Corporate Finance, Module 15, “Payout Policy”

Readings for Ninth Edition

(The attached PDF file has better formatting.)

Updated: November 19, 2007

The page numbers here are for the *ninth* edition of Brealey and Myers. You may also use the seventh or eighth editions of this text. The page numbers for the seventh and eighth editions are in separate postings.

{The Brealey and Myers textbook is excellent. We say to read certain sections and to skip others. This does not mean that certain sections are better; it means that the homework assignments and exam problems are based on the sections that you must read for this course. Some of the skipped sections are fascinating, but they are not tested.}

The term *dividend policy* in the seventh edition has been changed to *payout policy* in the eighth edition. Both terms are used in the online postings, the practice problems, and the final exam questions.

Read the introduction on page 442. As Brealey and Myers say, the central question is “How does payout policy affect firm value?”

Read section 17.1, “Choice of Payout Policy,” on pages 443-444. This is an introduction.

Read section 17.2, “Dividend Payment and Stock Repurchase,” on pages 444-446. These are facts about dividends; even if you know how stocks are traded, the section on stock repurchase plans contains much new information.

Skip section 17.3, “How Do Companies Decide on Dividend Payments,” on pages 446-447. We don’t need Lintner’s model for the financial theory in this textbook. The model is reasonable, but it is not used elsewhere in this course.

Read section 17.4, “The Information in Dividends and Stock Repurchases,” on pages 447-450, skipping “The Dividend Cut Heard Round the World” on page 449. Many common dividend practices are hard to explain, and financial analysts presume that dividends send information to investors, not just money. There are more efficient ways of getting money to investors, but dividends may be a good source of information.

Read section 17.5, “The Payout Controversy,” on pages 450-455, focusing on the sub-section “Dividend Policy Is Irrelevant in Perfect Capital Markets” on page 451. The illustration on pages 451-452 is helpful for understanding the theory and answering final exam questions. Understanding this irrelevance theorem is important; the irrelevance theorem for capital structure is similar, so make sure you grasp the concept.

Skip section 17.6, “The Rightists,” on pages 444-457; skip section 17.7, “Taxes and the Radical Left,” on pages 457-461; and skip section 17.8, “the Middle-of-the-Roaders,” on pages 461-464. Brealey and Myers are middle-of-the-roaders. But financial analysts differ so much in their views of dividends that Brealey and Myers present the full range of current opinion. If you trade common stocks, you may want to read these sections to better judge how dividends affect your stock values, but these sections are not tested on the final exam.

Read the summary on pages 464-465, stopping at the line: “… to run a tighter ship”; skip the rest of the summary.

The payout (dividend) issue highlights the corporate finance problems facing us, and the eighth edition of the textbook shows these issues more clearly. We have many facts: a hundred years of dividend payments by thousands of firms. But we still can’t explain what is happening, and we have widely divergent perspectives (left, right, and middle). This is not like a statistics course, where everything is mathematically proved; it is not like a social science class where it is hard to find hard data. Here we have data as hard as we would like, but we still can’t figure out why firms pay the dividends that they do. This is what make corporate finance so fascinating – and so promising for the student you can interpret the real world.