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APPROACHES TO THE DIVIDEND POLICY IN THE MARKET ECONOMY

The article reveals dominant approaches to the company's dividend policy in the market economy through analyzing a system of core finance managers' objectives for the company's dividend policy that contemplate maximizing owner wealth while providing adequate financing for the company; enlightening the key factors that influence dividend policy, among which should be mentioned company growth rate, profitability, earnings stability etc.; examining the main issues of stockholder tax consideration based on the fact that dividends are considered ordinary income and are taxed at the full rate. This fact generates investor's psychological dilemma between choosing a stock repurchase or taking earnings as dividends. In particular, capital gains that arise from the appreciation of the market price of stock have a tax advantage over dividends except in certain situations.

The article also unveils the existing dividend policy controversy that could be defined as a choice between earning retention or capital gains of the company and dividends depending on the particular characteristics of the firm and its owners.

У статті розкриваються основні підходи до дивіденДної політики підприємства в ринковій економіці шляхом аналізу системи основних завдань фінансових менеджерів з дивіденДної політики компанії, що передбачають максимізацію багатства власника, забезпечуючи адекватне фінансування для компанії; висвітлення ключових факторів, що впливають на дивіденДну політику, серед яких необхідно зазначити швидкість росту компанії, рентабельність, стабільність прибутку тощо; вивчення основних питань розгляду податку акціонерами, засноване на тому, що дивіденди вважаються звичайним доходом і оподатковуються за повною ставкою. Цей факт породжує психологічну дилему інвестора при виборі між зворотнім викупом акцій або отриманням доходу у вигляді дивідендів. Зокрема, доходи від приросту капіталу, які виникають з оцінки ринкової вартості акцій мають податкові переваги перед дивідендами, окрім певних ситуацій.

У статті також розкриваються існуючі розбіжності дивіденДної політики, що можуть бути визначені як вибір між утриманням доходів або приростом капіталу компанії і дивідендами, в залежності від конкретних характеристик фірми і її власників.

В статье раскрываются основные подходы к дивидендной политике предприятия в рыночной экономике путем анализа системы основных задач финансовых менеджеров в дивидендной политике компании, предусматривающие максимизацию богатства владельца, обеспечивая адекватное финансирование для компании; акцентирования на ключевых факторах, влияющих на дивидендную политику, среди которых необходимо отметить скорость роста компании, рентабельность, стабильность прибыли и т.п.; изучение основных вопросов рассмотрения налога акционерами, основанного на том, что дивиденды считаются обычным доходом и облагаются налогом по полной ставке. Этот факт порождает психологическую дилемму инвестора при выборе между обратным *выкупом акций или получением дохода в виде дивидендов. В частности, доходы от прироста капитала, которые возникают в результате оценки рыночной стоимости акций, имеют налоговые преимущества перед дивидендами, кроме определенных ситуаций.*

В статье также раскрываются существующие разногласия дивидендной политики, которые могут быть определены как выбор между удержанием доходов или приростом капитала компании и дивидендами, в зависимости от конкретных характеристик фирмы и ее владельцев.

Key words: dividend policy, factors, stockholders, dividends.

Introduction. Corporate earnings distributed to stockholders are called dividends. Dividends are paid in either cash or stock and are typically issued quarterly. They may be paid only out of retained earnings and not from invested capital such as capital stock or the excess received over stock par value. In general, the more stable a company's earnings, the more regular its issue of dividends.

Formalization of the task. A company's dividend policy is important for the following reasons:

1. It bears upon investor attitudes. For example, stockholders look unfavorably upon the corporation when dividends are cut, since they associate the cutback with corporate financial problems. Further, in setting a dividend policy, management must ascertain and fulfill the objectives of its owners. Otherwise, the stockholders may sell their shares, which in turn may bring down the market price of the stock. Stockholder dissatisfaction raises the possibility that control of the company may be seized by an outside group.
2. It impacts the financing program and capital budget of the firm.
3. It affects the firm's cash flow position. A company with a poor liquidity position may be forced to restrict its dividend payments.
4. It lowers stockholder's equity, since dividends are paid from retained earnings, and so results in a higher debt to equity ratio.

If a company's cash flows and investment requirements are volatile, the company should not establish a high regular dividend. It would be better to establish a low regular dividend that can be met even in years of poor earnings.

Relevant dates associated with dividends are as follows:

1. *Declaration date.* This is the date on which the board of directors declares the dividend. On this date, the payment of the dividend becomes a legal liability of the firm.
2. *Date of record.* This is the date upon which the stockholder is entitled to receive the dividend.
3. *Ex-dividend date.* The ex-dividend date is the date when the right to the dividend leaves the shares. The right to a dividend stays with the stock until 4 days before the date of record. That is, in the fourth day prior to the record date, the right to the dividend is no longer with the shares, and the seller, not the buyer of that

stock, is the one who will receive the dividend. The market price of the stock reflects the fact that it has gone ex-dividend and will decrease by approximately the amount of the dividend.

Methods of study. Research is made by analysis and comparison of information. Theoretical basis of study are:

- information-analytical editions;
- information on pages of economic literature and Internet recourses of this problem.

Results of study. A finance manager's objectives for the company's dividend policy is to maximize owner wealth while providing adequate financing for the company. When a company's earnings increase, management does not automatically raise the dividend. Generally, there is s time lag between increased earnings and the payment of a higher dividend. Only when management is confident that the increased earnings will be sustained will they increase the dividend. Once dividend are increased, they should continue to be paid at the higher rate. The various types of dividend policies are:

1. *Stable dividend-per-share policy.* Many companies use a stable dividend-per-share policy since it is looked upon favorably by investors. Dividend stability implies a low-risk company. Even in a year that the company shows a loss rather than profit the dividend should be maintained to avoid negative connotations to current and prospective investors. By continuing to pay the dividend, the shareholders are more apt to view the loss as temporary. Some stockholders rely on the receipt of stable dividends for income. A stable dividend policy is also necessary for a company to be placed on a list of securities in which financial institutions (pension funds, insurance companies) invest. Being on such a list provides greater marketability for corporate shares.

2. *Constant dividend-payout-ratio (dividend per share/ earnings per share) policy.* With this policy a constant percentage of earnings is paid out in dividends. Because net income varies dividends paid will also vary using this approach. The problem this policy causes is that if a company's earnings drop drastically or there is a loss, the dividends paid will be sharply curtailed or nonexistent. This policy will not maximize market price per share since most stockholders do not want variability in their dividend receipts.

3. *A compromise policy.* A compromise between the policies of a stable dollar amount and a percentage amount of dividends is for a company to pay a low dollar amount per share plus a percentage increment in good years. While this policy affords flexibility, it also creates uncertainty in the minds of investors as to the amount of dividends they are likely to receive. Stockholders generally do not like such uncertainty. However, the policy may be appropriate when earnings vary considerably over the years. The percentage, or extra, portion of the dividend should not be paid regularly; otherwise it becomes meaningless.

4. *Residual-dividend policy.* When a company's investment opportunities are not stable, management may want to consider a fluctuating dividend policy. With this kind of policy the amount of earnings retained depends upon the availability of investment opportunities in a particular year. Dividends paid represent the residual amount from earnings after the company's investment needs are fulfilled.

Theoretically, a company should retain earnings rather than distribute them when the corporate return exceeds the return investors can obtain on their money elsewhere. Further, if the company obtains a return on its profits that exceeds the cost of capital, the market price of its stock will be maximized. Capital gains arising from the appreciation of the market price of stock has a tax advantage over dividends. On the other hand, a company should not, theoretically, keep funds for investment if it earns less of a return than what the investors can earn elsewhere. If the owners have better investment opportunities outside the firm, the company should pay a high dividend.

Although theoretical considerations from a financial point of view should be considered when setting dividend policy, the practicality of the situation is that investors expect to be paid dividends. Psychological factors come into play which may adversely affect the market price of the stock of a company that does not pay dividends.

A firm's dividend policy is a function of many factors, some of which have been described. Other factors that influence dividend policy are as follows:

1. *Company growth rate.* A company that is rapidly growing, even if profitable, may have to restrict its dividend payments in order to keep needed funds within the company for growth opportunities.

2. *Restrictive covenants.* Sometimes there is a restriction in a credit agreement that will limit the amount of cash dividends that may be paid.

3. *Profitability.* Dividend distribution is keyed to the profitability of the company.

4. *Earnings stability*. A company with stable earnings is more likely to distribute a higher percentage of its earnings than one with unstable earnings.

5. *Maintenance of control.* Management that is reluctant to issue additional common stock because it does not wish to dilute its control of the firm will retain a greater percentage of its earnings. Internal financing enables control to be kept within.

6. *Degree of financial leverage.* A company with a high debt-to-equity ratio is more likely to retain earnings so that it will have the needed funds to meet interest payments and debts at maturity.

7. *Ability to finance externally.* A company that is capable of entering the capital markets easily can afford to have a higher dividend payout ratio. When there is a limitation to external sources of funds, more earnings will be retained for planned financial needs.

8. *Age and size.* The age and size of the company bear upon its ease of access to capital markets.

9. *Tax penalties.* Possible tax penalties for excess accumulation of retained earnings may result in high dividend payouts.

The answer to the question of which is preferred by stockholders – income from dividends or from capital gains (sale of stock) – depends on the individual stockholder's tax bracket. Capital gains, arising from appreciation in market price, are subject to a long-term capital gain deduction. Only 40 percent of the gain on the sale of stock that has been held more than 6 months is subject to taxation. Of course, a broker's commission will have to be paid on the sale. Dividends are considered ordinary income and are taxed at the full rate. The theoretical dispute regarding dividend policy relates to investor psychology in terms of whether earnings should be taken as capital gains or as dividends.

A stock dividend is the issuance of additional shares of stock to stockholders. A stock dividend may be declared when the cash position of the firm is inadequate and/or when the firm wishes to prompt more trading of its stock by reducing its market price. With a stock dividend, retained earnings decrease but common stock and paid in capital on common stock increase by the same total amount. A stock dividend, therefore, provides no charge in stockholder's wealth.

A stock split involves issuing a substantial amount of additional shares and reducing the par value of the stock on a proportional basis. A stock split is often prompted by a desire to reduce the market price per share, which will make it easier for small investors to purchase shares.

The differences between a stock dividend and a stock split are as follows:

- With a s stock dividend, retained earnings are reduced and there is a pro rata distribution of shares to stockholders. A stock split increases the shares outstanding but does not lower retained earnings.
- The par value of stock remains the same with a stock dividend but is proportionally reduced in a stock split.

The similarities between a stock dividend and a stock split are:

- Cash is not paid.
- Shares outstanding increase.
- Stockholders' equity remains the same.

Treasure stock is the name given to previously issued stock that has been purchased by the company. Buying treasury stock is an alternative to paying dividends. Since outstanding shares will be fewer after stock has been repurchased, earnings per share will rise (assuming net income is held constant). The increase in earnings per share may result in a higher market price per share.

To *stockholders,* the *advantages* arising from a stock repurchase include the following:

1. If market price per share goes up as a result of the repurchase, stockholders can take advantage of the capital gain deduction. This assumes the stock is held more than 6 months and is sold at a gain.

2. Stockholders have the option of selling or not selling the stock, while if a dividend is paid, stockholders must accept it and pay tax.

To the *company*, the *advantages* from a stock repurchase include the following:

1. If there is excess cash flow that is deemed temporary, management may prefer to repurchase stock than to pay a higher dividend that they feel cannot be maintained.

2. Treasure stock can be used for future acquisitions or used as a basis for stock options.

3. If management is holding stock, they would favor a stock repurchase rather than a dividend because of the favorable tax treatment.

4. Treasury stock can be resold in the market if additional funds are needed.

To *stockholders*, the *disadvantages* of treasury stock acquisitions include the following:

1. The market price of stock may benefit more from a dividend than a stock repurchase.

2. Treasury stock may be brought at an excessively high price to the detriment of the remaining stockholders. A higher price may occur when share activity is limited or when a significant amount of shares are reacquired.

To *management*, the *disadvantages* of treasury stock acquisition lay in the fact that if investors feel that the company is engaging in a repurchase plan because its management does not have alternative good investment opportunities, a drop in the market price if stock may ensue.

Dividends are paid to providers of capital to a company. Dividends are not reflected in the income statement but are shown in the statement of equity changes. Only dividends that have been paid are reflected. Changes in dividends can have a significant impact. However, many companies are not very forthcoming about their dividend policy.

Conclusion. Summing up, it’s necessary to mention that peculiarity of this article lays in the fact that it analyzes the dividend policy in the context of specific market economy, focusing on the key aspects of behavior of the modern market’s participants.

Speaking about the dividend policy controversy, it can be described by presenting the approaches put forth by various authors:

1. Gordon et al. believe that cash flows of a company having a low dividend payout will be capitalized at a higher rate because investors will perceive capital gains resulting from earnings retention to be more risky than dividends.

2. Miller and Modigliani argue that a change in dividends impacts the price of the stock since investors will perceive such a change as being a statement about expected future earnings. They believe that investors are generally indifferent to a choice between dividends or capital gains.

3. Weston and Brigham et al. believe that the best dividend policy varies with the particular characteristics of the firm and its owners, depending on such factors as the tax bracket and income needs of stockholders, and corporate investment opportunities.

Having examined various empirical trends in the dividend policy we can finally make a conclusion that the theory behind firm's dividend policies, reality, observed in the market, and the contrast between them requires more investigation.

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