# SECTION – 4

## QUESTION-1.

## ANSWER:-

### Essentials of a Sound Dividend Policy:-

A dividend policy can be defined as the dividend distribution guidelines provided by the board of directors of a company. It sets the parameter for delivering returns to the equity shareholders, on the capital invested by them in the business.

While taking such decisions, the company has to maintain a proper balance between its debt and equity composition.

Essentials of a Sound Dividend Policy

A company's dividend decisions and policy signify its future and financial well-being. Therefore, it needs to be systematically framed and implemented

Lower Dividends in Initial Stage: When the company is at the beginning stage and earns little profit, it should still provide dividends to the shareholders, though less.

Gradual Increase in Dividends: As the company prosper and grow, the dividend should be kept on increasing proportionately, to build shareholders' confidence.

Stability: It is one of the crucial features of a superior dividend policy. When the company can survive in the market, it should ensure a stable rate of return in the form of dividends to its shareholders. This leads to retention of shareholders and gains investors interest, all resulting in the enhancement of shares market value.

Stock Dividend:-

A stock dividend, a method used by companies to distribute wealth to shareholders, is a dividend payment made in the form of shares rather than cash. Stock dividends are primarily issued in lieu of cash dividends when the company is low on liquid cash on hand. The board of directors decides on when to declare a (stock) dividend and in what form the dividend will be paid.

Advantages of a Stock Dividend

1. Maintaining cash position

A company that does not have enough cash may choose to pay a stock dividend in lieu of a cash dividend. In other words, a cash dividend allows a company to maintain its current cash position.

2. Tax considerations for a stock dividend

No tax considerations exist for issuing a stock dividend. For this reason, shareholders typically believe that a stock dividend is superior to a cash dividend – a cash dividend is treated as income in the year received and is, therefore, taxed.

3. Maintaining an “investable” price range

As noted above, a stock dividend increases the number of shares while also decreasing the share price. By lowering the share price through a stock dividend, a company’s stock may be more “affordable” to the public.

For example, consider an investor with $1,000 looking to invest in Stock A or Stock B. Stock A is priced at $2,000 while Stock B is priced at $500. Stock A would be deemed “unaffordable” for the investor since he only has $1,000 to invest.

Disadvantages of a Stock Dividend

1. Market signaling and asymmetric information

The market may perceive a stock dividend as a shortage of cash, signaling financial problems. Market participants may believe the company is financially distressed, as they do not know the actual reason for management issuing a stock dividend. This can put selling pressure on the stock and depress its price.

2. Risky projects

Issuing a stock dividend instead of a cash dividend may signal that the company is using its cash to invest in risky projects. The practice can cast doubt on the company’s management and subsequently depress its stock price.

Lease Financing:-

Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee.

The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.