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Flawed fairy tale of modern finance

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From Prof Eric De Keuleneer.

Sir, John Authers ("Where dividends fit in the financial puzzle", **The Long View, March 5)** reminds us that in modern finance paying dividends on shares appears to be such a strange usage. His analysis of dividend-paying patterns leads him to show that higher dividends go together with better returns, which he says could stem from discipline imposed on management.

But he seems to abide by the dogma that shares are primarily for trading, and that income from owning them might come from buying and selling them. Yet this may be a flaw of modern finance.

Fundamentally, shares are little else than voting rights and the promise of future dividends. For most shareholders in large public companies, if we drop the dividends, all that remains is an act of faith that investors will remain willing to buy shares at or close to their theoretic value.

The concept of a dividend-less world is flawed. It is a fairy tale in which companies do not have to remunerate their shareholders – the market would do that for them. Company managers often prefer not to pay dividends because in case they own stock options they almost mathematically will benefit more, at least if the efficient market theory holds. But bosses and employees with stock options are encouraged to be fixated on stock price fluctuations and thus on short-term results.

Shareholders should be remunerated, with steady dividends, to keep their shares and vote with them and not simply be encouraged to treat the stock market as a casino. Saying that shareholders can just as easily get their remuneration or express their disapproval by selling their shares is denying them any role as owners of businesses.

It would help if more countries were like the UK and taxed dividends at the same level as capital gains or even lower. If enough consideration is given to dividends, shares can provide pension plans with an income that has a fair chance over the long term to preserve purchasing power. It may sound dull and does not justify paying high commissions to bankers and financial advisers, but it is more reliable than any alternative that rely on market vagaries.

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