1.

The dividend payback policy may not matter when there is no tax, no transaction costs and the real investment policy of the company is fixed.

The firm has 150,000 shares outstanding in the market. 1,200,000/8=150,000

150,000\*1.5=$225,000

The share price of the company after the dividend paid is (1,200,000-225,000)/150,000=$6.5

The total wealth of the shareholders by receiving dividends= $225,000+$6.5\*150,000=$1,200,000

The total wealth of the shareholders by accepting the share buy back scheme=150,000\*8=$1,200,000

Hence, the wealth of the shareholders is indifferent by receiving dividends or accepting the share buyback scheme.

2. The management should consider the signal that the company is sending to the investors when deciding on its dividend policy. By issuing a large amount of dividend often indicates that the company is operating very well. The company is forecasting a large cash flows from the future. It can thus possibly increase the share price of the company. Announcing a share buyback program often offer a negative signal to investors, hence its share price may drop. However, it can give the management greater flexibility in distributing value as the buyback program can be ended quietly at any time. Hence if the future cash flows of the company is not certain, management would prefer the shares buyback program as it can cause less effect on the share price of its company if the cash flows decline in the future.

It is mentioned that the earnings of the company have been growing rapidly, but unlikely to maintain the high growth rate much longer. I would recommend the management to announce a share buyback program instead of a dividend payment as a conservative approach. Even though it might send a bad signal to the investors, it is unlikely that the share price of the company would drop because of its high growth rate in the recent years. The company would have more flexibility in distributing value in the future as the management can end it quietly at any time if the future cash flows do decline in the future. Hence, it would have less damage on the company’s share price. Offering a large dividend to shareholders could increase the company’s share price momentarily. However, it is forecasted that the company’s growth rate is going to decline in the future. Hence, the share price of the company would be significantly damaged when the cash flows are declined . Therefore, the share buyback program is recommended as the management would have more flexibility in distributing value of the company and have greater control on its share price in the future.