Session 25a: Post class test solutions

1. **b, d &e. Older, poorer individual, income-oriented mutual funds, pension funds.** The first two groups value immediate cash flow more and care less about taxes. Pension funds don't pay taxes and often need the cash flows to meet current claims.
2. **b. Freeze dividends and allow the payout ratio to decrease over time.** Though this may be cowardly, I would start by freezing the dollar dividends and watching how the competition affects my profits. If it looks like the competition is hurting my bottom line and making it more volatile, I would reduce dividends over time.
3. **c. No**. If you are a high-growth company, where investors thought you had great investment opportunities lined up, the payment of a dividend may send the signal that these investment opportunities are not as good or plentiful as assumed.
4. **e. Negative in the short term, Positive in the long term**. It is tough to predict how markets will behave, but I would not be surprised to see stock prices drop on the announcement (partly because investors might not believe me and partly because my clientele may not like a cut in dividends). Eventually, I would expect the stock price to reflect the positive effects of taking good investments but that may be a long time coming.
5. **c. Decrease**. The stock buyback takes cash out of the firm. Since that cash balance made the firm more credit-worthy, paying it out will make it less so and my bond prices will drop to reflect that.