DIVIDENDS in SMG

A common question from participants in The Stock Market Game (SMG) program is "How are dividends handled in The Stock Market Game?"

The simple answer is that we try to handle dividends as closely as possible to how they are handled in real life. That is, holders of a stock on the record date will receive the dividends on the payout date (whether or not they still hold that stock). Naturally, both dates must fall within the dates of the session in which the team holding the stock is registered.

In practice, however, it is more complicated. Companies pay dividends normally in terms of a percent (referred to as "yield" in the financial data), and always adjust the stock's price by approximately the amount of the dividend. The percent yield can be anywhere from a fractional percent to a much more substantial amount, based on profits and other factors relevant to the company's financial condition and economic strategy. Sometimes stock dividends are paid instead of cash dividends, increasing the number of shares a holder has, but in all cases, adjustments to the price of the stock are made on the ex-dividend date.

The two methods for determining the ex-dividend date are spelled out in a document published for members by NASD, the National Association of Securities Dealers, Inc., in August of 2000. NASD governs this and many other practices in the industry. These methods plus the implications for SMG participants are as follows:

Dividends or distributions that are less than 25% of the security's value. This method provides that the ex-date shall be the second business day preceding the record date. The price of the stock is adjusted downward on the ex-date so that the amount of the distribution is reflected in the current stock price. Thus, an investor who buys the security in these two days after the record date will pay the lower price but is not eligible for the dividend.

To better understand the dividend process, a few terms must be understood:

Announcement or declaration date – when a company announces the upcoming dividend. This date of the announcement is not regulated and can be anywhere from at least ten days to a few months.

Record date – the date on which stockholders must hold the security in order to be eligible for the dividend.

Ex-dividend date – (also called ex-date) the date on or after which a security is traded but is no longer eligible for the dividend. There are two methods used to determine the ex-date, based on the amount of the dividend.

Payable or payout date – the date on which eligible shareholders receive the dividend. It is not required that the shareholder still own the security to receive the dividend.

Dividends or distributions greater than 25% of the security's value. This provides that the ex-date shall be the first business day following the payable date, the day on or after which a buyer would purchase the security without receiving the dividend and, therefore, the date on which the price of the stock is adjusted downward. The one day between the payout date and the price drop is when investors should avoid purchasing the security since the price will still be higher but they will not be eligible for the dividend.

In SMG, teams should check to see if a company lists a yield in its financial records and, if so, further check to find out when the next dividend may be scheduled (normally paid quarterly if less than 25%, but there will be news releases related to special dividends that are greater than 25%). In real life, securities professionals are aware of these dates and prevent investors from buying in the interim period, but in the SMG, teams need to be aware of these various dates and avoid buying stocks in situations where they could lose a great deal on the price drops.