Event Study of Corporate Dividend Decisions

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Dividends refer to that portion of a firm's net earnings that are paid out to shareholders. Since dividends are distributed out of profit, the alternative to payment of dividend is retention of earning/profit. Retained earnings constitute an easily accessible source of financing. There is thus an inverse relationship between retained earnings and cash dividend: large retention, lesser dividend and small retention, larger dividend. The typical dividend policy of the most firms is to retain a portion of net earnings and distribute the rest to shareholders. Questions relating to dividend policy of the firm are:

- What are shareholders' preferences? Do they want dividend income or capital gain?
- What are the financial needs of the company?
- How much should be paid out as dividend? What are the constraints on paying dividend?
- Should the company follow a stable dividend policy?
- What should be the form of the dividend?

A number of factors will have to be evaluated to analyse each of these questions to evolve a long term dividend policy for the firm. Broadly speaking, directors should aim

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at bringing a balance between the desire of shareholders and company needs.