Essentials of a sound dividend policy:

This article looks at dividend policy. It concerns those dividends paid by publicly quoted companies on their common stock. Dividends paid by privately owned companies or subsidiaries of groups are subject to different criteria.

Dividend policy should be part of an overall financial strategy that comprises strategies on returns for shareholders, leverage, investment and risk management. Because dividends are essentially voluntary, and broadly decided by management, equity investors look for a dividend policy.

From an academic point of view, there are broadly three approaches to dividends:

In practice, a further factor is that some investors seek out the regular income that dividends provide.

Let us look at two extremes of dividends to illustrate these approaches and lead us to the concept of signalling:

Firstly, a high-growth company, say in the technology sector, should always have projects in which it wishes to invest, and so paying cash to shareholders would be curtailing opportunities for this growth. It should not pay dividends.

Secondly, a mature company, such as in the tobacco industry, has very few projects in which to invest and so should pay high dividends, returning cash to shareholders so that they can invest in other opportunities offering higher returns.

If the high-growth company starts to pay dividends, then this might be because the high-growth period is at an end. If the mature business suddenly discovers a new product, it may curtail dividends to finance it. Both these actions are signals to shareholders. Cutting of a dividend has always been difficult, however, sometimes leading to management change, so such cuts are often deferred for too long.

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.

Impact of a Stock Dividend on Market Capitalization:

Similar to a cash dividend, a stock dividend does not increase shareholder wealth or market capitalization. Although it increases the number of shares outstanding for a company, the price per share must decrease accordingly. An understanding that the market capitalization of a company remains the same explains why share price must decrease if more shares are issued. The following diagram illustrates the concept:

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.

Venture Capital:

Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banks and any other financial institutions. However, it does not always take a monetary form; it can also be provided in the form of technical or managerial expertise. Venture capital is typically allocated to small companies with exceptional growth potential, or to companies that have grown quickly and appear poised to continue to expand.

Dividend:

A dividend is the distribution of a portion of the company's earnings, decided and managed by the company’s board of directors, and paid to a class of its shareholders. Common shareholders of dividend-paying companies are typically eligible as long as they own the stock by the ex-dividend date. Dividends may be paid out as cash or in the form of additional stock.