

DPBS (PG) COLLEGE , ANOOPSHAHR

PAPER : FINANCIAL MANAGEMENT

PAPER CODE : C 305

TOPIC : DIVIDEND POLICY

PRACTICE SET (I)

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1. The residual theory of dividends suggests that dividends are _____ to the value of the firm.

- (a) Residual
- (b) Relevant
- (c) Irrelevant
- (d) Integral

Answer : C

2. The information content of dividends refers to

- (a) Nonpayment of dividends by corporations.
- (b) Dividend changes as indicators of a firm's future.
- (c) A stable and continuous dividend.
- (d) A dividend paid as a percent of current earnings.

Answer : B

3. According to the residual theory of dividends, if the firm's equity need exceeds the amount of retained earnings, the firm would

- (a) Borrow to pay the cash dividend.
- (b) Sell additional stock to pay the cash dividend.
- (c) Pay no cash dividends.
- (d) Not need to consider its dividend policy.

Answer : C

4. According to the residual theory of dividends, if the firm's equity need is less than the amount of retained earnings, the firm would

- (a) Borrow to pay the cash dividend.
- (b) Declare a dividend equal to the remaining balance.
- (c) Pay no cash dividends.
- (d) Not need to consider its dividend policy.

Answer : B

5. The clientele effect refers to

- (a) The relevance of dividend policy on share value.
- (b) The firm's ability to attract stockholders whose dividend preferences are similar to the firm's dividend policy.
- (c) The informational content of dividends.
- (d) The "bird in the hand" argument.

Answer : B

6. Modigliani and Miller suggest that the value of the firm is not affected by the firm's dividend policy, due to

- (a) The relevance of dividends.
- (b) The clientele effect.
- (c) The informational content.
- (d) The optimal capital structure.

Answer: B

7. Modigliani and Miller, recognizing that dividends do somehow affect stock prices, suggest that positive effects of dividend increases are attributable

- (a) Directly to the dividend policy.
- (b) Directly to the optimal capital structure.
- (c) Not to the informational content but to the consistency in the payment of dividends.
- (d) Not to the dividend itself but to the informational content of the dividends with respect to future earnings.

Answer : D

8. Modigliani and Miller argue that when the firm has no acceptable investment opportunities, it should

- (a) Close its doors.
- (b) Distribute the unneeded funds to the owners.
- (c) Lower its cost of capital.
- (d) Retain the funds until an acceptable project arises.

Answer : B

9. Gordon's "bird in the hand" argument suggests that

- (a) Dividends are irrelevant.
- (b) Firms should have a 100 percent payout policy.
- (c) Shareholders are generally risk averse and attach less risk to current dividends.
- (d) The market value of the firm is unaffected by dividend policy.

Answer : C

10. Proponents of the dividend irrelevance theory argue that, all else being equal, an investor's required return and the value of the firm are unaffected by dividend policy, for all of the following reasons, EXCEPT

- (a) The firm's value is determined solely by the earning power and risk of its assets.
- (b) Investor's are generally risk averse and attach less risk to current as opposed to future dividends or capital gains.
- (c) If dividends do affect value, they do so solely because of their information content, which signals managements' earnings expectations.
- (d) A clientele effect exists which causes a firm's shareholders to receive the dividends that they expect.

Answer : B

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