Telkom University

Dividend Policy

Basic Concepts - Understanding

1. Dividend used to determine the stock valuation
2. Dividend as signal and information for investors
3. Dividend as a way to obtain external financing

Dividend Payment Procedure (1)

Holder of Record Date

The date when companies closed their records related to stock transfer ownership and listing the dividend recipient.

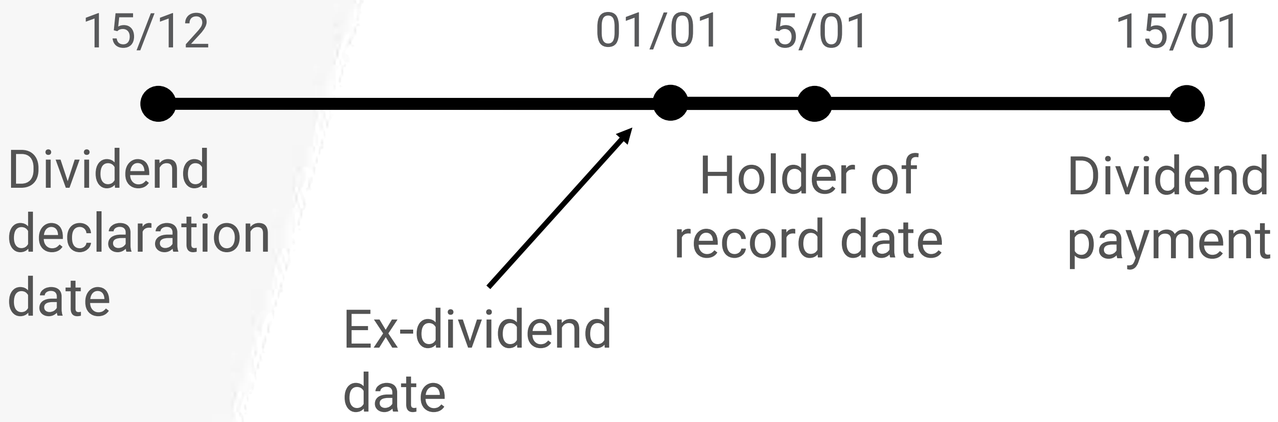
Ex-dividend Date

It's a date that usually comes from brokers to avoid chaos of administration where they determine cut-off date the name listed of ownership prior the holder of record date.

Payment Date

The date when the stocks issuer (company listed at the market) transfer of clearing payment to all shareholders.

Dividend Payment Procedure (2)



Dividend Re-investment Plans (DRP)

A strategic that allows shareholders to use the dividends they earned to acquire additional shares in whole or some part of it with certain transaction fee (at secondary market) or without transaction fee (at primary market).

Dividend Theory

01

The Residual Theory of Dividend

02

The Irrelevant Theory of Dividend

03

The Relevant Theory of Dividend

Dividend Theory

01

The Residual Theory of Dividend

At this point, the shareholders of the company have a typical appetite if the company holds its profits to be reinvested than if the profits are paid in the form of dividends where re-investment will be more productive than other stocks whose risks are roughly balanced.

Residual Theory Procedure

STEP 01

Determine the optimum level of capital expenditure, where:

(IOS > WACC/WMCC)

STEP 02

Determine company's capital structure

STEP 03

Retained earnings are used to financing company's operation. Issuing new common stocks can be done if needed.

Dividend Theory

02

The Irrelevant Theory of Dividend

Put forward by Merton H. Miller & Franco Modigliani (M & M)

"In a perfect world (no certainty, no taxes, no transaction costs and no other perfect market), the value of the company (shares) is not affected by the distribution of dividends."

In other words, the valuation of a share of a company not affected by dividend policy that company adopted.

The Irrelevant Theory of Dividend

Client Effect:

Where a company being attractive to the shareholders whose have preferences to the stability and rate of dividend payouts within company's increasing performance.

Reasons Why Dividends Not Affect Value of Enterprise

1. Firm value is influenced by the company's ability to generate profits and minimizing risk;

2. If somehow dividends affect the value of the company its caused by information that shows management's expectations of company earnings;

3. Client effect.

Dividend Theory

03

The Relevant Theory of Dividend

Put forward by Myron J. Gordon and John Lintner.

“Shareholders prefer for present dividends because there is a direct relationship between dividend policy and its market value.”

In other word, dividend policy will affect on value of firm.

Factors Affect Dividend Policy

01 Law and regulations

02 Liquidity

03 Instalment on debt

04 Debt positions

05 Increasing of Capital expenditure

06 Rate of return

07 Profita bility

08 Capital market

09 Organizing and Controlling

10 Dividend policy

Dividend Policy (Understanding)

The company's dividend policy is a plan of action that must be followed in making dividend decisions.

Dividend policy should be formulated for two basic purposes:

1. Maximizing the wealth of the company owner
2. Sufficient financing

3 Types of Dividend Policy

01 Constant-payout ratio dividend policy

02 Regular dividend-policy

03 Low-regular and extra dividend policy

Constant-payout Ratio Dividend Policy

01

Is a percentage of each rupiah generated distributed to the owner in the form of cash?

Calculated by **dividing cash dividends per share by earnings per share**.

Year	Earnings/share	Dividends/share	Average price/share
2006	−$0.50	$0.00	$42.00
2005	3.00	1.20	52.00
2004	1.75	0.70	48.00
2003	− 1.50	0.00	38.00
2002	2.00	0.80	46.00
2001	4.50	1.80	50.00

Regular Dividend-policy

02

Dividend policy based on dividend payments in rupiah which is fixed in each period.

Often a regular dividend policy is used by using a target dividend payout ratio

Target dividend-payout ratio, is a policy in which the company tries to pay dividends in a certain percentage and adjusted to the payment target that proves an increase in yield.

Regular Dividend-policy

Year	Earnings/share	Dividends/share	Average price/share
2006	$4.50	$1.50	$47.50
2005	3.90	1.50	46.50
2004	4.60	1.50	45.00
2003	4.20	1.00	43.00
2002	5.00	1.00	42.00
2001	2.00	1.00	38.50
2000	6.00	1.00	38.00
1999	3.00	1.00	36.00
1998	0.75	1.00	33.00
1997	0.50	1.00	33.00
1996	2.70	1.00	33.50
1995	2.85	1.00	35.00

Low-regular and Extra Dividend Policy

03

A dividend policy based on regular low dividend payments, plus extra dividends if there is guaranteed income.

Stock Dividend

Stock dividends are dividend payments in the form of shares to shareholders.

Often dividends in the form of shares are paid as a substitute or supplement to cash dividends.

In the accounting aspect, the payment of stock dividends is a shift of funds between capital estimates rather than capital use.

Stock Dividend

If somehow company declares a 10% stock dividend and the share price is IDR 30,000 per share, then retained earnings of IDR 300,000,000 (10% x 100,000 shares x IDR 30,000 per share) will be capitalized.

If the dividend is a stock dividend, the approximate balance is as follows:

Preffered Stock	Rp	600.000000
Common stock (100.000 shares @ Rp 8.000)		800.000.000
Capital Surplus		1.200.000.000
Retained Earning		1.400.000.000
Total Capital	Rp	4.000.000.000

Preffered Stock	Rp	600.000000
Common stock (100.000 shares @ Rp 8.000)		880.000.000
Capital Surplus		1.420.000.000
Retained Earning		1.100.000.000
Total Capital	Rp	4.000.000.000

Stock Dividend

From a shareholder's point of view:

Shareholders who receive dividend shares do not actually get any value. After the dividend is paid, the value per share decreases according to the dividend payment where the market value of total earnings does not change.

The proportion of shareholder ownership in the company remains the same, as long as the company's income does not change.

Stock Split

A method commonly used to lower the market price of a company by increasing the number of shares held by each shareholder.

Stock Split

Delphi Company, a forest products concern, had 200,000 shares of $2-par value common stock outstanding and declares a 2-for-1 split.

The total before and after split impact on stockholders equity is:

Before split	
Common stock (200,000 shares at $2 par)	$ 400,000
Paid-in capital in excess of par	4,000,000
Retained earnings	2,000,000
Total stockholders' equity	$6,400,000

After 2-for-1 split	
Common stock (400,000 shares at $1 par)	$ 400,000
Paid-in capital in excess of par	4,000,000
Retained earnings	2,000,000
Total stockholders' equity	$6,400,000

Reverse Stock Split

Stock split is a method used to increase the market price of a company's stock by exchanging a number of outstanding shares for one new share.

A stock split is proposed when it is sold at too low a price to perform well.

Buy Back

Repurchase of a number of common stock that already outstanding in the market by the company with the aim of:

- Increase the value of shares owned saham
- Prevent unwanted parties from taking over the company.

3 Methods of Buy Back

01 Buying shares at the open market

02 Through a tender offer, namely a formal offer to buy a number of shares at a price above the market price to attract sellers

03 Purchase by negotiation

References

- Gitman, Lawrence J and Zutter, Chad J. Principles of Managerial Finance. 14th edition, Pearson.
- Keown, Arthur J., Martin, John D and Petty, J William. Foundations of Finance. 9th edition, Pearson.