How Much More Will You Earn With a Growing Dividend?

Description

Dividend stocks are great, and stocks that grow their dividends are even better. I'm going to have an in-depth look at just how much more money you could earn if you decided to invest in a dividend-growth stock versus a payout that does not increase over time.

BCE Inc. (TSX:BCE)(NYSE:BCE) is a good example of a growing dividend stock, and the company recently raised its payouts again, as expected. In five years, BCE's dividend has grown by 30%, which equates to a compounded annual growth rate (CAGR) of 5.3%. The CAGR gives you an indication of how much of an increase you can expect each year, although there can certainly be fluctuations based on market conditions.

Dividend income over 20 years

Let's assume that you invest $100,000 in BCE and hold the stock for 20 years. In this scenario, we'll assume the stock's yield remains unchanged and that you'll earn 5.4% every year. For simplicity, we won't assume that the dividends get reinvested automatically, since not all stocks will have those options.

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Under the non-dividend growth scenario, you would earn just $5,400 every year, which, in 20 years, would earn you a dividend income of $108,000.

However, if we assume that payouts were to grow by 5.3% every year, then that dividend income would rise to $184,000 by the end of year 20.

In the long term, there is certainly a big advantage to buying growing dividend payouts, but let's take a look at how much of a benefit it would be if you'd held the stock for a shorter period of time.

Dividend income over five and 10 years

Over the course of a decade, the dividend-growth stock would yield you income of a little less than $69,000, which is 28% more than the $54,000 that a non-growing divided would earn you.

In a shorter time frame of five years, however, the difference would only be $3,000, as a growing dividend would yield you $30,000 compared with $27,000 if the stock didn't raise its payouts.

Why a growing dividend isn't always better

Although the results clearly show that a growing dividend will give your income a boost, the impact isn't as significant over the short term.

There are also a couple reasons why you might not prefer a growing dividend. The first is that 10 or 20 years is a long time to hold a stock, and especially given the rate of technological change we're seeing, it's hard to predict the financial viability of a company over so many years, much less its ability to continue paying and raising its dividend.

The second reason is that companies that pay dividends are under the expectation to continue to do so. This can put pressure on a company to prioritize dividends over opportunities for expansion and to otherwise grow the business. This is also why growth stocks often outperform dividend stocks.

Bottom line

If you're looking for a dividend stock and planning to hold it for at least a decade, then a dividend-growth stock is what you should look for, but just be aware that it comes with no guarantees. However, if you're looking for strong capital appreciation or don't plan to hold the stock for more than a decade, then you shouldn't place too much importance on whether the dividend will grow or not.

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