Session 24: Post Class tests

1. Dividends, at least for US companies, are often described as “sticky”. Which of the following do we mean when we say that dividends are sticky?
   a. Companies are reluctant to pay dividends
   b. Companies are reluctant to change dividends per share
   c. Companies are reluctant to change dividend payout ratios
   d. Companies are reluctant to change dividend yield
   e. None of the above

2. In the last three decades, US companies have shifted away from paying dividends to stock buybacks. Which of the following offers the best explanation for why this may have happened?
   a. Dividends are taxed at much higher rates, relative to capital gains.
   b. The proportion of stock held by institutional investors has increased.
   c. Transactions costs for trading equity have decreased
   d. Companies feel much less secure or certain about future earnings
   e. Investors are more short term than they used to be.

3. Looking at history, which of the following best characterizes the relationship between dividends and earnings.
   a. Dividend increases tend to lead earnings increases, i.e., they happen before earnings increases
   b. Dividend increase contemporaneously with earnings
   c. Dividends increases lag earnings increases

4. The dividend payout ratio measures the proportion of net income paid out in dividends. A company that pays out more than its earnings as dividends has a payout ratio greater than 100%. Under which of the following scenarios might this occur?
   a. A firm that is shrinking its asset base (by selling businesses)
   b. A cyclical firm during a recession year
   c. A company paying a special dividend (a one time dividend)
   d. All of the above
   e. None of the above

5. The life cycle view of dividends suggests that dividend policy should change as a firm progresses through the life cycle. In particular, growth companies should not be expected to pay dividends. Which of the following is a good explanation for why?
   a. Growth companies often lose money
   b. Growth companies have investors who don’t like dividends
   c. Growth companies have to reinvest significant amounts to grow
   d. All of the above
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1. **b. Companies are reluctant to change dividends per share.** Companies try to maintain their dividends per share over time. They change dividends infrequently, and when they do, it is more likely to be an increase than a decrease.

2. **d. Companies feel much less secure or certain about future earnings.** The tax disadvantage associated with dividends has actually decreased over the last three decades and the link between transactions costs or short termism with dividend policy is not clearly established.

3. **c. Dividend increases lag earnings increases.** Companies tend to wait to make sure that earnings increases are sustainable before paying dividends.

4. **d. All of the above.** Declining firms can sell assets and use the proceeds to pay more than their earnings as dividends. Cyclical firms tend to pay dividends based on average earnings over a cycle, which implies that dividends can be higher than earnings during the down cycle. Special dividends may represent cash accumulated in prior years and thus can push the dividend payout ratio over 100%.

5. **d. All of the above.** Growth companies are more likely to lose money, and even if they do make money, will need to reinvest large amounts back into their businesses to grow. They also tend to attract investors who are more interested in capital gains than dividends.