Dividend Policy: Meaning and Types of Dividend

Meaning of Dividend Policy

Dividend policy refers to the policy or decision of a company regarding how much of its earnings should be distributed to shareholders as dividends and how much should be retained in the business for future growth and expansion. It is an important financial decision taken by the management of a company because it affects the firm's liquidity, growth prospects, cost of capital, and the expectations of shareholders.

A sound dividend policy aims to balance the interests of shareholders, who prefer regular income, and the needs of the company, which requires retained earnings for financing projects and strengthening its financial position. Dividend policy is influenced by factors such as profitability, availability of cash, growth opportunities, legal requirements, and shareholder expectations.

Types of Dividend

Dividends may be classified into the following main types:

1. **Cash Dividend**
   Cash dividend is the most common form of dividend. It is paid in cash to shareholders, usually at a fixed amount per share. Cash dividends provide regular income to shareholders and signal financial strength of the company. However, they reduce the company's cash reserves.
2. **Stock Dividend (Bonus Shares)**
   Stock dividend refers to the issue of additional shares to existing shareholders in proportion to their current holdings. Instead of paying cash, the company capitalizes its reserves. This type of dividend does not involve cash outflow and helps the company retain funds for future use.
3. **Interim Dividend**
   Interim dividend is declared and paid by the company during the financial year, before the finalization of annual accounts. It is usually declared when the company earns sufficient profits during the year and wishes to distribute a part of it to shareholders.
4. **Final Dividend**
   Final dividend is declared at the Annual General Meeting (AGM) after the preparation of final accounts. It is paid out of the profits of the financial year and requires the approval of shareholders.
5. **Special Dividend**
   Special dividend is paid on special occasions, such as exceptionally high profits, sale of assets, or windfall gains. It is not a regular dividend and does not create expectations of continuity.
6. **Preference Dividend**
   Preference dividend is paid to preference shareholders at a fixed rate before any dividend is paid to equity shareholders. It may be cumulative or non-cumulative depending on the terms of issue.

7. **Extra Dividend**
   Extra dividend is declared when a company has surplus profits over and above its normal earnings. Like special dividends, it is irregular in nature.