# What Is Dividend Policy?

Worksheet

Dividend policy is management's decision on the proportion of earnings to distribute to shareholders, balancing current returns against future growth opportunities.

## Questions

1. A company decides to increase dividends despite slowing growth. Likely reason:

A) To fund expansion
B) To reduce shareholder anxiety
C) To improve cash flow
D) To decrease stock price

2. Which investor prefers high dividend-paying stocks?

A) Growth investor seeking capital appreciation
B) Retiree needing current income
C) Young saver with stable income
D) Tech startup founder

3. A company retains 70% of earnings. Its payout ratio is:

A) 70%
B) 30%
C) 50%
D) Cannot calculate

4. Dividend policy affects which stakeholder groups most?

A) Employees
B) Creditors
C) Shareholders
D) Suppliers

5. A company earns $10 million. Pays $6 million in dividends. What is the payout ratio?

6. Stock A pays 4% dividend yield; Stock B pays 0% but grew 15% in value. Which suits a retiree?

7. Company's earnings stable at $50M/year. Cutting dividend from 80% to 50% payout. What changes?

8. Define: What is dividend policy?

9. Define: What is a payout ratio?

10. Define: Why do companies retain earnings?

# Answer Key

1. B) To reduce shareholder anxiety - Companies increase dividends to reassure shareholders during uncertain periods.
2. B) Retiree needing current income - Retirees rely on regular dividends for living expenses.
3. B) 30% - Payout ratio = % of earnings paid out = 30%.
4. C) Shareholders - Dividends directly impact shareholder returns and shareholder expectations.
5. Payout ratio = Dividends / Earnings = $6 million / $10 million = 60% Retained earnings = 40% = $4 million
6. Retiree needs income Stock A (4% dividend) Growth investor Stock B (capital appreciation) Dividend policy shapes investor fit
7. Old dividend: $50M 80% = $40M New dividend: $50M 50% = $25M Retained for growth: $25M (+$10M) Stock may fall initially, rise later if growth materializes
8. Management's decision on what portion of earnings to pay to shareholders vs. retain for growth.
9. Dividends paid divided by earnings. Example: if a company pays $2 per share and earns $5, payout ratio is 40%.
10. To fund R&D, expansion, pay down debt, and maintain financial flexibility for opportunities.