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STOCKS · BEGINNER · LESSON 10 OF 15

Dividends

How companies share their profits with shareholders, the dates that decide who gets paid, why the price drops on the ex-dividend date and how to read yield, payout ratio and buybacks

12 min read 8 quiz questions with answer key

STOCKS · BEGINNER · LESSON 10 OF 15

Dividends

IN ONE SENTENCE

A dividend is a part of a company's profit paid to its shareholders, usually in cash and, in the United States, usually every quarter. To receive it, you must own the shares before the ex-dividend date, and on that date the share price usually falls by about the dividend. A high yield is not always good news, and many companies also return money through share buybacks.

What a dividend is

In Lesson 1 you saw that shareholders can make money in two ways: a rising share price and **dividends**. A dividend is a part of a company's profit that it pays out to its shareholders, usually in cash. Every share receives the same amount, so the more shares you own, the more you receive.

When a company makes a profit, its board of directors decides what to do with it. There are three main choices:

- **Reinvest it** in the business: new products, factories, research or buying other companies.
- **Pay dividends** to shareholders.
- **Buy back its own shares** from the market, which you will meet later in this lesson.

Most companies use a mix. In the United States, dividends are usually paid **every quarter**. Many European and Japanese companies pay once or twice a year instead. Our imaginary Bright Bean (BRBN) from Lesson 6 pays **$0.84 a year**, as four quarterly payments of **$0.21** per share.

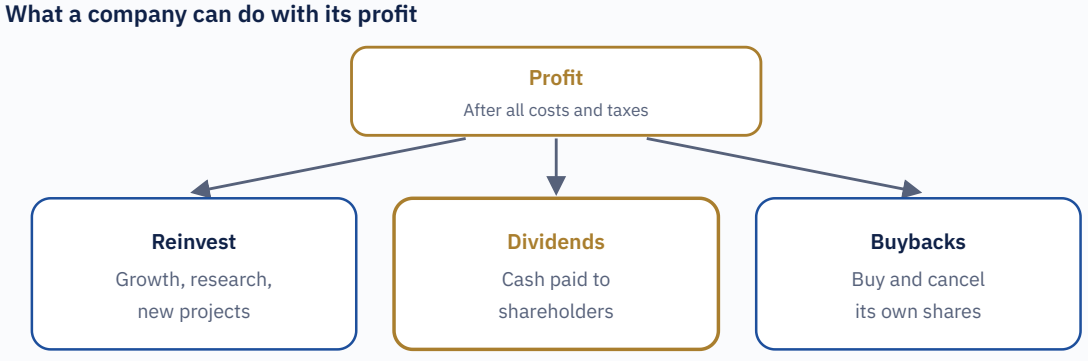


Figure 1. A company can reinvest its profit, pay it out as dividends or use it to buy back its own shares.

Which companies pay dividends

Dividends are most common among **mature companies**: large, established businesses with steady profits and fewer big new projects to spend money on, such as banks, energy producers, utilities, food and household goods companies, and drug makers. Young, fast-growing companies often pay nothing at all, because they can earn more by reinvesting every dollar in growth.

Neither choice is better in itself. A company that pays no dividend but grows quickly can reward shareholders through a rising share price. A company that pays a large dividend but cannot grow may see its share price go nowhere.

For the US market as a whole, dividends are a meaningful amount of money. According to S&P Dow Jones Indices, companies in the S&P 500 paid a record **$664.9 billion** in dividends in the 12 months to September 2025. Because share prices have risen faster than dividends, the index's dividend yield was only about **1.1%** in September 2026, much lower than in earlier decades.

The dividend dates that matter

Every dividend comes with a set of dates, and one of them decides who gets paid:

- **Declaration date:** the board announces the dividend, its amount and the other dates.
- **Ex-dividend date:** the key date. To receive the dividend, you must own the shares **before** this date. If you buy on the ex-dividend date or later, the seller gets the dividend, not you.
- **Record date:** the company checks its list of shareholders. Since US settlement moved to T+1 in May 2024, the ex-dividend date and the record date are normally the **same day**.
- **Payment date:** the cash arrives in shareholders' accounts, often a few weeks later.

A simple rule: you need to have bought by the close of the trading day **before** the ex-dividend date. Selling on the ex-dividend date or later does not take the dividend away from you.

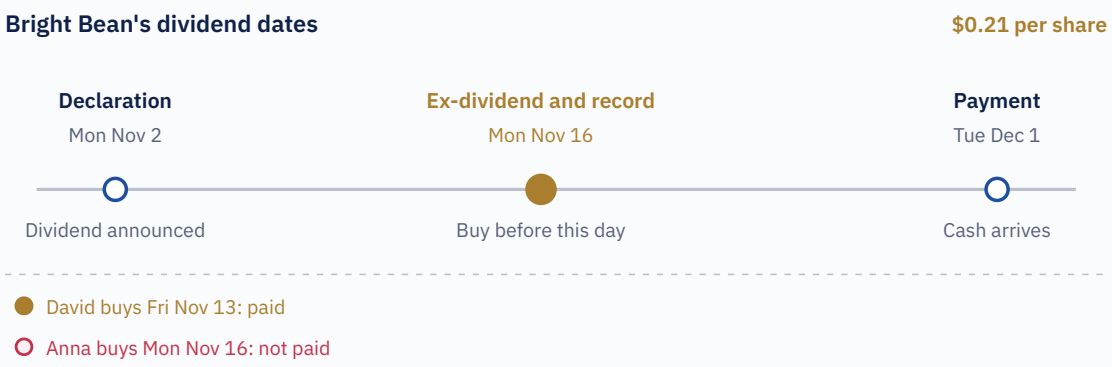


Figure 2. You must own the shares before the ex-dividend date to receive the dividend. The cash arrives on the payment date.

EXAMPLE: BRIGHT BEAN'S QUARTERLY DIVIDEND

On Monday, November 2, Bright Bean declares a dividend of **$0.21 per share**. The ex-dividend date and record date are Monday, November 16, and the payment date is Tuesday, December 1. Emma, who already owns 100 shares, buys nothing new. David buys 100 shares on Friday, November 13, the last trading day before the ex-dividend date. Anna buys 100 shares on Monday, November 16. On December 1, Emma and David each receive **$21**. Anna receives nothing this quarter, because she bought on the ex-dividend date.

Why the price falls on the ex-dividend date

If you could buy a stock the day before the ex-dividend date, collect the dividend and sell the next morning at the same price, dividends would be free money. They are not, because on the ex-dividend date the share price usually **falls by about the amount of the dividend**.

This makes sense. The cash that will be paid out leaves the company, so each share is worth that much less. Exchanges even adjust the reference price on the morning of the ex-dividend date. If BRBN closes at $42.60 the day before its ex-dividend date, it will start the next day at about **$42.39**, all else being equal.

So a dividend does not make you richer on the day it is paid. It moves part of your money from the share price into cash. Over time, dividends matter because a healthy company keeps earning, its share price can recover and grow, and it keeps paying. That is why the **total return** from Lesson 1, price change plus dividends, is the fair way to measure results.

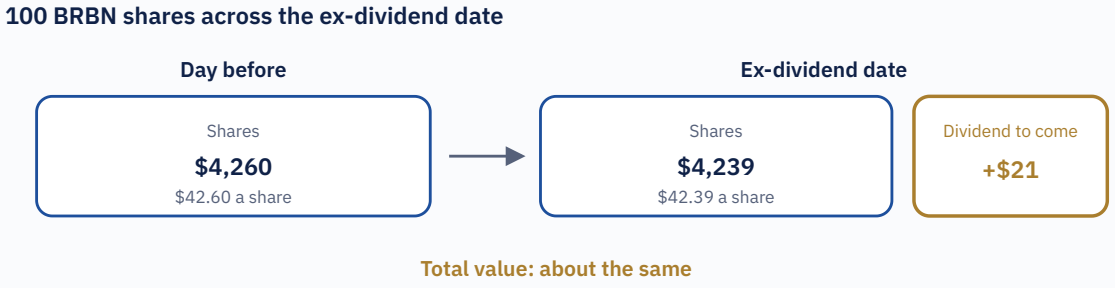


Figure 3. On the ex-dividend date, part of the value moves from the share price into the dividend. The total stays about the same.

Dividend yield, payout ratio and the yield trap

In Lesson 6 you met the **dividend yield**: the yearly dividend divided by the share price. BRBN pays $0.84 a year at a price of $42.60, a yield of 1.97%. A second number shows how safe the dividend is:

- **Payout ratio:** the dividend divided by earnings per share. BRBN pays $0.84 out of EPS of $1.85, a payout ratio of about **45%**. It keeps more than half of its profit to reinvest, and has room to keep paying if profits dip.

A payout ratio close to or above 100% means the company is paying out everything it earns, or more. That cannot last unless profits grow.

Be careful with very high yields. Because the yield is the dividend divided by the **price**, it rises when the price falls. A stock that drops from $50 to $25 while paying $2.00 a year sees its yield jump from 4% to 8%. That high yield is often a warning that investors expect the dividend to be **cut**. If the company then halves its dividend, investors lose on both the income and the share price. This is called a **yield trap**.

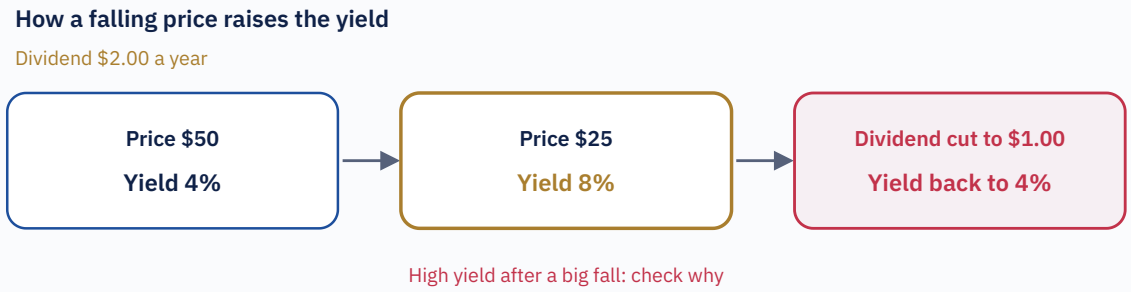


Figure 4. The same dividend gives a higher yield when the price falls. A very high yield can come before a dividend cut.

Growing dividends and reinvesting them

Many investors care more about a dividend that **grows** each year than about a high yield today. A company that raises its dividend year after year is usually one whose profits are growing steadily. The S&P 500 Dividend Aristocrats index follows S&P 500 companies that have raised their dividend for at least **25 consecutive years**. In early 2026 there were about **69** of them.

Dividends can also be **reinvested**. Many brokers offer a dividend reinvestment plan, or **DRIP**, which automatically uses each dividend to buy more shares, often including fractions of a share. More shares then earn more dividends, which buy more shares, and so on.

Figure 5 shows a simple illustration: 100 shares of a stock yielding 4%, with every dividend reinvested and the price unchanged. After 10 years the investor owns about **148 shares**, and after 20 years about **219**, without adding any new money. In real life prices and dividends move, but the principle of compounding is the same.

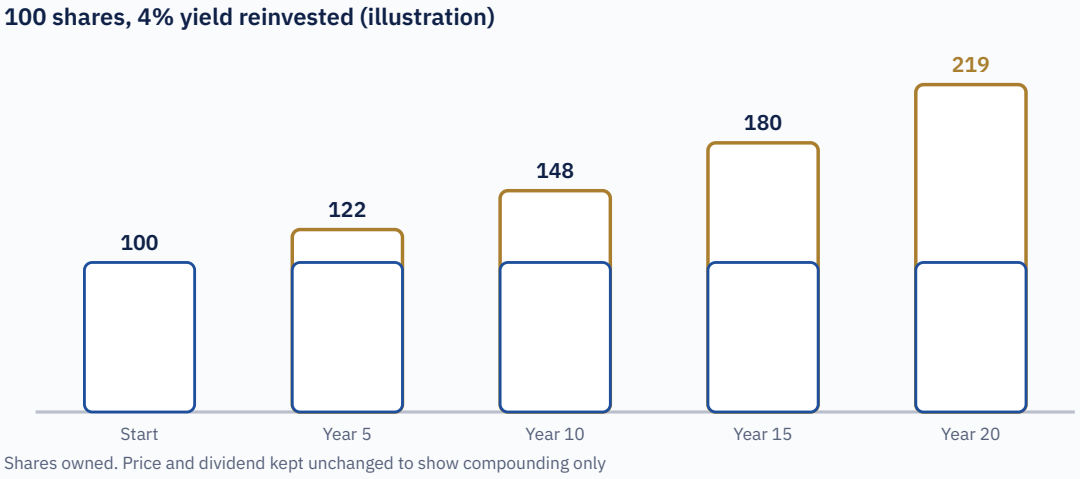


Figure 5. Reinvesting dividends buys more shares, which earn more dividends. An illustration with an unchanged price.

Buybacks and special dividends

Dividends are not the only way companies return cash. In a **share buyback**, a company uses its cash to buy its own shares on the market and then cancels them. With fewer shares, each remaining share owns a slightly bigger piece of the company and its profits, so earnings per share rise even if total profit stays the same.

In the United States, buybacks are now larger than dividends. According to S&P Dow Jones Indices, S&P 500 companies spent a record **$1.020 trillion** on buybacks in the 12 months to September 2025, compared with **$664.9 billion** in dividends. Companies like buybacks because they can be switched on and off more easily than a dividend, which investors expect to be steady.

Companies sometimes also pay a **special dividend**: a one-off payment, often after an unusually good year or the sale of a business. Unlike a regular dividend, investors should not expect it to be repeated.

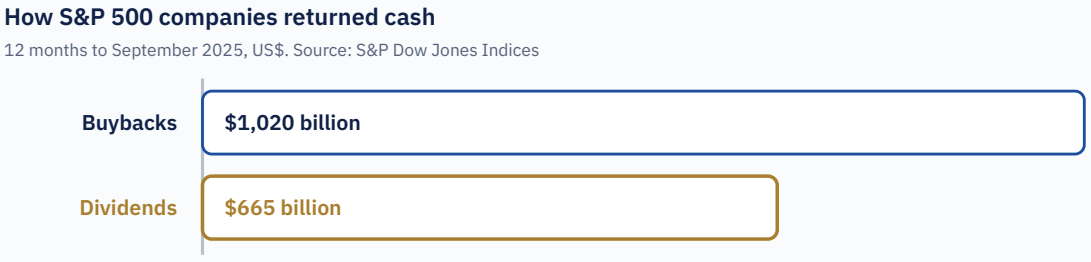


Figure 6. In the US, companies now return more cash through buybacks than through dividends.

Dividends and taxes

Dividends are usually taxed as income, and the rules depend on where you live and where the company is based. Two points matter for most international investors:

- **Withholding tax.** When a US company pays a dividend to a foreign investor, US tax is normally taken off before the cash arrives. The standard rate is **30%**, but many countries have tax treaties with the United States that lower it, often to **15%**. Brokers usually ask foreign customers to complete a form called the **W-8BEN** to apply the treaty rate.
- **Local tax.** Your own country may also tax the dividend, sometimes with a credit for the tax already withheld.

Other countries have their own withholding rules for foreign shareholders. Because tax rules are personal and change over time, check with your broker and a local tax adviser before relying on dividend income.

IMPORTANT: DIVIDENDS ARE NEVER GUARANTEED

Unlike the interest on a bond, a dividend is not a promise. The board can raise, lower, suspend or cancel it at any time. In difficult years, such as the 2008 financial crisis and the early months of the COVID-19 pandemic in 2020, many companies cut or stopped their dividends. Treat a dividend as a share of profits that the company can afford, not as a fixed income.

Why this matters for traders

- **Expect the ex-dividend drop.** On the ex-dividend date the price falls by about the dividend. Charts and stop orders do not always adjust for it, so a stop placed just below the price can be triggered by the dividend alone.
- **Dividend changes are news.** A dividend increase often shows confidence, while a cut usually sends the share price sharply lower.
- **High yields need checking.** A yield far above similar companies often means the market doubts the dividend will last.
- **Short sellers pay dividends.** A trader who has sold short over the ex-dividend date must pay the dividend to the lender of the shares, a topic for the Intermediate level.

Key terms

Dividend	A part of a company's profit paid to shareholders, usually in cash, the same amount for every share.
Declaration date	The day the board announces a dividend, its amount and its dates.
Ex-dividend date	The first day a stock trades without the right to the next dividend. You must own the shares before this date to be paid.
Record date	The day the company checks who its shareholders are. In the US it is now normally the same day as the ex-dividend date.
Payment date	The day the dividend cash is paid to shareholders.
Dividend yield	The yearly dividend per share divided by the share price.
Payout ratio	The dividend divided by earnings per share: the share of profit paid out.
Yield trap	A stock whose yield looks high only because its price has fallen, often before a dividend cut.
DRIP	Dividend reinvestment plan: using dividends automatically to buy more shares.
Share buyback	A company buying its own shares on the market, reducing the number of shares.
Withholding tax	Tax deducted from a dividend before it is paid, usually by the company's home country.

Key takeaways

1. A dividend is a share of profit paid to shareholders, usually quarterly in the US. Mature companies pay most of them, while many fast-growing companies pay none.
2. To receive a dividend you must own the shares before the ex-dividend date. In the US the record date is now normally the same day.
3. On the ex-dividend date the price usually falls by about the dividend, so dividends are not free money. Measure results by total return.
4. The payout ratio shows how safe a dividend is. A very high yield after a big price fall can be a yield trap.

5. Reinvested dividends compound over time. Buybacks are another, now larger, way US companies return cash. Dividends are never guaranteed and are usually taxed.

Test yourself

Circle one answer for each question. The answer key with explanations is on the next page. You can also take this quiz online at markettalks.info and see your score instantly.

1. What is a dividend?

- A) A part of a company's profit paid to its shareholders
- B) A fee paid to the broker
- C) The difference between the bid and the ask
- D) A loan from shareholders to the company

2. Which kind of company is most likely to pay a large dividend?

- A) A young company growing very fast
- B) A company that is losing money
- C) A company that has just gone public
- D) A mature company with steady profits

3. Bright Bean's ex-dividend date is Monday, November 16. Anna buys on that Monday. Does she receive the dividend?

- A) Yes, because she bought on the ex-dividend date
- B) No, she had to own the shares before the ex-dividend date
- C) Only half of it
- D) Only if she sells on the payment date

4. In the US, since the move to T+1 settlement, how do the ex-dividend date and record date usually relate?

- A) The ex-date is two days before the record date
- B) The record date comes first
- C) They are normally the same day
- D) They are a month apart

5. BRBN closes at $42.60 the day before its ex-dividend date and pays $0.21. Where does it tend to start on the ex-dividend date, all else equal?

A About $42.81
B About $42.60
C About $42.39
D About $21.30

6. BRBN pays $0.84 a year and earns $1.85 per share. What is its payout ratio?

A About 2%
B About 23%
C About 45%
D About 220%

7. A stock paying $2.00 a year falls from $50 to $25, so its yield rises from 4% to 8%. What should an investor think?

A It is now a guaranteed bargain
B The high yield may be a warning that the dividend could be cut
C The dividend has doubled
D Yields cannot change

8. What does a share buyback do?

A Creates new shares for investors
B Pays a fixed interest rate
C Moves the company to a new exchange
D Reduces the number of shares, so each remaining share owns a bigger piece of the company

Answer key

1 A

A part of a company's profit paid to its shareholders

A dividend is a share of the company's profit paid out to shareholders, the same amount for every share.

2 D

A mature company with steady profits

Mature companies with steady profits and fewer big projects to fund are the most common dividend payers.

3 B

No, she had to own the shares before the ex-dividend date

Buyers on or after the ex-dividend date do not get the dividend. David, who bought on Friday the 13th, does.

4 C

They are normally the same day

With one-day settlement, a buyer on the day before the ex-date is on the books by the record date, so the two dates are normally the same.

5 C

About $42.39

The price usually falls by about the dividend on the ex-dividend date: $42.60 − $0.21 = $42.39.

6 C

About 45%

Payout ratio = dividend ÷ EPS = $0.84 ÷ $1.85 ≈ 45%.

7 B

The high yield may be a warning that the dividend could be cut

The yield rose because the price fell, not because the dividend grew. A high yield like this can be a yield trap.

8 D

Reduces the number of shares, so each remaining share owns a bigger piece of the company

The company buys and cancels its own shares. With fewer shares, earnings per share rise even if total profit is unchanged.

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