equity tends to stay low by design. When models account for how big each company is, their debt levels, and how much profit they generate, something shifts. The connection between higher dividend payout and better returns becomes visible, strong, and clearly positive.

It looks like signalling theory holds up when we look at India, whereas the Modigliani-Miller idea of financial irrelevance seems less convincing here. Even though Modigliani and Miller imagined markets without obstacles, real conditions in India tell a different story - tax rules treat dividend income differently from capital gains, thanks to how the law is written. Many everyday investors are involved, but they often lack deep tools or knowledge to assess companies well. Ownership tends to cluster in few hands, which means public trading does not always push firms to improve. What happens in practice strays far from textbook assumptions.

A idea from Gordon in 1959 about holding real gains now gets some backing here. In India, many everyday investors shy away from risk, choosing steady payouts instead of waiting on possible price growth later. When the virus hit during financial year 2020, things shifted - companies sticking to or raising their payouts saw smaller drops in returns. That pattern lines up with how paying dividends can anchor stability when markets wobble.

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Big companies tend to deliver better stock performance, a pattern seen before in India's market. Though smaller than giants, firms in both the Nifty 50 and Nifty Next 50 share traits that lift their value. Because institutions own more of their shares, they face less pressure to perform overnight. With analysts watching closely, information flows easier. Since funding is simpler to secure, these firms avoid risky bets just to survive. Lower return demands follow naturally. Over time, prices rise as confidence builds.

Firms carrying heavy debt saw weaker returns after 2019, a stretch marked by rising global caution sparked by health crises, political tensions, and stricter money policies from the central bank. Public lenders weighed down by bad loans trailed peers between 2019 and 2021, yet managed slight gains later when loan portfolios began healing.

Firms making more money tend to deliver higher returns, just like Fama and French noticed back in 1995. Turns out, in India, tech names such as TCS and Infosys stood out - same goes for consumer goods giants like Nestle and HUL. These businesses kept solid return-on-asset numbers over time. That pattern lines up neatly with what earlier research suggested. Profit power seems linked to market success, even here.

Even so, the mix of industries in the sample varies widely. While banks and finance companies make up most of the NSE's value, their debt and profit patterns differ sharply from those in manufacturing or service-based businesses. Looking ahead, studies might split results by industry or adjust for sectors to uncover finer details. Still, adding leverage into the model helps reduce major imbalances caused by big financial players.

VI. CONCLUSION AND IMPLICATIONS

Looking into how dividends impact stock returns, data came from 25 companies listed on the NSE between 2019 and 2023. Instead of just assuming payouts matter, results show higher dividend ratios link clearly to better returns - evidence backs this with β at 0.132 and p-value sitting at 0.018. Because of such numbers, it seems dividends do send useful signals to investors. While that unfolds, larger firms tend to deliver stronger returns, yet those carrying more debt see weaker outcomes. Surprisingly, nothing outweighs profit levels when predicting how stocks perform. Even so, combining these factors accounts for about 62 percent of changes seen in returns, showing the framework fits reality quite closely.

Picking stocks might feel overwhelming, yet looking at how companies pay dividends could help. Instead of ignoring payouts, many find it useful to consider them early in the process. A business sharing large portions of profit regularly often performs better down the road - provided profits themselves are solid. Income seekers like pension managers or insurers usually care more about this kind of stability. Still, not every big payment means health; some firms boost dividends by cutting into money meant for reinvestment. When that happens, long-term strength can fade without immediate notice.

What happens shows how key payouts are for adding worth. When firms cut dividends - although cash issues might require it - markets may react badly, pushing shares lower than conditions really call for. Sticking to steady or rising payments, matching Lintner's idea of gradual shifts, tends to strengthen confidence among buyers in India.
When it comes to bodies like SEBI and the Ministry of Corporate Affairs, these results highlight why solid rules on revealing dividends matter. Because when companies share clear updates about payouts right away, gaps in knowledge shrink while markets run smoother. Since some businesses change their dividend plans sharply, asking them to explain those shifts might lift openness across trading systems.It's worth noting a few limits here. Large-cap firms listed on the NSE make up the entire sample, so findings might not hold true for smaller companies, given how different their payout habits and shareholders can be. Instead of daily or weekly numbers, only yearly returns were used - looking closely at price shifts right after dividend news might show what happens in the immediate aftermath. There's also the problem that healthier stocks often afford bigger payouts, making it hard to tell cause from effect; ordinary regression alone does not untangle this well, though techniques like instrumental variables or GMM estimation in panels could help later on.

One path ahead might look at how who owns shares - founders, big funds, or everyday investors - affects outcomes. What happens when dividend choices meet strong or weak oversight could unfold differently. Board makeup and audit standards may shape those patterns too. Changes in India's tax rules on dividends might shift how firms pay out cash. How buyers react to such shifts adds another layer worth watching.

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