**Module 8**

**Dividend Decision**

Dividend policy is the guideline for dividend distribution drafted by the board of directors of the company. The policy includes parameters for sharing profits with the shareholders. It also includes how often, and in which form the dividends are to be distributed. This article covers in detail about dividend policy and different types of dividend policy in detail.

**What is a Dividend Policy?**

The dividend policy of a company is the decision about the distribution of dividends to its shareholders. A dividend policy is a financial decision that involves deciding on the dividend payout ratio, the frequency of dividends and should they pay dividends at all or not. It is drafted by the company’s board of directors and acts as a guideline for distributing dividends to the investors.

The dividend decision of a firm depends on the profits, investment opportunities in hand, availability of funds, industry trends in dividend payment, and the company’s dividend payment history.

* **Profits:** Dividend payment is made from the profits of the company. If the company has no profits, then the company won’t be able to pay dividends.
* **Investment opportunities:** If the firm has projects that will lead to the expansion and growth of the company, then the company would prefer retaining back the profits to fund the new projects.
* **Availability of funds:** A firm’s availability of funds impacts the dividend decision. If the firm has enough retained earnings to fund new projects, then they have enough funds to distribute dividends from the current year’s profits.
* **Industry trends in dividend payment:** A company has to keep up with the industry’s dividend payment to survive. Else the shareholders might liquidate their shares in the company to invest in competitors’ companies.
* **Company’s dividend payment history:** A company that is paying regular dividends tends to keep the dividends stable over the years. They either keep the dividend payout ratio steady or the dividend amount stable.

**How Does Dividend Policy Work?**

When a company makes a profit, it must take a decision to either retain the profits or share them with the shareholders. A company decides dividends based on multiple factors. However, the payment of dividends can happen in terms of cash, stock, property or scrip. Following are the different types of dividends:

* **Cash Dividend:** Cash dividends are the most common and popular form of dividend payouts. The company issues a dividend to all shareholders. The cash dividend amount is deposited into the bank account of the shareholder as per their shareholding.
* **Stock Dividend:** Through stock dividend payouts, a company issues additional shares to its common shareholders without any consideration. When a company issues less than 25% of the previously issue, then the dividend is a stock dividend. On the other hand, it is a stock split when the company issues more than 25% of the last issue.
* **Property Dividend:** A company sometimes issues a non-monetary dividend to its shareholders. The company records the property dividend against the current market price of the asset. The market price of the asset can be either higher or lower than the book value. Therefore, the company records the transaction as either a profit or loss.
* **Scrip Dividend:** In a scenario where the company does not have enough dividends, it may issue a promissory note. A promissory note that is indicating to pay dividends later. Essentially, this creates note payables for the company.

**What are the Types of Dividend Policies?**

Companies follow different patterns for paying out dividends. The patterns depend on the type of dividend policy chosen by them. There are four different types of dividend policy that companies usually follow, and they are:

**Stable Dividend Policy**

A stable dividend policy involves fixing a certain amount of dividend that the shareholders periodically receive. Even if the company incurs a loss, the amount of dividend does not change.

**Regular Dividend Policy**

In a regular dividend policy, the company fixes a certain percentage of dividend from the company’s profits. When the profits are high, the dividend payment will automatically be high. While the profits are low, the dividend payment will remain low. Experts usually considers this to be the most appropriate policy for paying dividends and creating goodwill.

**Irregular Dividend Policy**

In an irregular dividend policy, the dividend payment solely depends on the company’s decision. If the company decides to pay a dividend to the shareholders, then the shareholders get the dividend. The decision solely depends on the company’s priorities. If the company has a new project to fund, then it may decide to retain the profits within the company instead of distributing it.

**No Dividend Policy**

In no dividend policy, the company always retains the profits and doesn’t distribute them to its shareholders. Usually, growth-oriented companies follow the no dividend policy. The strategy might suit companies who aim for growth. However, it may discourage investors who are looking for sustainable income in the long term.

**What is the Difference Between a Cash Dividend and a Stock Dividend?**

Dividend-paying companies often pay shareholders cash as a percentage of the share price. A cash dividend is a regular cash payment by a company to its shareholders. The money that the company issues as a dividend is often a percentage of free cash that it doesn’t use for any investment.

On the other hand, stock dividends are in the form of more company shares. For example, when a company announces a 10% stock dividend, it means that an investor with 100 shares is eligible to get ten shares as a stock dividend. Therefore, the investor will now have 110 shares.

Cash dividends are taxable. At the same time, stock dividends are subject to tax only when the investor chooses to turn around and sell the extra stocks for cash.

**What is an Interim Dividend?**

An interim dividend is a dividend payment during a fiscal year to the shareholders. In other words, it is the payment of dividends before the annual audit of financial statements. An interim dividend is paid out in smaller amounts than the annual dividend and in monthly or quarterly intervals (paid more than once). Furthermore, the company uses retained earnings to pay such dividends. Retained earnings are the earnings from previous fiscal years that the company retains back in the company. These do not include the current year’s profits.

The board of directors of a company are the ones who declare, vote and approve the disbursement of the interim dividend. However, the shareholders have the right to overturn the decision and refuse the interim dividend payments.

Often companies declare interim dividends along with the release of quarterly or semi-annual results. Interim dividends are often paid out more frequently to a company’s equity shareholders. Thus their rate of dividends is lower than the final dividend payout. Alternatively, some companies issue stock dividends instead of cash dividends.

**What is a Final Dividend?**

A final dividend is a payout that the company’s board of directors announce after publishing the company’s full-year financial results. The final payout is generally higher than any interim dividends paid throughout the fiscal year.

The final dividend payment is a set amount per share of common stock and the announcement of which happens at the annual shareholders’ meeting. The amount depends on the annual profits of the company and also the dividend policy. It’s usually a cash distribution rather than a stock dividend.

The Board of Directors announce the final dividend at the AGM through an Ordinary Resolution and approved by shareholders. To pass the resolutions, approval of 51% of the shareholders is mandatory.

The final dividend is not the same as the last dividend given by companies. The last dividend is the liquidating dividend that is paid at the time of liquidation of the company. It is the surplus that is left after selling all assets and paying off all the liabilities.

**What is the Difference Between the Interim Dividend and Final Dividend?**

An interim dividend is a dividend that a company pays during the financial year before the company’s Annual General Meeting (AGM) and releasing the financial statements. On the other hand, the final dividend payment is after the declaration of financial results.

The Board of directors declares the interim dividend, and shareholders declare the final dividend in the AGM.

Retained earnings are the source for paying the interim dividends. Current earnings are the source for paying final dividends.

Interim dividends are related to a part of the financial year, usually six months. Whereas final dividends relate to the full financial year.

The Board declares interim dividend only when the Articles of Association of the company permits them to. Whereas final dividends are the right of the shareholders, and there need not be any explicit provision to declare final dividends.

Once the company declares interim dividends, there is no debt obligation on it. The company can cancel the interim dividend after the declaration. However, once the company declares the final dividend, it cannot cancel it. Also, there is a debt obligation on the final dividend.

**What is the Benefit of Dividend Stocks?**

Dividend-paying stocks are profitable to shareholders in two ways. They offer capital gains through capital appreciation and also additional income through dividends. Also, they provide consistent income through dividends. Dividend-paying companies are usually cash-rich and strong companies that have good prospects for long term performance. Additionally, dividend-paying stocks are less vulnerable to volatility.

**Twofold benefits:** Dividend-paying stocks offer two-fold benefits to its shareholders. Firstly, shareholders benefit from long term capital appreciation. Secondly, they offer additional income to their shareholders. This also enhances their investment portfolio as the dividend reinvestment can generate more returns.

**Consistent income to shareholders:** Dividend-paying stocks provide consistent income to its shareholders. This helps them to earn additional income to the shareholders.

**Strong companies:** Dividend-paying stocks are cash-rich. They are strong companies and have good financials. It also gives confidence to the shareholders about the prospects of the company.

**Low volatility:** Dividend-paying stocks usually belong to sectors whose performance don’t wholly depend on economic cycles. Hence these stocks are less vulnerable to market volatility.