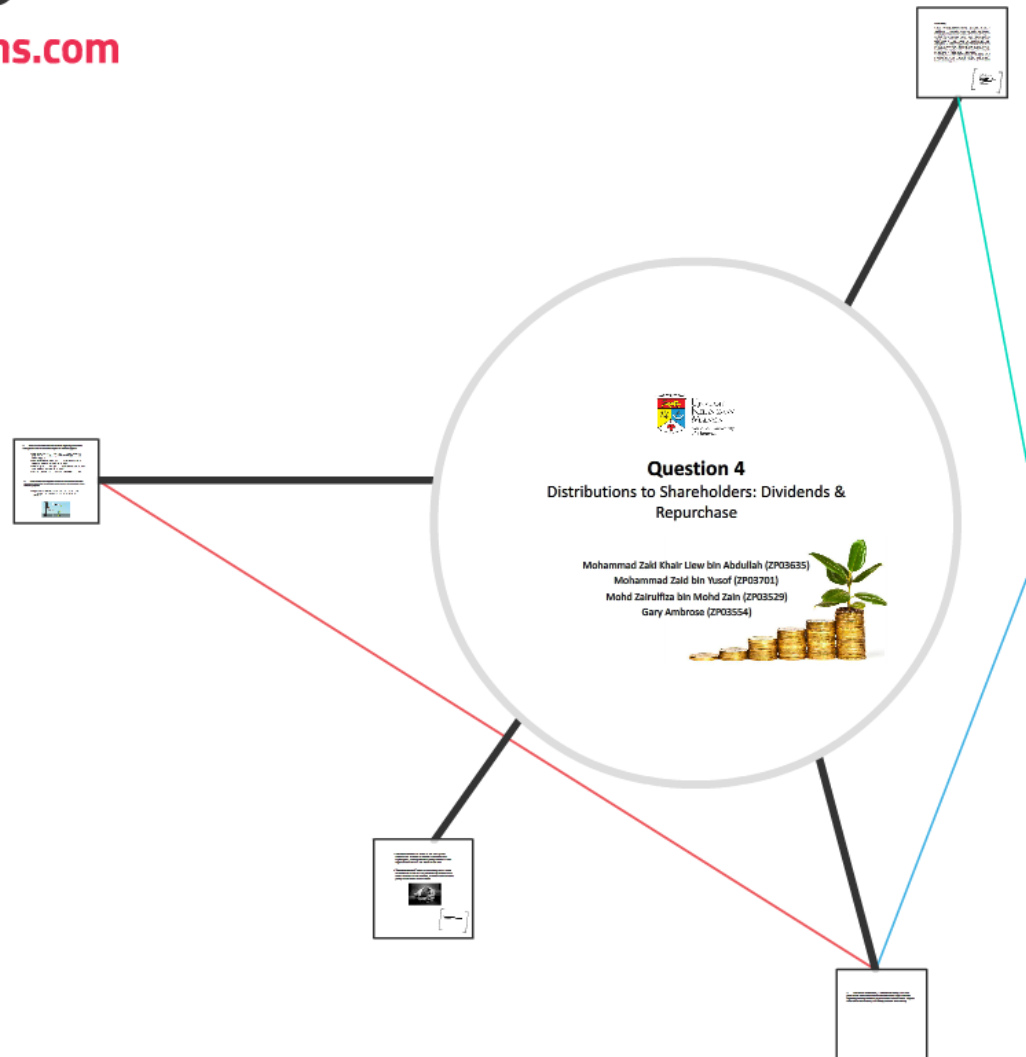# Managerial Finance

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Question 4
Distributions to Shareholders: Dividends & Repurchase

Mohammad Zaid Khair Liew bin Abdullah (ZP03635)
Mohammad Zaid bin Yusof (ZP03701)
Mohd Zairulfiza bin Mohd Zain (ZP03529)
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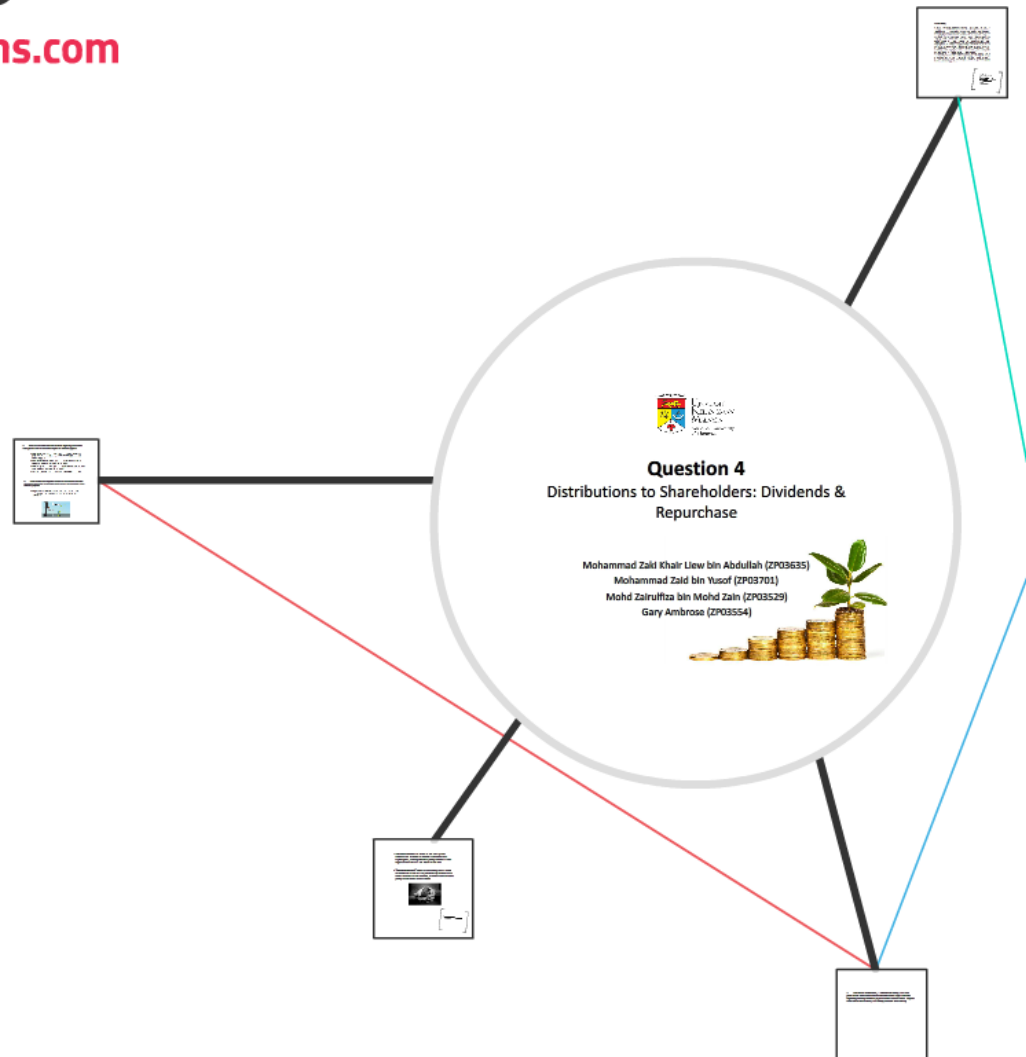Mohammad Zaid Khair Liew bin Abdullah (ZP03635)
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Case Study

Southeastern Steel Company (SSC) was formed 5 years ago to exploit a new continuous-casting process. SSC's founders, Donald Brown and Margo Valencia, had been employed in the research department of a major integrated-steel company, but when that company decided against using the new process (which Brown and Valencia had developed), they decided to strike out on their own. One advantage of the new process was that it required relatively little capital in comparison with the typical steel company, so Brown and Valencia have been able to avoid issuing new stock, and thus they own all of the shares. However, SSC has now reached the stage where outside equity capital is necessary if the firm is to achieve its growth targets yet still maintain its target capital structure of 60 percent equity and 40 percent debt. Therefore, Brown and Valencia have decided to take the company public. Until now, Brown and Valencia have paid themselves reasonable salaries but routinely reinvested all after-tax earnings in the firm, so dividend policy has not been an issue. However, before talking with potential outside investors, they must decide on a dividend policy.

Assume that you were recently hired by Arthur Adamson & Company (AA), a national consulting firm, which has been asked to help SSC prepare for its public offering. Martha Millon, the senior AA consultant in your group, has asked you to make a presentation to Brown and Valencia in which you review the theory of dividend policy and discuss the following questions.

1. What is meant by the term "distribution policy"?

- Distribution policy is defined as the firm's policy with regard to
  - the level of distributions,
  - the form of distributions (dividends or stock repurchases),
  - the stability of distributions.