

# [The dividend policy test](https://assignbuster.com/the-dividend-policy-test/)

[Finance](https://assignbuster.com/essay-subjects/finance/)

Q1. There are following assumptions to be used for Modigliani and Miller's dividend irrelevancy theory. Which are the correct assumptions? (MRQ)

* There are no tax preferences
* Transaction cost is insignificant
* Directors convey all information to shareholders
* No inflation
(2 marks)

Q2. Select the appropriate option for the given statements relevant to irrelevancy theory. (HA)

* All shareholders want their wealth to increase TRUE FALSE
* As dividends are paid share price increases TRUE FALSE
(2 marks)

Q3. The process of manufacturing dividends in the dividend irrelevance theory refers to? (MCQ)

* Dividends received from a manufacturing company
* Sale of shares by the investors to earn dividends
* Plans set to earn a continuous return
* Creative accounting to pay a dividend
(2 marks)

Q4. The 'dividends as residuals' view of dividend policy are best described as (MCQ)

* Dividends are paid if the company generates profits greater than the prior year (The difference is residual)
* The profits made by the division of the company in a particular city should be paid to shareholders of the same city
* Dividends should amount to the entire annual profit less the amount paid in manager incentive schemes
* Dividends should only be paid out of cash flow after the company has financed all its positive NPV project
* (2 marks)

Q5. In which situation does a residual dividend policy is likely to be applicable? (MCQ)

* A public listed company
* In a market norm where taxes on dividends are lower
* A small listed company seeking maximum capital growth for shareholders
* An unlistedfamilybusiness where earnings are based on dividend income
(2 marks)

Q6. The companies have following payment history:
2015 2016 2017

* Tuna Co (Dividend) 400 410 421
* Tuna Co (Earnings) 800 800 801
* Sauna Co (Dividend) 20 80 10
* Sauna Co (Earnings) 40 160 20
* Mona Co (Dividend) 0 100 0
* Mona Co (Earnings) 200 150 300
* The dividend policy for each company is? (HA)
* Tuna Co CONSTANT GROWTH CONSTANT PAY-OUT RESIDUAL
* Sauna Co CONSTANT GROWTH CONSTANT PAY-OUT RESIDUAL
* Mona Co CONSTANT GROWTH CONSTANT PAY-OUT RESIDUAL
(2 marks)

Q7. Juju Co. director has given the following statement at the annual general meeting " In mychildhood, I got a rise in my half-yearly allowance from my father and I expected it to continue in the future. The shareholders expect the same to have a rise in their dividends". Which of the following supports the statement of the director? (MCQ)

* Dividend irrelevancy theory
* Dividend dependency theory
* Director is concerned about the company liquidity
* Director indicates a signaling effect on dividends
(2 marks)

Q8. Which of the following given below relate to Dividend relevance theory keeping in mind having an imperfect capital market? (MRQ)

* Taxes applicable on dividends ; capital gains are different
* Shareholders have not disclosed all information received to the directors
* No transaction cost is applicable
* Shareholders would like a stable or growing dividend policy
(2 marks)

Q9. Which of the following factor affect the shareholder in setting its dividend policy? (MCQ)

* The local laws ; regulations given by the government
* The repayment of new debtfinancein 10 years
* The deflation effect
* The demand for customers products
(2 marks)

Q10. A scrip dividend is a:

* A dividend paid at a fixed rate on the face value of the shares
* A dividend paid at a fixed percentage rate on the market value of the shares on the date that the dividend is announced
* A dividend payment that converts in a form of new shares instead of cash
* A cash dividend that is variable and is decided upon by the directors and approved by the shareholders
(2 marks)

Q11. Select appropriate option in relation to scrip dividends. (HA)

* It can save the company's cash if a number share options are taken up by the shareholders ADVANTAGE DISADVANTAGE
* Scrip dividends may trigger a negative signaling effect ADVANTAGE DISADVANTAGE
(2 marks)

Q12. Which of the following is a drawback of a share repurchase scheme? (MCQ)

* Increase in earnings per share
* Increase in gearing
* The possibility of a takeover is reduced
* Some shareholders may suffer tax on capital gain after the purchase of shares
(2 marks)

## DIVIDEND POLICY (ANSWERS)

Q1.

* There are no tax preferences (Assumption)
* Transaction cost is insignificant (Assumption)
* Directors convey all information to shareholders (Assumption)
* No inflation, M&M theory does not state anything about the existence or otherwise of inflation

Q2.

* All shareholders want their wealth to increase TRUE As dividends are paid share price increases FALSE
* All the shareholders are concerned about their wealth increment whether by capital gains or by the dividend. The share price decreases as dividends are paid because if there will be no retain earnings left by the company new equity will have to be raised resulting decrease in share prices.

Q3. B

Q4. D

* The residual theory states that if a company can identify positive NPV projects it should invest in them. Only when these investment opportunities are exhausted should dividends be paid

Q5. C

* Residual income will not give a reliable income & is geared to financing investments that provide capital gains.

Q6.

* Tuna Co CONSTANT GROWTH Sauna Co CONSTANT PAY-OUT Mona Co RESIDUAL
* Tuna Co dividends grow at 10% per annum.
* Sauna Co pays a 50% of its earnings as dividends
* Mona Co dividends are not connected with earnings so their policy is residual

Q7. D

Q8. All others are correct except for No transaction cost

* Taxes applicable on dividends & capital gains are different
* Shareholders have not disclosed all information received to the directors
* No transaction cost is applicable (Applicable only if there is a perfect capital market)
* Shareholders would like a stable or growing dividend policy

Q9. A

* The local laws & regulations given by the government
* The repayment of new debt finance in 10 years. The repayment of previous debt should be considered rather than the new debt finance.
* The deflation effect. The consideration should be of inflation effect rather than deflation as deflation is a benefit
* The demand for customer products. Dividends are given to shareholders rather than to customers.

Q10. C

* A dividend paid at a fixed rate on the face value of the shares would most commonly be a preference dividend. A cash dividend that is variable and is decided by the directors and approved by the shareholders is a definition of a normal dividend.

Q11.

* It can save the company's cash if a number share options are taken up by the shareholders ADVANTAGE Scrip dividends may trigger a negative signaling effect DISADVANTAGE

Q12. D

* Increase in earnings per share, through a reduction in the number of shares in issue.(Advantage)
* Increase in gearing, Repurchase of a company's own shares allows debt to be substituted for equity, so raising gearing. (Advantage)
* The possibility of a takeover reduced, Share repurchase might prevent take over as this can enable the company to withdraw from the market. (Advantage)
* Some shareholders may suffer tax on capital gain after the purchase of shares (Disadvantage)