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Critically Analyze Microsoft Corporation’s Dividend Payment Over the Past Eight Years

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Abstract

The focus of the work described in this paper is to critically analyse Microsoft's evolving dividend payments over the past eight years. This is based on the company's dividend policy and the associated practical theory of dividends. The paper documents eight consecutive years of data on the value of Microsoft's dividend payments and their impact, and shows that Microsoft's changing dividend payments can contribute to the management objective of maximising shareholder wealth.

Keywords

Dividend Payment; Dividend Theory; Shareholder Wealth; Share Repurchase.

1. Introduction

Microsoft is an American multinational technology company founded by Bill Gates and Paul Allen on April 4, 1975. It develops, manufactures, licenses and provides a wide range of computer software services. Microsoft has grown rapidly since going public in 1986, but it has refused to pay a dividend to shareholders for 26 years. In 2003, Microsoft finally announced that it would issue a cash dividend of $0.08 per share for shareholders for the first time. Until now, the cash dividend has risen to $0.62 per share in September 2021. Bill Gates (2004) [1] declared that the focus of Microsoft's cash management is to increase the cash dividend payment to shareholders, and ensure that the company's prospects are optimistic, and all major investment cases will not be affected by dividend payment. This means that the enterprise adopts a stable dividend policy. Even if the cash flow changes dramatically, the enterprise will try not to reduce the dividend payment level. Therefore, in the past eight years, Microsoft's high cash dividend policy and strong stock repurchase policy have ensured the quality of shareholders' wealth even under the epidemic situation. However, the high dividend will also have some negative impact on Microsoft's investment decisions.

2. Application of Dividend Theory

2.1. Impact on Shareholder Wealth Maximization

2.1.1. Proof of MM Theory

Firstly, it can be theoretically proven that changes in dividend policy do have an impact on shareholder wealth. An extension of MM theory (Modigliani and Miller,1958) [2] - the dividend irrelevance theory - yields the conclusion that 1) a firm's stock price is independent of its dividend policy 2) a firm's cost of equity capital is independent of its dividend policy. However there are three assumptions in the theory 1) the complete capital market assumption, 2) the rational behavior assumption, where every investor is an individual wealth maximizer and the form of increasing wealth does not matter 3) the full certainty assumption, where the investor is completely sure of future investment opportunities and profits and is confident in the future growth of the company. For example, Warren Buffett, one of the world's greatest value investors, also did not choose Microsoft to invest, which is in a great situation, he stated (2018):

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"I cannot predict the future surplus of Microsoft with great confidence, nor can I calculate the future value of Microsoft." Especially since technology stock companies like Microsoft are also somewhat controversial in society. Therefore all three assumptions are too harsh and do not hold in a realistic environment. Dividend policy affects share prices. Since shareholder wealth is the value of equity capital, changes in share prices in the absence of other factors other than dividend policy reflect changes in investors' valuation of the value of equity capital, changes in share prices arising from dividend policy also reflect changes in shareholder wealth. As many factors affect stock price fluctuations in reality, share prices are also affected by investment behavior and macroeconomic influences.

2.2. Empirical Analysis of Microsoft's Financial Statements

To determine how Microsoft's dividend payments contribute to maximizing shareholder wealth, an empirical analysis is also required using statements from the last eight years of corporate financial accounting periods. Table1 below shows the dividend distribution of Microsoft Corporation from 2014 to 2021[3]:

Table 1. Microsoft Annual Report,2014-2021

Year	Cash Dividend	Stock Dividend
2014	$0.31/share	non
2015	$0.36/share	non
2016	$0.39/share	non
2017	$0.42/share	non
2018	$0.46/share	non
2019	$0.51/share	non
2020	$0.56/share	non
2021	$0.62/share	non

By summarizing the dividend distribution policy of Microsoft Corporation in the past 8 years, it has the following characteristics: 1) Continuous and stable dividend distribution policy, as can be seen from the data in Figure 1, Microsoft Corporation has distributed cash dividends every year, from $0.31 per share in 2014 to $0.62 per share in 2021, with an annual increase of 0.03-0.06 per share. The stability is reflected not only in the payment of a fixed amount of cash dividends, but also in the continuous and steady growth trend of cash dividends paid out. Even with the 2020 epidemic sweeping the world, Microsoft showed strong resilience to the epidemic by relying on its special cloud-based core business (work and study at home), and Microsoft went on to rise to a distribution of US$0.56 per share. 2) Microsoft's dividend distribution method is only cash dividends, implying that Microsoft's business is stable and its operating cash flow is sufficient to fully cover its investment capital needs and financing costs, which is conducive to the efficiency of investors' capital allocation and can better attract investors and maximize shareholders' wealth.

3. Dividend Policy

3.1. Application in MSFT

The dividend policy determines the number of cash dividends received by shareholders and the amount of retained earnings of the business to be invested, thereby conveying information to shareholders and the public about the company's operating performance. Therefore, Microsoft's consistently rising cash dividend payments are very optimistic, enhancing shareholder and market confidence in the business and demonstrating the strong strength of

Microsoft, thus attracting more investment. However, is Microsoft's high dividend payout to shareholders really entirely conducive to maximizing shareholder wealth? Figure 1 below shows Microsoft's cash flow statement for 2014-2021[3]:

(MICROSOFT)[MSFT.O] - ARD.	2021-06-30	2020-06-30	2019-06-30	2018-06-30	2017-06-30	2016-06-30	2015-06-30	2014-06-30
Report Type（The annual report）								
Net Profit	6,127,100	4,428,100	3,924,000	1,657,100	2,120,400	1,679,800	1,219,300	2,207,400
Net cash flows from operating activities	7,674,000	6,067,500	5,218,500	4,388,400	3,950,700	3,332,500	2,908,000	3,223,100
Issue income of ordinary shares	169,300	134,300	114,200	100,200	77,200	66,800	63,400	60,700
Payment for the repurchase of common stock	-2,738,500	-2,296,800	-1,954,300	-1,072,100	-1,178,800	-1,596,900	-1,444,300	-731,600
Payment of dividends on ordinary shares	-1,652,100	-1,513,700	-1,381,100	-1,269,900	-1,184,500	-1,100,600	-988,200	-887,900
Cash flows from other financing activities	-76,900	-33,400	-67,500	-97,100	-19,000	-36,900	36,200	-3,900
Net cash flows from financing activities	-4,848,600	-4,603,100	-3,688,700	-3,359,000	840,800	-839,300	-908,000	-839,400
Purchase of property and equipment	-2,062,200	-1,544,100	-1,392,500	-1,163,200	-812,900	-834,300	-594,400	-548,500
Payments made to acquire a business	-890,900	-252,100	-238,800	-88,800	-2,594,400	-139,300	-372,300	-593,700
Buy investment	-6,292,400	-7,719,000	-5,769,700	-13,738,000	-17,690,500	-12,975,800	-9,872,900	-7,269,000
Income due from investment	5,179,200	6,644,900	2,004,300	2,636,000	2,804,400	2,205,400	1,501,300	527,200
Sale of investment income - investment activities	1,400,800	1,772,100	3,819,400	11,757,700	13,635,000	9,328,700	7,084,800	6,009,400
Securities lending payable - Investment activities			0	-9,800	-19,700	20,300	-46,600	-8,700
Cash flow from other investment activities	-92,200	-124,100						
Net cash flows from investing activities	-2,757,700	-1,222,300	-1,577,300	-606,100	-4,678,100	-2,395,000	-2,300,100	-1,883,300
The effect of exchange rate fluctuations on cash	-2,900	-20,100	-11,500	5,000	1,900	-6,700	-7,300	-13,900
Net increase in cash and cash equivalents	64,800	222,000	-59,000	428,300	115,300	91,500	-307,400	486,500
Balance of cash and cash equivalents at beginning	1,357,600	1,135,600	1,194,600	766,300	651,000	559,500	866,900	380,400
Ending cash and cash equivalents balance	1,422,400	1,357,600	1,135,600	1,194,600	766,300	651,000	559,500	866,900

Figure 1. Microsoft Annual Report,2014-2021

$$\$ \text{ Based on Calculations: } FCF=OCF-CE \quad (1)$$

$$\text{Equity Returns}=\text{Cash dividends}-\text{stock repurchase} \quad (2)$$

[MSFT.O] - ARD.	2021-06-30	2020-06-30	2019-06-30	2018-06-30	2017-06-30	2016-06-30	2015-06-30	2014-06-30
FCF（OCF-CE）	5,611,800	4,523,400	3,826,000	3,225,200	3,137,800	2,498,200	2,313,600	2,674,600
Cash Dividend	1,689,128	1,550,706	1,410,912	1,293,264	1,206,855	1,137,204	1,011,003	928,060
Srock Repurchase	-4,221,300	-3,676,200	-3,221,200	-2,241,800	-2,286,100	-2,630,700	-2,369,100	-1,558,800
Equity Returns	5,910,428	5,226,906	4,632,112	3,535,064	3,492,955	3,767,904	3,380,103	2,486,860
FCF-ER	-298,628	-703,506	-806,112	-309,864	-355,155	-1,269,704	-1,066,503	187,740
	High	High	High	High	High	High	High	Moderate

Figure 2. Calculation

3.2. Cash Dividend Payments

According to the core of the "bird in hand" theory (Gordon, 1962), Gordon criticized the dividend irrelevance theory by arguing against the assumption that investors require the same rate of return on capital gains and dividend income. This theory argues that dividend income is more reliable in the eyes of investors than capital gains from retained earnings and therefore requires companies to pay high dividends to shareholders on a regular basis. However, high dividends are not entirely conducive to shareholder wealth maximisation and corporate growth. Using the data in Figures 2 and 3, it can be obtained that dividend have been high from 2015 to date, except for 2014 when Microsoft paid a relatively modest dividend. Based on Jensen's agency cost theory of free cash flows (1976) [4], Dividend payments can reduce agency costs ， thus alleviating the conflict between managers and shareholders. The market also divides dividend policies into three categories 1) a low cash dividend policy where too much cash is retained and not enough cash dividends are distributed relative to the company's existing net present value items 2) a company distributes all of its free cash flows to shareholders as cash dividends, known as a moderate dividend policy 3) The company distributes all of its free cash flow to shareholders in addition to a portion of its non-free cash flow corresponding to cash assets as cash dividends, known as a high cash dividend policy. Microsoft Corporation clearly falls under the high cash dividend policy from FCF-equity return in 2015 (-$1,066,503) to 2021 (-$298,628). The high cash dividend policy demonstrates Microsoft's strong cash-generating ability and earns the company widespread acclaim, all of which brings considerable brand equity to the company. A long-term high cash dividend policy also encourages the company to focus on long-term goals and creates favourable conditions for long-term sustainability and continuous improvement of the company's intrinsic value. Furthermore, the high cash dividend policy is not entirely conducive to shareholder wealth either, as the excessive amount of cash dividends distributed can also lead to some investments above the cost of capital being abandoned, increasing the company's overall return on investment on assets greater than the return on investment that would have been achieved with a moderate cash dividend policy, thereby reducing shareholder wealth. Overall, the high level of dividends has resulted in the current lack of competitiveness of Microsoft's investable projects. Microsoft's dominance in the PC era has not been reflected in the mobile era and lacks a successor to enter a new era of stability. A moderate cash dividend policy is therefore the cash dividend policy that maximises shareholder wealth.

3.3. Share Repurchase Policy

For Microsoft, the distribution of cash dividends does not affect the profit generated from operations at all. Not only does the company use dividends in order to increase its return on total assets and return on net assets, but Microsoft also has a very strong share buyback policy. As can be seen in Figure 3, Microsoft is actively creating value for shareholders through buybacks, for example, using approximately $6.7 billion for share buybacks in the first quarter of 2020, relative to net income of approximately $13.9 billion and cash inflows from operating activities of approximately $19.3 billion for the period. The amount spent by Microsoft on share repurchases in the fourth quarter of 2020 increased by approximately 37% compared to the same period last year, reflecting management's aggressive approach to giving back to shareholders. Shares in both companies jumped 9.89% in 2019 after Sony announced a partnership with Microsoft and plans to buy back more than $1 billion in stock, with analyst Yu Okazaki (2020) at Nomura Securities writing in a report that "both companies are now able to invest in growth and reward shareholders at the same time due to the growth in free cash flow, which gives the market a good impression. " So what exactly has Microsoft's buyback policy of nearly eight years effect to shareholder wealth and corporate value?

Through the survey and analysis (Microsoft Annual Report, 2005-2021) of the capital structure of Microsoft Corporation, for equity capital Microsoft's cumulative dividends and buybacks since 2005 have totaled US$291.7 billion, meaning that 76% of its earnings have been returned to investors through dividends and share buybacks, and its net worth has increased from US$48.1 billion in 2005 to US$142 billion. It is due to the high percentage of dividends and buybacks that Microsoft's ROE improved from 26.2% to 47.1% from 2014 to 2021, and its long-term ROE averaged 32.6%, despite a profit boost of only 10%. This shows that Microsoft has maintained its long-term high profitability and its market capitalisation has increased from US$408.9 billion in 2014 to the current US$2.4 trillion, a cumulative increase of six times. Assuming Microsoft never paid dividends and buybacks, Microsoft's net worth would have been US$421.4 billion in 21 years, its ROE would have been only 14.5% instead of 47.1%, and its market capitalisation would have been only US$918.6 billion instead of US$2.4 trillion, but instead Microsoft's market capitalisation has risen 176% due to high dividends and buybacks, and investors have also earned additional dividends. For Microsoft's debt capital, the debt-to-capital ratio was 7.8% as of June 2019, down from 10.5% at fiscal year-end in June 2018 and

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13.9% in June 2017. The decline in the company's leverage usage indicates that management is reducing its use of debt capital. Successful decision makers raise capital scientifically in line with the needs of the business to grow and fully leverage their finances to maximise shareholder wealth.

4. Shareholder Wealth Maximization

4.1. Return to Shareholders

For shareholder returns, increasing ROE is the most effective way to increase shareholder returns as Microsoft's EQUITY CAGR reaches maturity. Repurchasing shares will continue to increase the enterprise value attributable to existing shareholders and is a favourable way to support share price performance, meaning that buying back shares will increase shareholder equity and is the right investment decision to maximise shareholder wealth. In addition, Microsoft should also pay attention to the reasonable pricing of share buybacks when buying back shares and have equity protection measures for small and medium-sized shareholders. The right business and investment decisions can also lead to new opportunities for shareholder wealth. For example, during the pandemic, except for the well-known Windows and Office, Microsoft's active growth business this year has been the cloud platform, which has become the largest contributor to all Microsoft's businesses in the first quarter of this year, up more than 20% year on year, at a time when the world is facing a huge crisis, Strong business and stable cash flow are undoubtedly the best return for Microsoft shareholders.

4.2. Impact of Share Price

The factors influencing the maximisation of shareholder wealth are also determined by both the number of shares owned by the shareholder and the market price of the shares, where the shareholder wealth is maximised when the price of the shares is at its highest, subject to a certain number of shares. It is evident that in 2015 and 2016 Microsoft Corporation had an extremely large decline in the annual growth rate of its business, Maret Watch [5]states that in the first quarter of 2016 it was a big disappointment to investors, this led to Microsoft's market capitalisation evaporating by more than 30 billion in an instant and Microsoft Corporation's stock price falling by 7.17%, the impact in the broader market is very significant， even so Microsoft continued to maintain its cash dividends to shareholders in 2015 and 2016, which reflects the company's stable dividend policy. To some extent shareholder wealth maximisation can be expressed as share price maximisation, where invested capital is constant and market value added to equity = market value of shareholders' equity (share price * number of shares) - shareholders' invested capital; an increase in share price is only of equal significance to an increase in shareholder wealth if shareholders' invested capital is constant, i.e. shareholder wealth maximisation can be expressed as share price maximisation. Since 2016 to date, Microsoft Corporation's average monthly price and annual revenue growth have been trending upwards, which is a positive sign. Microsoft Corporation may cause the share price to rise when buying back shares, but this will not affect shareholder wealth.

5. Conclusion

In summary, this report critically analyses the contribution of Microsoft's dividend policy and related dividend theory to the management objective of maximising shareholder wealth over the last eight years, discussing how optimal capital structure and corporate investment decisions, among others, apply to the operation of corporate finance. From 2014 to date, it is concluded from the data that Microsoft's stable dividend policy and high dividend cash dividend payments have significantly increased shareholder wealth, and the continued increase in share price and strong share buyback policy indicate that Microsoft has significant cash flow to make efforts to maximise corporate market capitalisation and shareholder wealth. The dividend payment methods of listed companies send different signals to shareholders about past earnings and future growth. As financial markets are not perfect markets, different dividend payment methods will definitely affect the size of shareholders' wealth. For Microsoft, therefore, it is important to develop a dividend policy and dividend payout method that is appropriate to the life cycle of the company.Microsoft also needs to be mindful of the uncertainty that long-term high dividend distributions can have on subsequent corporate investment decisions in order to ensure shareholder wealth.

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