Corporate Finance, Module 15, “Payout Policy”

Readings for the Fourteenth Edition (2022) of the Brealey, Myers, Allen, and Edmans text

(The attached PDF file has better formatting.)

The sections in this posting are for the *fourteenth* edition of the Brealey, Myers, Allen, and Edmans text. You may also use the seventh through thirteenth editions; final exam problems can be answered from any edition.

{The Brealey, Myers, Allen, and Edmans 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 terms *dividend policy* and *payout policy* are both used in corporate finance. Both terms are used in the online postings, practice problems, and final exam questions. The tenth through fourteenth editions of the textbook use the term payout policy; earlier editions used the term dividend policy.

Read section 15.1, “Facts about Payout.” Focus on the sections “How firms pay dividends” on page 436 and “How firms repurchase stocks” on page 437. Even if you know how stocks are traded, the section on stock repurchase plans contains new information. Know the sequence in Figure 15.2 on page 436 and the terms for each date. The stock price declines by the dividend amount on the *ex-dividend date*, not the payment date.

Read the subsection “The Information Content of Dividends” on pages 437-439 and the subsection “The Information Content of Share Repurchases” on page 439. 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. No hard data exists, so these ideas are speculative.

Read section 15.2, “Dividends or Repurchases? Does the Choice Affect Shareholder Value?” Final exam problems may specify perfect capital markets (with no taxes or dividend clienteles). The textbook notes several irrelevance theorems; figure 15.5 on page 443 helps you grasp the absence of an effect from paying dividends on the firm’s value in perfect capital markets. The irrelevance theorem for capital structure is similar, so make sure you understand the concept.

No final exam problems are drawn from section 15-3 Dividend Clienteles. Years ago, some older persons relied on stock dividends for income. But cashing small checks every few weeks is inefficient; few investors now require high dividend shares.

Read section 15-4 Taxes and Payout Policy. Taxes affect values of stock and bonds as well as firms’ capital structure. They affect final exam problems on weighted average cost of capital and the return on debt capital. Dividends, bond interest, and stock capital gains are taxed at different rates, affecting the choice of dividend payments vs repurchases and bond issues vs stock issues.

Read section 15-45 “Payout Policy and the Life Cycle of the Firm” on pages 449-452.

Dividend payouts highlight some unsolved problems. This is not a math course, where everything is proved; it is not a social science class where data are sparse. We have a hundred years of data from thousands of firms, but we still can’t figure out why firms pay the dividends that they do. This makes corporate finance so fascinating – and so promising for the student who can interpret the real world.

Review end of chapter problems 1, 2, 3, 5, 14, and 15a,b.

Illustrative test questions, problems, and homework assignments are shown separately on the discussion forum.