The Editor
Australian Financial Review
Fax 02 9282 3137

4 November, 1996

Dear Sir,

Dividend Delays Don't Degrade

Your editorial and articles (4 November 1996) criticising companies for the delays in making dividend payments after balance date are not well founded, and appear to be based on an assumption that owners are somehow like creditors. Funds retained by a company prior to dividend payout will earn a rate of return which accrues to the shareholders as owners of that company. There is no "sacrifice" by shareholders, unless funds are utilised inefficiently by the company (which is a separate and more general matter), although the timing of cash flows is clearly affected by the timing of dividend payments.

Does the timing of dividend cash flows actually matter? There is a lot of finance theory which would tend to suggest not. Absent tax and transaction cost considerations (which unfortunately we are not) the timing would be irrelevant. Paying a dividend later rather than earlier simply means that the share price will be higher in the interim, enabling a shareholder desiring an earlier cash flow to achieve that and capture the equivalent return via selling shares.

In practice, the imperfect substitutability of dividends and capital gains for investors (due to tax and transaction costs) might be taken to mean that the timing of dividend payments does matter. They may, but not in the way or for the reasons suggested in your commentaries.

Investors can buy or sell shares at any time, at prices reflecting expected future dividends. The notion, which appears to underlie your arguments, that a particular shareholder was the provider of credit over the arbitrary period of the company's financial year, and should receive a cash return as soon as possible thereafter, has no firm basis in fact or logic. What matters for investors is the amount and timing of expected future cash flows, which will be reflected in the price at which they can purchase shares. All else equal, delay in receipt of those cash flows will be exactly offset by the higher expected value (arising from the company's use of the funds) leaving the share price unaffected. For investors concerned about dividend cash flows (when tax and transactions costs factors make selling shares an inferior source of cash flow) it is the predictability of timing and amount which matter - not the relationship to the company's balance date.

Finally, one would hope that the dividend timing policy of companies would reflect some rational assessment by the board of the company's cash flow situation, and that this would influence the timing decision. Dividend payments constitute a cash outflow which can be timed, to some extent, to help smooth out cyclical patterns in cash flows and reduce working capital costs. It is probably far better for the company to "borrow" on a short term basis from itself (shareholders) by appropriate timing of dividends than from a bank.

Yours sincerely

Kevin Davis