

- **Forms of Dividends** Dividends may take two forms: cash dividend and bonus shares (stock dividend). In India, bonus shares cannot be issued in lieu of cash dividends. They are paid with cash dividends. Bonus shares have a psychological appeal. They do not increase the value of shares.
- **Target Payout Ratio** Companies generally prefer to pay cash dividends. They finance their expansion and growth by issuing new shares or borrowing. This behaviour is based on the belief that shareholders are entitled to some return on their investment. Most companies have long-term payment ratio targets. But they do not apply target payout ratios to each year's earnings. They try to stabilize dividend payments by moving slowly towards the target payout each year. Also, they consider past dividends and current as well as future earnings in determining dividend payment. Investors recognize this. Any extreme changes are read as signals of management's expectations about the company's performance in future. Thus dividends have information contents.
- **Stable Dividend Policy** Companies like to follow a stable dividend policy since investors generally prefer such a policy for the reason of certainty. A stable dividend policy does not mean constant dividend per share. It means reasonably

predictable dividend policy. Companies determine dividend per share or dividend rate keeping in mind their long-term payout ratio.

- **Firm's Ability to Pay Dividend** depends on its funds requirements for growth, shareholders' desire and liquidity. A growth firm should set its dividend rate at a low level (because of its high needs for funds) and move towards its target slowly.
- **Practical consideration** Financial Need of company, Shareholders Expectations, Closely/Widely Held Company, Constraints on Paying Dividends, Legal Restrictions, Liquidity, Borrowing Capacity, Access to the Capital Market, Restrictions in Loan Agreements.
- **Lintner's Model**

$$DIV_t = a + b * p * EPS_t + (1 - b)DIV_{t-1} + e_t$$