CHAPTER 18

Dividends and Dividend Policy

I. DEFINITIONS

DIVIDENDS

a 1. Payments made out of a firm's earnings to its owners in the form of cash or stock are called:
- a. dividends.
- b. distributions.
- c. share repurchases.
- d. payments-in-kind.
- e. stock splits.

DISTRIBUTIONS

b 2. Payments made by a firm to its owners from sources other than current or accumulated earnings are called:
- a. dividends.
- b. distributions.
- c. share repurchases.
- d. payments-in-kind.
- e. stock splits.

REGULAR CASH DIVIDENDS

c 3. A cash payment made by a firm to its owners in the normal course of business is called a:
- a. share repurchase.
- b. liquidating dividend.
- c. regular cash dividend.
- d. special dividend.
- e. extra cash dividend.

SPECIAL DIVIDENDS

d 4. A cash payment made by a firm to its owners as a result of a one-time event is called a:
- a. share repurchase.
- b. liquidating dividend.
- c. regular cash dividend.
- d. special dividend.
- e. extra cash dividend.

LIQUIDATING DIVIDENDS

a 5. A cash payment made by a firm to its owners when some of the firm's assets are sold off is called a:
- a. liquidating dividend.
- b. regular cash dividend.
- c. special dividend.
- d. extra cash dividend.
- e. share repurchase.

DECLARATION DATE

e 6. The date on which the board of directors passes a resolution authorizing payment of a dividend to the shareholders is the _____ date.
- a. ex-rights
- b. ex-dividend
- c. record
- d. payment
- e. declaration

EX-DIVIDEND DATE

b 7. The date before which a new purchaser of stock is entitled to receive a declared dividend, but on or after which she does not receive the dividend, is called the _____ date.
- a. ex-rights
- b. ex-dividend
- c. record
- d. payment
- e. declaration

DATE OF RECORD

c 8. The date by which a stockholder must be registered on the firm's roll as having share ownership in order to receive a declared dividend is called the:
- a. ex-rights date.
- b. ex-dividend date.
- c. date of record.
- d. date of payment.
- e. declaration date.

DATE OF PAYMENT

d 9. The date on which the firm mails out its declared dividends is called the:
- a. ex-rights date.
- b. ex-dividend date.
- c. date of record.
- d. date of payment.
- e. declaration date.

HOMEMADE DIVIDENDS

e 10. The ability of shareholders to undo the dividend policy of the firm and create an alternative dividend payment policy via reinvesting dividends or selling shares of stock is called (a):
- a. perfect foresight model.
- b. M&M Proposition I.
- c. capital structure irrelevancy.
- d. homemade leverage.
- e. homemade dividend policy.

INFORMATION CONTENT EFFECT

a 11. The market's reaction to the announcement of a change in the firm's dividend payout is the:
a. information content effect.
b. clientele effect.
c. efficient markets hypothesis.
d. M&M Proposition I.
e. M&M Proposition II.

CLIENTELE EFFECT

b 12. The observed empirical fact that stocks attract particular investors based on the firm's dividend policy and the resulting tax impact on investors is called the:
a. information content effect.
b. clientele effect.
c. efficient markets hypothesis.
d. M&M Proposition I.
e. M&M Proposition II.

RESIDUAL DIVIDEND APPROACH

c 13. A policy under which the firm pays dividends only after its capital investment needs are met while maintaining a constant debt/equity ratio is called a:
a. homemade dividend.
b. clientele effect.
c. residual dividend approach.
d. bird-in-the-hand approach.
e. constant dividend growth model.

TARGET PAYOUT RATIO

d 14. The fraction of earnings a firm expects to pay out as dividends over the long-run is its:
a. internal rate of return.
b. required return on investment.
c. target ROA.
d. target payout ratio.
e. target capital structure.

SHARE REPURCHASE

e 15. A _____ is an alternative method to stock dividends which is used to pay out a firm's earnings to shareholders.
a. merger
b. tender offer
c. payment-in-kind
d. stock split
e. share repurchase

STOCK DIVIDENDS

a 16. A payment made by a firm to its owners in the form of new shares of stock is called a _____ dividend.
- a. stock
- b. normal
- c. special
- d. extra
- e. liquidating

STOCK SPLITS

b 17. An increase in a firm's number of shares outstanding without any change in owners' equity is called a:
- a. special dividend.
- b. stock split.
- c. share repurchase.
- d. tender offer.
- e. liquidating dividend.

TRADING RANGE

c 18. The difference between the highest and lowest prices at which a stock has traded is called its:
- a. average price.
- b. bid-ask spread.
- c. trading range.
- d. opening price.
- e. closing price.

REVERSE SPLITS

d 19. In a reverse stock split:
- a. the number of shares outstanding increases and owners' equity decreases.
- b. the firm buys back existing shares of stock on the open market.
- c. the firm sells new shares of stock on the open market.
- d. the number of shares outstanding decreases but owners' equity is unchanged.
- e. shareholders make a cash payment to the firm.

II. CONCEPTS

CASH DIVIDENDS

b 20. Which one of the following statements concerning cash dividends is correct?
- a. The chief financial officer of a corporation determines whether or not a dividend will be paid.
- b. A dividend is not a liability of a firm until it has been declared.
- c. If a firm has paid regular quarterly dividends in the past it is legally obligated to continue doing so.
- d. Cash dividends always reduce the paid-in capital account balance.
- e. The dividend yield expresses the dividend amount as a percentage of the net income.

DIVIDEND PAYMENTS

b 21. The ex-dividend date is _____ business days before the date of record.

a. 1
b. 2
c. 3
d. 4
e. 5

DIVIDEND PAYMENTS

c 22. The last date on which you can purchase shares of stock and still receive the dividend is the date _____ business days prior to the date of record.

a. 1
b. 2
c. 3
d. 4
e. 5

DIVIDEND PAYMENTS

b 23. Leslie purchased 100 shares of GT, Inc. stock on Wednesday, July 7th. Marti purchased 100 shares of GT, Inc. stock on Thursday, July 8th. GT declared a dividend on June 20th to shareholders of record on July 12th and payable on August 1st. Which one of the following statements concerning the dividend paid on August 1st is correct given this information?

a. Neither Leslie not Marti are entitled to the dividend.
b. Leslie is entitled to the dividend but Marti is not.
c. Marti is entitled to the dividend but Leslie is not.
d. Both Marti and Leslie are entitled to the dividend.
e. Both Marti and Leslie are entitled to one-half of the dividend amount.

DIVIDEND PAYMENTS

b 24. All else equal, the market value of a stock will tend to decrease by roughly the amount of the dividend on the:

a. dividend declaration date.
b. ex-dividend date.
c. date of record.
d. date of payment.
e. day after the date of payment.

DIVIDEND POLICY

d 25. Automatic dividend reinvestment plans:

I. require that stockholders reinvest all of the dividends to which they are entitled.
II. sometimes grant stockholders the privilege of purchasing additional shares at a discounted price.
III. help stockholders create their own homemade dividend policies.
IV. help make corporate dividend policies irrelevant to individual stockholders.

a. II only
b. III only
c. II and II only
d. II, III, and IV only
e. I, II, III, and IV

FACTORS FOR LOW DIVIDENDS

a 26. Which one of the following is an argument in favor of a low dividend policy?
- a. the tax on capital gains is deferred until the gain is realized
- b. few, if any, positive net present value projects are available to the firm
- c. a preponderance of stockholders have minimal taxable income
- d. a majority of stockholders have other investment opportunities that offer higher rewards with similar risk characteristics
- e. corporate tax rates exceed personal tax rates

FACTORS FOR LOW DIVIDENDS

e 27. The fact that flotation costs can be significant is justification for:
- a. a firm to issue larger dividends than their closest competitors.
- b. a firm to maintain a constant dividend policy even if they frequently have to issue new shares of stock to do so.
- c. maintaining a constant dividend policy even when profits decline significantly.
- d. maintaining a high dividend policy.
- e. maintaining a low dividend policy and rarely issuing extra dividends.

FACTORS FOR LOW DIVIDENDS

e 28. Which of the following tend to keep dividends low?
- I. state laws restricting dividends in excess of retained earnings
- II. terms contained in bond indenture agreements
- III. the desire to maintain constant dividends over time
- IV. flotation costs
- a. II and III only
- b. I and IV only
- c. II, III, and IV only
- d. I, II, and III only
- e. I, II, III, and IV

FACTORS FOR HIGH DIVIDENDS

d 29. Ignoring capital gains as an alternative, the tax law changes in 2003 tend to favor a:
- a. lower dividend policy.
- b. constant dividend policy.
- c. zero-dividend policy.
- d. higher dividend policy.
- e. restrictive dividend policy.

FACTORS FOR HIGH DIVIDENDS

e 30. Which of the following are factors that favor a high dividend policy?
- I. stockholders desire for current income
- II. tendency for higher stock prices for high dividend paying firms
- III. investor dislike of uncertainty
- IV. high percentage of tax-exempt institutional stockholders
- a. I and III only
- b. II and IV only
- c. I, III, and IV only
- d. II, III, and IV only
- e. I, II, III, and IV

FACTORS FOR HIGH DIVIDENDS

b 31. An investor is more likely to prefer a high dividend payout if a firm:

a. has high flotation costs.
b. has few, if any, positive net present value projects.
c. has lower tax rates than the investor.
d. has a stock price that is increasing rapidly.
e. offers high capital gains which are taxed at a favorable rate.

INFORMATION CONTENT

c 32. The information content of a dividend increase generally signals that:
a. the firm has a one-time surplus of cash.
b. the firm has few, if any, net present value projects to pursue.
c. management believes that the future earnings of the firm will be strong.
d. the firm has more cash than it needs due to sales declines.
e. future dividends will be lower.

CLIENTELE EFFECT

c 33. The dividend market is in equilibrium when:
a. all firms adopt a low dividend policy.
b. half of the firms adopt a low dividend policy and half adopt a high dividend policy.
c. all clienteles are satisfied.
d. dividends remain constant and no special dividends are declared.
e. the amount of the regular dividend is equal to the amount of the special dividend.

RESIDUAL DIVIDEND POLICY

c 34. A firm which adopts a residual dividend policy:
a. prefers to offer new securities for sale on a routine basis.
b. prefers constant dividends to a constant debt-equity ratio.
c. places a higher priority on funding its investment needs than on paying dividends.
d. will pay regular cash dividends that are constant in amount.
e. tends to also have a high dividend policy.

RESIDUAL DIVIDEND POLICY

d 35. A strict residual dividend policy:
a. tends to produce higher dividend payout ratios for high-growth firms versus low-growth firms.
b. tends to produce steady, predictable dividend payments.
c. is best suited to cyclical firms who prefer steady dividends.
d. adds considerable uncertainty to the payment of future dividends.
e. guarantees that a minimal amount will be paid as a dividend on a quarterly basis.

COMPROMISE DIVIDEND POLICY

d 36. A compromise dividend policy advocates:
a. rejecting positive net present value projects in order to maintain constant dividends.
b. varying the debt-equity ratio so that the firm can sell equity to fund increases in the dividends.
c. selling equity to maintain a high dividend policy.
d. trying to avoid cutting back on either positive net present value projects or dividends.
e. strict adherence to short-run debt-equity ratios at the expense of constant dividends.

COMPROMISE DIVIDEND POLICY

a 37. A compromise dividend policy can be viewed as a:
a. set of long-term goals.

b. strict set of short-term policies.
c. set of rules that require increasing dividends in the short-run.
d. set of inflexible rules that mandate a constant debt-equity ratio in both the short and the long-term.
e. guideline for the reduction of dividends over the long-term.

COMPROMISE DIVIDEND POLICY

a 38. Which one of the following is considered to be the primary goal of a compromise dividend policy?
a. the avoidance of cutting back on positive net present value projects
b. maintaining a constant debt-equity ratio
c. the avoidance of reducing the dividend amount
d. maintaining a target dividend payout ratio
e. avoiding the need to sell new equity

DIVIDEND SURVEY RESULTS

b 39. Of the following factors, which one is considered to be the primary factor affecting a firm's dividend decision?
a. personal taxes of company stockholders
b. consistent dividend policy
c. attracting retail investors
d. attracting institutional investors
e. sustainable changes in earnings

DIVIDEND SURVEY RESULTS

a 40. Financial managers:
a. are reluctant to cut dividends.
b. tend to ignore past dividend policies.
c. tend to prefer cutting dividends every time quarterly earnings decline.
d. prefer cutting dividends over incurring flotation costs.
e. place little emphasis on dividend policy consistency.

STOCK REPURCHASE

c 41. If you ignore taxes and transaction costs, a stock repurchase will:
I. reduce the total assets of a firm.
II. increase the earnings per share.
III. reduce the PE ratio more than an equivalent stock dividend.
IV. reduce the total equity of a firm.
a. I and III only
b. II and IV only
c. I, II, and IV only
d. I, III, and IV only
e. I, II, III, and IV

STOCK REPURCHASE

b 42. From a tax-paying investor's point of view, a stock repurchase:
- a. is equivalent to a cash dividend.
- b. is more desirable than a cash dividend.
- c. has the same tax effects as a cash dividend.
- d. is more highly taxed than a cash dividend.
- e. creates a tax liability even if the investor does not sell any of the shares they own.

STOCK DIVIDENDS

b 43. All else equal, a stock dividend will _____ the number of shares outstanding and _____ the value per share.
- a. increase; increase
- b. increase; decrease
- c. not change; increase
- d. decrease; increase
- e. decrease; decrease

STOCK DIVIDENDS

c 44. A small stock dividend is defined as a stock dividend of less than _____ percent.
- a. 10 to 15
- b. 15 to 20
- c. 20 to 25
- d. 25 to 30
- e. 30 to 35

STOCK DIVIDENDS

e 45. Which one of the following is a result of a small stock dividend?
- a. retained earnings increase
- b. total owner's equity decreases
- c. cash decreases
- d. capital in excess of par decreases
- e. common stock increases

STOCK DIVIDENDS

c 46. Which of the following account changes occur as a result of a large stock dividend?
- I. common stock increases
- II. cash decreases
- III. capital in excess of par increases
- IV. retained earnings decreases
- a. I and III only
- b. II and IV only
- c. I and IV only
- d. II and III only
- e. I, III, and IV only

STOCK DIVIDEND

d 47. Nu Tech, Inc. is a technology firm with good growth prospects. The firm wishes to do something to acknowledge the loyalty of their shareholders but needs all of their available cash to fund their rapid growth. The market price of their stock is currently trading in the middle of their preferred trading range. The firm could consider:

a. issuing a liquidating dividend.
b. a stock split.
c. a reverse stock split.
d. issuing a stock dividend.
e. a special stock dividend.

STOCK DIVIDENDS

d 48. Which of the following are valid reasons for a firm to reduce or eliminate its cash dividends?

I. The firm is on the verge of violating a bond restriction which requires a current ratio of 1.8 or higher.
II. A firm has just received a patent on a new product for which there is strong market demand and they need the funds to bring the product to the marketplace.
III. The firm can raise new capital easily at a very low cost.
IV. The tax laws have recently changed such that dividends are taxed at an investor's marginal rate while capital gains are tax exempt.

a. I and III only
b. II and IV only
c. II, III, and IV only
d. I, II, and IV only
e. I, II, III, and IV

STOCK SPLITS

c 49. A stock split:

a. increases the total value of the common stock account.
b. decreases the value of the retained earnings account.
c. does not affect the total value of any of the equity accounts.
d. increases the value of the capital in excess of par account.
e. decreases the total owners' equity on the balance sheet.

STOCK SPLITS

a 50. Stock splits are often used to:

a. adjust the market price of a stock such that it falls within a preferred trading range.
b. decrease the excess cash held by a firm.
c. increase both the number of shares outstanding and the market price per share simultaneously.
d. increase the total equity of a firm.
e. adjust the debt-equity ratio such that it falls within a preferred range.

STOCK SPLITS

d 51. Which of the following tend to increase the appeal of a firm’s stock to the average investor?

I. a cessation of dividends by a firm which has a long history of increasing dividends
II. the distribution of a special dividend by a dividend-paying firm
III. a reverse stock split for a low-priced stock
IV. the declaration of a stock dividend by a growth firm

a. I and III only
b. II and IV only
c. I, II, and IV only
d. II, III, and IV only
e. I, II, III, and IV

STOCK SPLIT

d 52. Wydex, Inc. stock is currently trading at $82 a share. The firm feels that their primary clientele can afford to spend between $2,000 and $2,500 to purchase a round lot of 100 shares. The firm should consider a:

a. reverse stock split.
b. liquidating dividend.
c. stock dividend.
d. stock split.
e. special dividend.

REVERSE STOCK SPLITS

d 53. A one-for-four reverse stock split will:

a. increase the par value by 25 percent.
b. increase the number of shares outstanding by 400 percent.
c. increase the market value but not affect the par value per share.
d. increase a $1 par value to $4.
e. increase a $1 par value by $4.

REVERSE STOCK SPLITS

d 54. A reverse stock split is sometimes used as a means of:

a. decreasing the liquidity of a stock.
b. decreasing the market value per share of stock.
c. increasing the number of stockholders.
d. keeping a firm’s stock eligible for trading on a stock exchange.
e. raising cash from current stockholders.

III. PROBLEMS

STOCK DIVIDEND

e 55. The Rent It Company declared a dividend of $.60 a share on October 20th to holders of record on Monday, November 1st. The dividend is payable on December 1st. You purchased 100 shares of Rent It Company stock on Wednesday, October 27th. How much dividend income will you receive on December 1st from the Rent It Company?

a. $0
b. $1.50
c. $6.00
d. $15.00
e. $60.00

STOCK DIVIDEND

c 56. You purchased 200 shares of ABC stock on July 15th. On July 20th, you purchased another 100 shares and then on July 21st you purchased your final 200 shares of ABC stock. The company declared a dividend of $1.10 a share on July 5th to holders of record on Friday, July 23rd. The dividend is payable on July 31st. How much dividend income will you receive on July 31st from ABC?

a. $0
b. $220
c. $330
d. $440
e. $550

STOCK DIVIDEND

d 57. On May 18th, you purchased 1,000 shares of BuyLo stock. On June 5th, you sold 200 shares of this stock for $21 a share. You sold an additional 400 shares on July 8th at a price of $22.50 a share. The company declared a $.50 per share dividend on June 25th to holders of record as of Thursday, July 10th. This dividend is payable on July 31st. How much dividend income will you receive on July 31st as a result of your ownership of BuyLo stock?

a. $100
b. $200
c. $300
d. $400
e. $500

STOCK DIVIDEND

a 58. The KatyDid Co. is paying a $1.25 per share dividend today. There are 120,000 shares outstanding with a par value of $1.00 per share. As a result of this dividend, the:

a. retained earnings will decrease by $150,000.
b. retained earnings will decrease by $120,000.
c. common stock account will decrease by $150,000.
d. common stock account will decrease by $120,000.
e. capital in excess of par value account will decrease by $120,000.

HOMEMADE DIVIDENDS

b 59. You own 300 shares of Abco, Inc. stock. The company has stated that it plans on issuing a dividend of $.60 a share at the end of this year and then issuing a final liquidating dividend of $2.20 a share at the end of next year. Your required rate of return is 9 percent. Ignoring taxes, what is the value of one share of this stock today?

a. $2.36
b. $2.40
c. $2.62
d. $2.80
e. $2.85

HOMEMADE DIVIDENDS

d 60. Priscilla owns 500 shares of Delta stock. The company recently issued a statement that it will pay a $1.00 per share dividend this year and a $.50 per share dividend next year. Priscilla does not want any dividend this year but does want as much dividend income as possible next year. Her required return on this stock is 12 percent. Ignoring taxes, what will Priscilla's homemade dividend per share be next year?

a. $0
b. $.50
c. $1.50
d. $1.62
e. $1.68

RESIDUAL DIVIDENDS

c 61. Merlo, Inc. maintains a debt-equity ratio of .40 and follows a residual dividend policy. The company has after-tax earnings of $1,600 for the year and needs $1,400 for new investments. What is the total amount Merlo will pay out in dividends this year?

a. $0
b. $200
c. $600
d. $640
e. $1,040

RESIDUAL DIVIDENDS

c 62. HiLo Enterprises maintains a debt-equity ratio of .75 and follows a residual dividend policy. The firm needs $2,000 for new investments next year. The after-tax earnings this year are $1,800. What is the amount that HiLo will pay out in dividends for this year?

a. $0
b. $300.00
c. $657.14
d. $1,142.86
e. $1,300.00

RESIDUAL DIVIDENDS

c 63. Margo, Inc. has planned investments of $1,750 for next year and an after-tax net income of $1,974 this year. The company has a residual dividend policy and maintains a .60 debt-equity ratio. How much new debt is required to fund the investments for next year?
- a. $0
- b. $393.75
- c. $656.25
- d. $725.00
- e. $1,050.00

STOCK REPURCHASE

d 64. A firm has a market value equal to its book value. Currently, the firm has excess cash of $600 and other assets of $5,400. Equity is worth $6,000. The firm has 500 shares of stock outstanding and net income of $900. What will the new earnings per share be if the firm uses its excess cash to complete a stock repurchase?
- a. $1.20
- b. $1.50
- c. $1.80
- d. $2.00
- e. $2.40

STOCK REPURCHASE

c 65. A firm has a market value equal to its book value. Currently, the firm has excess cash of $800 and other assets of $5,200. Equity is worth $6,000. The firm has 600 shares of stock outstanding and net income of $700. The firm has decided to spend all of its excess cash on a share repurchase program. How many shares of stock will be outstanding after the stock repurchase is completed?
- a. 480 shares
- b. 500 shares
- c. 520 shares
- d. 540 shares
- e. 560 shares

STOCK REPURCHASE

c 66. A firm has a market value equal to its book value. Currently, the firm has excess cash of $500 and other assets of $7,500. Equity is worth $8,000. The firm has 250 shares of stock outstanding and net income of $1,120. The firm is going to use all of its excess cash to repurchase shares of stock. What will the stock price per share be after the stock repurchase is completed?
- a. $28
- b. $30
- c. $32
- d. $34
- e. $36

CASH DIVIDEND

b 67. A firm has a market value equal to its book value. Currently, the firm has excess cash of $500 and other assets of $9,500. Equity is worth $10,000. The firm has 250 shares of stock outstanding and net income of $1,400. What will the stock price per share be if the firm pays out its excess cash as a cash dividend?

a. $36
b. $38
c. $40
d. $42
e. $44

CASH DIVIDEND

e 68. A firm has a market value equal to its book value. Currently, the firm has excess cash of $400 and other assets of $7,600. Equity is worth $8,000. The firm has 200 shares of stock outstanding and net income of $900. The firm has decided to pay out all of its excess cash as a cash dividend. What will the earnings per share be after the dividend is paid?

a. $.25
b. $.45
c. $2.50
d. $3.80
e. $4.50

SMALL STOCK DIVIDEND

d 69. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account, and $42,700 in the retained earnings account. The firm just announced a 10 percent (small) stock dividend. What will the balance in the capital in excess of par account be after the dividend?

a. $32,500
b. $36,000
c. $38,500
d. $39,500
e. $40,500

SMALL STOCK DIVIDEND

a 70. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account, and $42,700 in the retained earnings account. The firm just announced a 10 percent (small) stock dividend. What will the balance in the retained earnings account be after the dividend?

a. $34,700
b. $35,700
c. $42,700
d. $49,700
e. $50,700

SMALL STOCK DIVIDEND

b 71. Murphy's, Inc. has 10,000 shares of stock outstanding with a par value of $1.00 per share. The market value is $8 per share. The balance sheet shows $32,500 in the capital in excess of par account, $10,000 in the common stock account and $42,700 in the retained earnings account. The firm just announced a 10 percent (small) stock dividend. What will the market price per share be after the dividend?

a. $7.20
b. $7.27
c. $7.33
d. $8.00
e. $8.80

LARGE STOCK DIVIDEND

a 72. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50 percent (large) stock dividend. What is the value of the capital in excess of par account after the dividend?

a. $58,000
b. $61,500
c. $87,000
d. $96,500
e. $100,000

LARGE STOCK DIVIDEND

a 73. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50 percent (large) stock dividend. What is the value of the retained earnings account after the dividend?

a. $29,000
b. $30,500
c. $32,500
d. $34,500
e. $36,000

LARGE STOCK DIVIDEND

d 74. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account and $32,500 in the retained earnings account. The firm just announced a 50 percent (large) stock dividend. What is the value of the common stock account after the dividend?

a. $7,000
b. $8,500
c. $9,000
d. $10,500
e. $14,000

LARGE STOCK DIVIDEND

b 75. Bruno's has 7,000 shares of stock outstanding with a par value of $1.00 per share and a market value of $12 per share. The balance sheet shows $7,000 in the common stock account, $58,000 in the capital in excess of par account, and $32,500 in the retained earnings account. The firm just announced a 50 percent (large) stock dividend. What is the market value per share after the dividend?

a. $6.00
b. $8.00
c. $9.00
d. $10.50
e. $12.00

STOCK SPLIT

d 76. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the paid in surplus account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. How many shares of stock will be outstanding after the split?

a. 10,000 shares
b. 12,500 shares
c. 20,000 shares
d. 22,500 shares
e. 27,500 shares

STOCK SPLIT

b 77. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the paid in surplus account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the market price per share be after the split?

a. $18
b. $24
c. $42
d. $48
e. $54

STOCK SPLIT

c 78. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the paid in surplus account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the value of the common stock account be after the split?

a. $10,000
b. $12,500
c. $15,000
d. $18,500
e. $22,500

STOCK SPLIT

d 79. Robinson's has 15,000 shares of stock outstanding with a par value of $1.00 per share and a market price of $36 a share. The balance sheet shows $15,000 in the common stock account, $315,000 in the paid in surplus account, and $189,000 in the retained earnings account. The firm just announced a 3-for-2 stock split. What will the paid in surplus account value be after the split?

a. $126,000
b. $210,000
c. $283,500
d. $315,000
e. $472,500

STOCK SPLIT

c 80. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a paid in surplus account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the common stock account balance be after the split?

a. $3,000
b. $4,500
c. $6,000
d. $9,000
e. $12,000

STOCK SPLIT

a 81. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a paid in surplus account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the market price per share be after the split?

a. $35
b. $40
c. $55
d. $70
e. $140

STOCK SPLIT

b 82. The Retail Outlet has 6,000 shares of stock outstanding with a par value of $1.00 per share. The current market value of the firm is $420,000. The balance sheet shows a paid in surplus account value of $136,000 and retained earnings of $234,000. The company just announced a 2-for-1 stock split. What will the retained earnings account balance be after the split?

a. $117,000
b. $234,000
c. $351,000
d. $410,000
e. $468,000

STOCK SPLIT

e 83. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 5-for-3 stock split. How many shares of stock will be outstanding after the split?

a. 62,500 shares
b. 75,000 shares
c. 83,333 shares
d. 175,000 shares
e. 208,333 shares

STOCK SPLIT

b 84. The Tinslow Co. has 125,000 shares of stock outstanding at a market price of $93 a share. The company has just announced a 7-for-3 stock split. What will the market price per share be after the split?

a. $38.27
b. $39.86
c. $40.40
d. $46.18
e. $55.80

STOCK SPLIT

a 85. The Winston Co. has 120,000 shares of stock outstanding. The current market value of the firm is $4.5 million. The company has retained earnings of $2.1 million, paid in surplus of $2.5 million, and a common stock account value of $.12 million. The company is planning a 3-for-1 stock split. What will the par value per share be after the split?

a. $.33
b. $.67
c. $1.00
d. $1.50
e. $3.00

STOCK SPLIT

a 86. The Winston Co. has 120,000 shares of stock outstanding. The current market value of the firm is $4.5 million. The company has retained earnings of $2.1 million, paid in surplus of $2.5 million, and a common stock account value of $.12 million. The company is planning a 3-for-1 stock split. What will the market price per share be after the split?

a. $12.50
b. $25.00
c. $37.50
d. $56.25
e. $75.00

STOCK SPLIT

b 87. The Winston Co. has 120,000 shares of stock outstanding. The current market value of the firm is $4.5 million. The company has retained earnings of $2.1 million, paid in surplus of $2.5 million, and a common stock account value of $.12 million. The company is planning a 3-for-1 stock split. What will the paid in surplus account value be after the split?

a. $.83 million
b. $2.5 million
c. $3.3 million
d. $5.0 million
e. $7.5 million

STOCK SPLIT

d 88. The common stock of Margot, Inc. is selling for $56 a share. The par value per share is $1. Currently, the firm has a total market value of $89,600. How many shares of stock will be outstanding if the firm does a 2-for-1 stock split?

a. 800 shares
b. 1,200 shares
c. 1,600 shares
d. 3,200 shares
e. 4,800 shares

STOCK SPLIT

e 89. The common stock of Wilt, Inc. is selling for $65 a share. The par value per share is $1. Currently, the firm has a total market value of $100,750. How many shares of stock will be outstanding if the firm does a 3-for-2 stock split?

a. 1,033 shares
b. 1,550 shares
c. 1,750 shares
d. 2,135 shares
e. 2,325 shares

REVERSE STOCK SPLIT

c 90. Bob's Auto Group has 25,000 shares of stock outstanding at a market price of $4.50 a share. What will the market price per share be if the company does a 1-for-5 reverse stock split?

a. $18.00
b. $20.00
c. $22.50
d. $27.00
e. $29.50

REVERSE STOCK SPLIT

a 91. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and paid in surplus of $340,000. The company just announced a 1-for-5 reverse stock split. How many shares of stock will be outstanding after the split?

a. 25,000 shares
b. 250,000 shares
c. 312,500 shares
d. 500,000 shares
e. 625,000 shares

REVERSE STOCK SPLIT

e 92. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and paid in surplus of $340,000. The company just announced a 1-for-5 reverse stock split. What will the par value per share be after the split?

a. $.20
b. $.50
c. $1.00
d. $2.50
e. $5.00

REVERSE STOCK SPLIT

e 93. Edie's Health and Beauty Supply has 125,000 shares of stock outstanding with a par value of $1 per share and a market value of $5 a share. The company has retained earnings of $76,500 and paid in surplus of $340,000. The company just announced a 1-for-5 reverse stock split. What will the market value per share be after the split?

a. $1.00
b. $2.50
c. $5.00
d. $12.50
e. $25.00

IV. ESSAYS

DIVIDEND POLICY

94. It has been shown that in the absence of taxes and other market imperfections firm value will be unaffected by dividend policy. Explain the logic behind this conclusion. Next, describe three real-world factors that may cause one dividend policy to be preferable to another.

The first part of the question asks the student to explain the "homemade dividends" proposition. The second part requires the student to identify and describe the effects on dividend policy of such things as taxes, transactions costs, the desire for current income, and information effects.

COMPROMISE DIVIDEND POLICY

95. List and briefly explain the five main goals of a compromise dividend policy.

    1. avoid cutting back on positive NPV projects to pay a dividend
    2. avoid cutting dividends
    3. avoid the need to sell new equity
    4. maintain a target debt/equity ratio
    5. maintain a target dividend payout ratio

CLIENTELE EFFECT

96. Explain the meaning of the dividend clientele effect and why it is important.

    There are certain groups that prefer low dividend payouts and certain groups that prefer high dividend payouts; these are dividend clienteles. If clienteles exist, then whenever a firm changes its dividend policy it just swaps one clientele for another. In the end, the firm cannot affect its value by making changes in its dividend policy unless there are unsatisfied clienteles.

FISCHER BLACK

97. In the text Fischer Black states: "I predict that under current tax rules, dividends will gradually disappear." Do you agree? Why or why not? Provide support for your position.

    This question challenges students to think about the relevance of dividends. Some will cite the factors leading to a high dividend payout as a reason dividends will continue to exist. Others will cite the factors in favor of a low dividend payout as a reason to agree with Black. In the end, students are more or less expected to take a position and support it using sound reasoning.

RESIDUAL DIVIDEND POLICY

98. Positive NPV projects enhance shareholder wealth. However, in some cases the payment of dividends limit the number of positive NPV projects a firm can accept. Why, then, shouldn't shareholders prefer a residual dividend policy?

    This question makes the assumption that the dividend decision effectively hampers the investment decision. The better student will realize that this may be short-sighted, for if the firm cannot fund positive NPV projects without cutting its dividend, then it will likely seek outside sources of capital instead. Since shareholders appear to dislike unstable dividends, a residual dividend policy will likely not be in the best interest of the existing shareholders even if adopting such a policy allows the firm to undertake all of its positive NPV projects.

INITIATING DIVIDENDS

99. Suppose that NO corporation in the United States paid a dividend. Do you think that a renegade firm could then increase its value by initiating a dividend payment, thereby making itself different from all the rest of the corporations? Explain.

    The question does not specify what the tax rules are relating to dividends, but most students generally assume the tax rules will remain the same. Most students will likely answer this question in the affirmative, supporting their position by citing the factors that encourage a high dividend payout such as the desire for current income, uncertainty resolution, and the tax and legal benefits from high dividends. In addition, some may argue that if there is an unsatisfied dividend clientele, the firm will benefit from initiating dividend payments. If any of these exist, then it is possible that the firm and its shareholders will benefit from making dividend payments.