CHAPTER 8

Dividend Decisions

MULTIPLE CHOICE QUESTIONS

1. Which one of the following is the assumption of Gordon's Model:

(*a*) Ke > g
(*b*) Retention ratio, (b), Once decide upon, is constant
(*c*) Firm is an all equity firm
(*d*) All of the above

2. What should be the optimum Dividend pay-out ratio, when r = 15% & Ke = 12%

(*a*) 100% (*b*) 50%
(*c*) Zero (*d*) None of the above

3. Which of the following is the irrelevance theory?

(*a*) Walter model (*b*) Gordon model
(*c*) M.M. hypothesis (*d*) Linter's model

4. If the company's D/P ratio is 60% & ROI is 16%, what should be the growth rate?

(*a*) 5% (*b*) 7%
(*c*) 6.4% (*d*) 9.6%

5. If the shareholders prefer regular income, how does this affect the dividend decision:

(*a*) It will lead to payment of dividend (*b*) If it's the indicator to retain more earnings
(*c*) It has no impact on dividend decision (*d*) Can't say

6. Mature companies having few investment opportunities will show high payout ratios, this statement is:

(*a*) False (*b*) True
(*c*) Partial true (*d*) None of these

7. Which of the following is the limitation of Linter's model?

(*a*) This model does not offer a market price for the shares
(*b*) The adjustment factor is an arbitrary number and not based on any scientific criterion or methods
(*c*) Both (*a*) & (*b*)
(*d*) None of the above

8. What are the different options other than cash used for distributing profits to shareholders?
   (*a*) Bonus shares
   (*b*) Stock split
   (*c*) Both (*a*) & (*b*)
   (*d*) None of the above

9. Which of the following statement is correct with respect to Gordon's model?
   (*a*) When IRR is greater than cost of capital, the price per share increases and dividend pay-out decreases
   (*b*) When IRR is greater than cost of capital, the price per share decreases and dividend pay-out increases
   (*c*) When IRR is lower than cost of capital, the price per share increases and dividend pay-out decreases
   (*d*) When IRR is lower than cost of capital, the price per share increases and dividend pay-out decreases

10. Compute EPS according to Graham & Dodd approach from the given information:

Market price	₹56
Dividend pay-out ratio	60%
Multiplier	2

   (*a*) ₹30
   (*b*) ₹56
   (*c*) ₹28
   (*d*) ₹84

11. Which among the following is not an assumption of Walter's Model?
   (*a*) Rate of return and cost of capital are constant
   (*b*) Information is freely available to all
   (*c*) There is discrimination in taxes
   (*d*) The firm has perpetual life

12. Walters Model suggests for 100% DP Ratio when:
   (*a*) ke = r
   (*b*) ke < r
   (*c*) ke > r
   (*d*) ke = 0

13. If a firm has ke > r the Walters Model suggests for:
   (*a*) 0% payout
   (*b*) 100% Payout
   (*c*) 50% Payout
   (*d*) 25% Payout

14. Walters Model suggests that a firm can always increase price share by:
   (*a*) Increasing Dividend
   (*b*) Decreasing Dividend
   (*c*) Constant Dividend
   (*d*) None of the above

15. Bird in hand argument is given by:
   (*a*) Walker's Model
   (*b*) Gordon's Model
   (*c*) MM Model
   (*d*) Residuals Theory

16. Residuals Theory argues that dividend is a:
   (*a*) Relevant Decision
   (*b*) Active Decision
   (*c*) Passive Decision
   (*d*) Irrelevant Decision

17. Which of the following is not true for MM Model?

(*a*) Share price goes up if dividend is paid

(*b*) Share price goes down if dividend is not paid

(*c*) Market price is unaffected by Dividend policy

(*d*) All of the above

18. MM Model argues that dividend is irrelevant as:

(*a*) The value of the firm depends upon earning power

(*b*) The investors buy shares for capital gain

(*c*) Dividend is payable after deciding the retained earnings

(*d*) Dividend is a small amount

19. If 'r' = 'ke', than MP by Walter's Model and Gordon's Model for different payout ratios would be:

(*a*) Unequal (*b*) Zero

(*c*) Equal (*d*) Negative

20. As per Modigliani-Miller hypothesis of dividend irrelevance price of share at year zero is -

(*a*) (D0 + P) ÷ (1+Ke) (*b*) (D1 + P1) × (1+Ke)

(*c*) (D1+ P1) ÷ (1+Ke) (*d*) 1 – [(D0 + P0) ÷ Ke]

21. Payout ratio is subtracted from one to calculate -

(*a*) Growth ratio (*b*) Present value ratio

(*c*) Retention ratio (*d*) Future value ratio

22. Constant payout ratio means -

(*a*) Declaration same bonus ratio every year.

(*b*) The payment of fixed percentage of earning as dividend every year.

(*c*) Constantly paying same dividend if EPS is same for all the year.

(*d*) None of the above

23. Myron Gordon believe that the required return on equity increases as the dividend payout ratio is decreased. Their argument is based on the assumption that:

(*a*) Investors are indifferent between dividends and capital gains.

(*b*) Investors require that the dividend yield and capital gains yield equal a constant.

(*c*) Capital gains are taxed at a higher rate than dividends.

(*d*) Investors view dividends as being less risky than potential future capital gains.

24. The cost of capital and rate of return on investment of X Ltd. is 10% and 15% respectively. The company has 10 lakh shares of ₹10 each. Its earnings per share is ₹7.5. Calculate the value of the firm per share using Walters Model assuming all earnings are distributed as dividends.

(*a*) ₹75 (*b*) ₹100

(*c*) ₹125 (*d*) ₹150

25. Details regarding SK Ltd. are given below:

EPS = ₹24

Ke = 11%

r = 12%

If retention ratio is 80%, market price as per Gordon's Model is -

(*a*) ₹340.68 (*b*) ₹346.82

(*c*) ₹324.65 (*d*) ₹342.86

26. A chemical company belong to a risk class for which P/E ratio is 10. It currently has 50,000 equity shares selling at ₹200 each. The firm is contemplating the declaration of dividend of ₹16 per share at the current fiscal year which has just started. Given the assumption of Modigliani-Miller, what will be the price of share at the end of the year if dividend is declared?

(*a*) ₹205 (*b*) ₹208

(*c*) ₹204 (*d*) ₹225

27. Current price of share of SK Ltd. is ₹760 and just paid dividend per share is ₹74. If the capitalization rate is 12%, what is the dividend growth rate?

(*a*) 3% (*b*) 5%

(*c*) 4% (*d*) 6%

Answer Key

1. (*d*)	**2.** (*c*)	**3.** (*c*)	**4.** (*c*)	**5.** (*a*)	**6.** (*b*)	**7.** (*c*)	**8.** (*a*)	**9.** (*a*)	**10.** (*a*)
11. (*c*)	**12.** (*c*)	**13.** (*b*)	**14.** (*d*)	**15.** (*b*)	**16.** (*c*)	**17.** (*c*)	**18.** (*a*)	**19.** (*c*)	**20.** (*c*)
21. (*c*)	**22.** (*b*)	**23.** (*d*)	**24.** (*a*)	**25.** (*d*)	**26.** (*c*)	**27.** (*b*)			