

CHAPTER 5: THE DIVIDEND POLICY.

Definition.

Dividends are the payments either with cash or stocks that are made to shareholders based on the policies established by the company. These policies are established by the CEO, who determine the **payout, dividend per share, dividend yield...**

Net Income.

The net income of a company can be either positive or negative. The Net Income, when is positive, it can be destined in either two ways:

- **Dividends:** Which goes straight to the shareholders pocket.
- **Retain Earnings:** Which goes straight to the **reserves** of the company or to **finance** future projects.

The policies will determine where is the money going to go.

Indicators of these Dividend Policies.

1. Dividend Per Share (DPS):

It is just the amount corresponding to each share. It does NOT take into account the Price of the Share in the market. **That means we cannot compare it with the rest.**

	Example A	Example B
Dividend per share	0,5 €	5 €
Price of the Share	5 €	200 €

Now you can clearly see that there is difference between the DPS but also the price in order to get a single share for the companies. It does not explain everything.

2. Payout:

Which is the Ratio of distribution of the Dividend, **between 0 and 1.** It depends exclusively on the manager as he decides what to do. Also, it is the **most relevant** as it is the one who gives more information and can be compared with the rest of the companies.

Formula

$$\frac{\text{Overall Dividend}}{\text{Net Income}}$$

Jokes:

- Why aren't koalas actual bears?
- They do not meet the koalafications.

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3. Dividend Yield:

This is the relation between the price and the dividend given. Basically, is the rentability of the dividend with respect the price paid.

Formula

$$\frac{\text{Dividend per Share}}{\text{Price of the Share}}$$

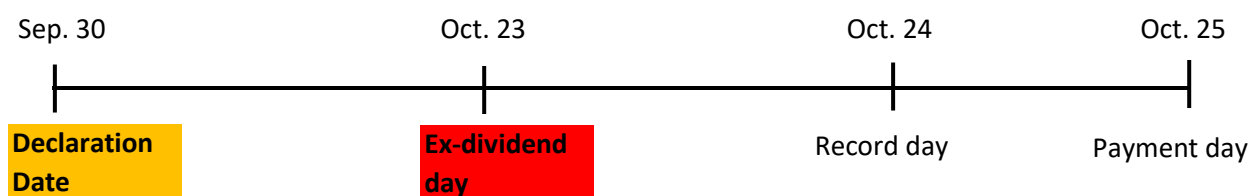
Payment of Dividends.

The Dividends can have different forms which I will list now:

- A. **Cash:** They pay you an amount for each share you have. This is the one we all know.
- B. **Non-Cash:** This is a % over the overall number of shares that you have. Instead of paying you money, they hand you more shares. Ex.: 5 %, for every 20 shares, you will receive an extra 1 share.

Types of Dividends.

- 1. **Regular Dividend:** It is paid in a regular basis. It can be once a year or more than once a year. Ex.: Every 21 of December or pay the same amount but in 4 different times during the year.
- 2. **Extraordinary Dividend:** This is a dividend which is very uncommon. The reasons can be various like:
 - a. Distributing Extra Cash available.
 - b. Altering the company's financial structure.
 - c. Instilling confidence in long-term value generation.
- 3. **Special Dividend:** This is even **more uncommon** than the previous one. The reason for a dividend like this is a **special operation**.
- 4. **Liquidation Dividend:** It is the last dividend given to the shareholders before the company stops existing.

Dividend Payment process.

The two days which have colors are the days where some **impact** will happen to the stock price. In orange, when the price will **increase** or **decrease** and in red when the price will **decrease**.

Note: See that the dates are actually the difference in days from one day to the other in real life

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Declaration day.

On the declaration day, the company **announces** that is going to give a Dividend. When it does so, there are three different outcomes:

- **Dividend is the same amount than the previous one:** There is **no new information** about how the company is going so there is no impact in the price of the share.

DPS = 1€ → P0 = 20€

DPS = 1€ → P1 = 20€

- **Bigger dividend than the previous one:** There is **new information** about the company, and it is positive. Shareholders believe the company is going better, so they increase the price of the share.

DPS = 1€ → P0 = 20€

DPS = 1,5€ → P1 = 22€

- **Smaller dividend than the previous one:** There is **new information** about the company, and it is negative. Shareholders believe the company is going worse, so they decrease the price of the share.

DPS = 1€ → P0 = 20€

DPS = 0,5€ → P1 = 17€

The driver for the lost or increase of value in the price of the share is the positive or negative information that is been given.

Ex-dividend day.

On this day the shareholders **lose the right to receive the dividend if they buy the share**. So, as there is no point on buying the share in order to receive the dividend the price of the share will **decrease**.

So the driver for the lost of value in the price of the share is the lost of the right for the dividend.

Note: Usually **the decrease in the price of the share will be equal or like the Dividend Per Share that has been given**. This makes sense as the dividend is part of the value of the company that is given back to the shareholders, so the company loses value.

Record day.

In the record day all the administrative task is done and nothing relevant happens here. As there is no new information or lose of right the price of the share does not change at all.

Payment day.

On the payment day the Dividend Per Share is paid, but the adjustment to the price of the share was already done in the ex-dividend day (the price decreases the same amount of Dividend Per Share that is been given).

Joke.

- An argument between two vegans is still called "beef"?

Dividend Policy and Shareholders Wealth.

1. Perfect World.

The situation of a perfect world goes with these conditions:

- No taxes
- No transaction costs
- Information is symmetric and equal to all

On this world the **dividend policy is irrelevant**. As we have studied, the impact that a new dividend will create will be fixed from the first day is announced. As the shareholders already have the information, a dividend will only make them have it in cash or with more dividends, but it will never result in an increase or decrease in value.

Example.

$P_0 = 10\text{€}$ before the dividend is declared.

$DPS = 1\text{€}$ a dividend has been declared of 1€ immediately, as the shareholders have all the information like the directors of the company, this results in the next step.

$P_1 = 9\text{€}$ Which in the end is the price of the stock, and the 1€ extra that the company is getting in the form of dividends.

Final result = 9€ of price of the stock + 1€ in the form of dividends = 10€ in value, which is equal.

1.1. Hand-made dividends.

We are still in a perfect world, but the company pays dividends with more dividends and you as a shareholder want cash. Then, this is what happens:

Example:

Number of shares = 1.000

$P_0 = 10\text{€}$

Company's $DPS = 0\text{€}$

Shareholder desire $DPS = 1\text{€}$

Result: Selling of 100 shares ending up with 900 shares with a total value of 9.000€.

You will end up with the same result that if you received a dividend, as the correction of the dividend if it had been paid would had made the price of the share fall 1€ ending up with 9.000€ of total value and 1.000€ in DPS. **The only thing that changes is the number of shares, which you have less.**

Joke.

- I was a little sad when I started doing this resumes during this Saturday morning. Do you want to know why?
- Why?
- Mi Korean friend died...he was so yung.

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2. Real World.

All those taxes, transaction costs and Information being asymmetric, that is the real world (Is all fucked up). Obviously, this situation will affect the dividend policy.

2.1. Taxes.

We have some types of Taxes that we will have to consider in order to give dividends.

- ✓ **Corporate taxes:** This is the taxes of the firm.
- ✓ **Personal taxes (Investors):** This is what affects the IRPF, we will have to look at it closely.

Opportunity Costs.

DPS = 1€ is the same than saying that $P_0 = -1€$

(Remember that giving Dividend diminishes the total value of the company).

Different situation with taxes and see where is good to pay dividends or not.

- ✚ **Tax dividend:** This are the dividends the investors need to pay in order to receive the dividend.
- ✚ **Tax Capital gain:** This are the taxes the firm will have to pay in order to keep the money in the firm, in the capital, in the Equity.

	Tax Dividend	Tax Capital gain
Situation 1	40%	20%
Situation 2	20%	20%
Situation 3	20%	40%

Solutions:

- 1) **Situation 1:** We do not want to pay dividends as the taxes are higher.
- 2) **Situation 2:** We are indifferent whether to pay dividends or not.
- 3) **Situation 3:** We do prefer to pay dividends as it is more expensive to keep the money in the company.

In Spain the situation that we have is the **Situation 2**, having a tax % to be paid off:

- **When Dividends are lower than 6.000€**

$x = 19\%$

- **When Dividends are between 6.000€ and 50.000€**

$x = 19\%$ to the first 6.000€

$x = 21\%$ to the rest of the money

- **When Dividends are higher than 50.000€**

$x = 19\%$ to the first 6.000€

$x = 21\%$ money between 6.000€ and 50.000€

$x = 23\%$ to the rest of the money

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Is it perfect the tax neutrality?

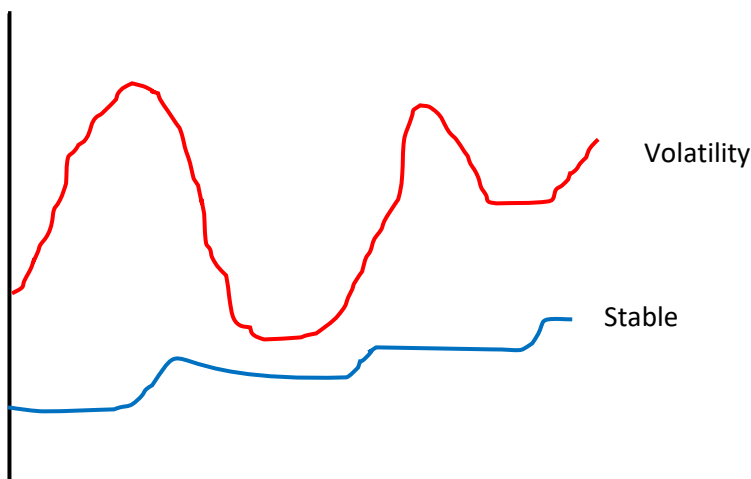
No, it has a clear effect on the capabilities of choosing when to pay taxes.

1. **Dividends:** It is mandatory to pay taxes when you receive the dividends, even if when you do the declaration of the rent you discount that payment of taxes. The shareholder **does NOT have the capability of deciding when to pay the taxes.**
2. **Capital gains:** Instead, when the taxes are through capital gains the **shareholder can decide when to pay the taxes.**

The importance of Information Content.

Information is important and has a lot of relevance in the financial markets. In the case of dividends, it is especially relevant when is compared to the previous dividend. As we have seen before, if the dividend is higher than the previous year it can denote as if the company is going better, but the opposite will happen as well.

Then, a company **must be careful** when increasing the Dividend Per Share, as it might be able to pay it this year, but not the following. Ending up with a situation like this:



As a company we prefer a more stable increase in the DPS, so we do not have sharp reactions on the financial markets. We must remember that **volatility** is not well seen by investors, as well as they tend to be pessimistic, so it is probable that the sharp falls tend to be worst than the big increases.

Clientele Effect.

This theory divides the investors into two categories, which will be consider by the company.

- A. High Income, young and generate savings:** It would be something close to all students at IQS.
 - ❖ **Looking for Low Payout Firms:** They want to reinvest in order to win more.
- B. Public pensions:** Old people who are investing their savings to generate something that could complement their pension.
 - ❖ **Looking for High Payout Firms:** They want to receive cash to complement their everyday costs.

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Different policies which are usual and their effects.**1. Fix Payout = 1 = 100% of the Net Income.****1.1. Advantages.**

- **Clientele Effect:** The Investors attracted by the dividend, will come. It is a stable policy which will not change, always the 100 % of the Net Income will be paid.
- **Stock Market Crises:** In this situation all shares will drop in their value. However, those companies which pay dividends will drop less, as you can see in this example:

Example:

$P_0 = 10€ \longrightarrow P_1 = 5€$

$DPS_0 = 0,5€ \longrightarrow DPS_1 = 0,5€$

$\text{Dividend Yield } 0 = 5\% \longrightarrow \text{Dividend Yield } 1 = 10\%$

As the stock does not change, the return of the stock, which is the Dividend Yield, will increase. Just look at the fucking formula and you will understand.

1.2. Disadvantages.

- **Dividend Per Share will be Volatile:** This will affect the information content that says the dividend should not be reduced if we want to prevent the stock from dropping.
- **We do not generate resources to finance future activity:** As we do not introduce some of that income in the Return Earnings, there are no resources generated which could help us finance future activity.

2. Fix Payout = 0 = 0% of Net Income.**2.1. Advantages.**

- **Clientele Effect:** Those who are looking for a company that reinvest the dividends it could be generated are probably going to invest in the company.
- **Information Content:** As there is no dividend given, there is no volatility on the price of the share and no information given to the shareholders that could have a negative or a positive effect.
- **Generates Reserves:** All that money that is not given, it is used to finance future projects through the **return earnings** or reserves.

2.2. Disadvantage.

- **Crisis:** There is no parachute if there is a crisis, the company's shares will drop more than it would if a dividend was paid.

3. Constant Payout = $(0 < x < 1) = 0\% < x < 100\%$ of the Net Income.**3.1. Advantages.**

- **Clientele Effect:** It is an stable policy that will attract either one's or the others.

3.2. Disadvantages.

- **Information Content:** Information is given here. The price of the share could rise or not.

3.3. In the Middle.

- **Generate Reserves:** It could generate reserves or not, is in the middle.
- **Parachute for a crisis:** It could generate a parachute or not.

Joke.

- Why did the Bicycle fall Over?
- Because it was "two tired"

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4. Constant slightly growing DPS.**4.1. Advantages**

- **Information Content:** It is an advantage as it never decreases.
- **Clientele Effect:** It is stable, so it is good.

4.2. Disadvantage.

- **Sustainability:** The company may reach a point where it is impossible to keep with the increase in DPS.

4.3. In the Middle.

- **Retain Earnings:** It might be created or not.

5. Residual dividend Policy.

This policy is explained as the one which only gives when there is spare money which is not needed for the company to function fully, taking into account also future investments.

Example:

Weight of Debt = 60%

Weight of Equity = 40%

Number of Shares = 1.000.000

Investment to be made = 150.000.000€

Net Income = 60.000.000€

The company wants to maintain the Capital Structure.

Debt to be used = $150.000.000€ \times 60\% = 90.000.000€$

Equity to be used = $150.000.000€ \times 40\% = 60.000.000€$

No dividends will be given to the shareholders.

5.1. Advantages

- **Sensible or Logical:** When we have spare, we give dividends, when the company does not have, it doesn't give.
- **Generate reserves:** When money is needed for future investment we do not give, when it is not needed we give.

5.2. Disadvantages.

- **Information Content:** One year we might give, but not the following one, decreasing the DPS which this theory forbids.
- **Clientele Effect:** It is not stable as well, which affects the two types of investors.

Non-Cash Dividends.

1. **Stock Dividends:** These are formed by a % needed to get an extra dividend. This is usually used by companies from IBEX-35, in the excel I will explain how that is so rentable for them.
2. **Script Dividends:** These are companies which let their shareholders decide either if they want to receive in cash or with dividends.
3. **Repurchase of Shares:** This happens when the company, instead of handing dividends or cash, it buys the shares from its shareholders.

All these different options, you will have the best mathematical explanation in the Excel I am about to do after the F1 2020 Shakir Classification of F1.

End of the Notes.



← CHAPTER 4

CHRISTMAS →

https://youtu.be/ZQ7_En2xEm4 - It is quite dangerous.