Solution

[go to problem](http://www.brainmass.com/student/library/solution.php?goal=1&sgr_id=1152669#problem)

Compare a regular cash dividend with a periodic share repurchase. Which has greater appeal to you? Explain.   
  
Periodic share repurchase are becoming now more popular because it is increasing the earnings per share post repurchase. This is because the number of shares outstanding gets reduced and its cost of capital is also reduced. This also increase the ownership percentage of the remaining shareholders. Moreover share repurchase does not attract any dividend taxes.   
Moreover once a dividend is put in place, it will be negative if it is decreased or ceased in the future but that is not the case with buyback. THus buyback has more appeal   
  
  
  
  
  
  
  
Would our investors prefer to receive cash dividends or stock dividends?  Explain your reasoning.   
  
As a part of the financing decision the dividend policy of the firm is a residual decision and the dividends are a passive residual.  So long firm is able to earn more than the equity capitalization rate than the investors would be content with the firm retaining the earning.  In contrast if the firm were able to earn less than the equity capitalization rate investors would prefer to receive the earnings.   
  
  
Explain a stock dividend and further explain if you would prefer it to a cash dividend.   
  
Stock prices fall after the dividend because the stock price adjusts the dividend paid by the firm and therefore the ex dividend price dividend adjusted price. As dividend is a inflow, therefore the prices fall.   
There is a definite advantage to the investors owing to the tax differential in dividend and capital gains tax. If tax on dividend is less than the investor will prefer the dividend instead of the capital gain. One must also consider the time value of money & uncertainty, the investors will prefer the current dividend. As the future dividend increases the uncertainty. It is referred to as bird in the hand argument.   
  
A number of dates relate to payment of cash dividends. They are:   
  
1 Declaration Date. This is the date on which a company's board of directors declares that a dividend will b paid and specifies the amount.   
  
2 Record Date. This is the date specified by the board of directors for determining shareholders who will be paid the dividend. All shareholders listed in the company's records on that date will be paid the dividend whether or not they actually own the stock on that particular date.   
  
3 Payment Date. As the name suggests, this is the date on which the dividend payment is made.   
  
4 Ex-dividend Date. This date comes after the declaration date and is usually two business days before the record date. From the ex-dividend date until the payment date, the stock is traded without the declared but unpaid dividend. This means if a sale is made after the ex-dividend date, the seller rather than the buyer is entitled to the dividend.   
  
A company may choose to pay a stock dividend, which is a dividend paid in shares or fractions of shares, instead of cash. A stock dividend merely lowers the cost per share of your holdings; it does not change the total value of your holdings. For example, if you owned 20 shares of stock worth $250, each share would be worth $12.5 . If a 25% stock dividend were paid, you would then own 25 shares whose total value would still be $250. However, each share would then be worth $10.   
  
A stock dividend is usually nontaxable at the time paid unless the company offers the stockholder the option of receiving the dividend in the form of either stock or cash.   
  
Generally the investor prefers cash dividend as they can use it as per their wish, on the other hand stock dividend is preferable when there is a greater tax differential as stock dividends are tax free. Thus in case of high tax rates on cash dividend, stock dividend will be preferable.   
  
  
  
  
Reference:   
1. Company law by N.D. Kapoor   
2. www.rediff.com   
3. FINANCIAL MANAGEMENT BY I.M. PANDEY   
  
  
  
  
  
Why Stock Splits   
  
When a company believes that investors are shying away from purchasing or holding its stock because the market price is too high or too low, the board of directors may approve a stock split. A stock split is similar to a stock dividend in that new shares of stock are issued to current stockholders.   
  
Stock splits are expressed as ratios such as "2 for 1" or "3 for 2." In a 3 for 2 split, for example, for every 2 shares you currently own, you would receive one additional share so that after the split was paid, you would have 3 "new" shares for every 2 "old" shares you previously held.   
  
As with a stock dividend, while the total value of your holdings remains the same, the value per share will change according to the split ratio. When a stock split takes place, the market price per share will generally be adjusted by the same ratio. Most stock splits result in additional shares being issued and the market price per share being reduced to a more attractive trading level for investors.   
  
In contrast, when the market price of a stock is unusually low, a reverse stock split may be declared. In a reverse split, shareholders are required to send their certificates to the company to be exchanged for new certificates representing a small number of shares. Again, the split is expressed as a ratio, such as "1 for 10" reverse split. In that example, for every 10 shares you currently own, you would receive a certificate for 1 new share. A reverse split will increase the market price per share by approximately the same ratio. Thus, the total value of your holdings will remain the same, but the market price per share will be approximately 10 times higher.   
  
Reference:   
1. Company law by N.D. Kapoor   
2. wikipedia   
3. www.investopedia.com