Share repurchase

Reasons for repurchases

- Information or Signaling Hypothesis

✓ No Profitable use for internally generated funds.

✓ Firm believe that stock is undervalued.

✓ Mixed results (positive or negative)

- Dividend or Personal Taxation Hypothesis

✓ In order to let the S/Holders benefit from the preferential tax treatment of repurchases relative to dividend.

Residual Dividend Policy

Example

An analysts gathered the following information about a company's investment plan:

- Capital Budget of Sh. 5 million
- Target capital structure is 70% debt and 30% equity
- Net income is Sh. 4 million

If the company follows a residual dividend policy, calculate the dividend payout ratio for this year?

Dividend Controversy

The Leftists

The leftist group believes that companies should avoid establishing a high payout ratio.

They believe that such a high ratio is inconsistent with the policy of maximising the company's value as well as shareholders' wealth.

Therefore, they believe that the company should adopt a low target payout policy in order to avoid affecting the company's value as well as the wealth of the shareholder in an adverse way.