

Financial analysis for managers

Finance



**ASSIGN
BUSTER**

Financial Analysis for Managers II

1. Why should companies pay out dividends? Why would Microsoft distribute dividends? What are the advantages and disadvantages to Microsoft's multi-billion dollar dividend payout?

The company's ability to distribute dividends often indicates its financial position. For instance, it should be noted that a business organization can only pay dividends to its stockholders if it shows sufficient income for the fiscal year. Secondly, the company should have ample cash in order to cover for the payout. With this, investors often look out for companies who are paying their stockholders frequently in order to have a steady flow of income. The issuance of dividends becomes incremental to the business organization because "dividends provide certainties about the company's financial well being" (Investopedia 3) as well as "attractive for investors looking to secure current income" (Investopedia 3). Thus, companies often pay dividends in order to attract potential investors, retain current ones who are more sensitive to cash inflows from investment, and indicate their strong financial muscle. In various studies, it has been apparent that declaration and payment of dividends bid up the price of the company's stock making the payment. Payment of dividends which is coupled by capital gains truly maximize the wealth of stockholders.

Even if Microsoft is recognized because of its financial strength, the company can opt not to issue dividends. It should be noted that most investors are very much interested in acquiring ownership of this company because of its financial viability and brand equity. The continuous appreciation of its share in the market can suffice and dividends are not really necessary to complement this. It should also be noted that the business organization will

<https://assignbuster.com/financial-analysis-for-managers/>

only be shedding out million dollar funds which it can use to finance its R&D and provide more value to its stockholders. However, one of the detrimental effects of not issuing dividends will be the reaction of stockholders who feels more secure with steady cash inflow from their investments. It should be noted that the company can also undergo lawsuits for not paying its owners amidst its strong financial position.

2. How might differences in tax treatment for dividends and capital gains affect dividend policy?

The tax treatment for dividends and capital gains often becomes a consideration of a business organization in its choice of dividend policy. In the United States, there has been a heated debate on the taxation of dividends. As both business organizations and investors receiving the dividend are taxed, double taxation together with the high tax rates has discouraged issuance of dividends. For example business organizations which report a pre-tax profit of \$100 will be required to pay corporate tax of \$35. The remaining \$65 will also be taxed if the company will declare all of this as cash dividends. Double taxation is seen to benefit not investors of corporations but the government which collects this tax (Michel 4). Capital gain which is the gain from stock price appreciation is also taxed based on the amount of appreciation. The taxation from capital gains and dividends squeeze out the earnings of both companies and investors.

When choosing a dividend policy, a company looks at the effects of taxes both on its operation and its investors. Having the primary goal of maximizing stockholder wealth, the business organization pursues what is most beneficial for a company. For instance, if the dividend tax is much higher than capital gains tax, the business organization opts for minimal

dividend and work on improving its overall financial position instead in order to boost its stock price. However, companies often opt to issue dividends amidst the high tax rates because of the appreciation of stock prices which can increase capital gain. The boost in capital gain will allow investor and business organization to recoup the taxes paid. Also, the presence of the government looking at the company's dividend issuance also pressures them to pay dividends to stockholders.

Such is the case of companies in the business arena. Even though some business organizations have had zero-dividend payout, more and more companies are turning to the issuance of cash dividends. For example, information technology company like Microsoft which retains its profit in the business organization announces its first issuance of dividend in 2003 (Ballmer 3). Another example is Intel which also stuck to the zero-dividend policy yet is now paying its investors (Intel's Board 1).

Works Cited

"How and Why do Companies Pay Dividends?" Investopedia. 2007. 15 February 2008 "Intel's Board Stares Down Critics, Declares Quarterly Dividend Payout." 2008. 15 February 2008 Balmer, S. "Microsoft Dividend Policy." 2004. 15 February 2008 Michel, N. "Who Really Benefits from Dividend Tax Relief?" 7 January 2003. 15 February 2008