

Dividend Policy

Once a company makes a profit, management must decide on what to do with those profits. They could continue to retain the profits within the company, or they could pay out the profits to the owners of the firm in the form of dividends.

Once the company decides on whether to pay dividends they may establish a somewhat permanent dividend policy, which may in turn impact on investors and perceptions of the company in the financial markets. What they decide depends on the situation of the company now and in the future. It also depends on the preferences of investors and potential investors.

Dividend/Retained Earnings Decision

There are various constraints that may impact on a firm's decision to pay out earnings in the form of dividends.

Considerations:

- Cash flow constraints
- Contractual constraints
- Legal constraints
- Tax considerations
- Return considerations

Types of Dividend Policies

Policy Types:

- Constant Dividend Policy
- Constant Payout Ratio
- Regular with Extras

Payment Procedures

Declaration Date

The Declaration Date is the date on which a firm's board of directors issues a statement declaring a dividend.

Holder-Of-Record Date

This is the date on which the company opens the ownership books to determine who will receive the dividend.

Ex-Dividend Date

This is the date on which the right to the next dividend no longer accompanies a stock, usually two business days prior to the holder-of-record date.

Dividend Reinvestment Plan (DRIP)

DRIP

A DRIP (Dividend Reinvestment Plan) is a plan that enables a stockholder to automatically reinvest dividends received back into the stock of the paying firm. The plan may either involve the firm repurchasing existing shares or it may involve newly issued shares.

Stock Dividends vs. Stock Splits

Stock Dividend

Here, the firm issues new shares in lieu of paying a cash dividend. If 10%, shareholders would get 10 shares for each 100 shares of stock owned.

Stock Split

When the board votes a stock split, the firm increases the number of shares outstanding, say 2:1.