The Impact of the Budget 2006 on Dividend Payout and Valuation

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Abstract
The taxation of New Zealand entities engaged in the sale of shares for short term gains, such as Managed Funds, was dramatically changed in October 2007, putting the entity on a similar footing to private investors. Prior to this change, Managed Funds were charged tax on any capital gains they earned whereas private investors were not. This differential was removed in October 2007.

This paper argues that prior to the change it was in the interests of Managed Funds for companies to pay high cash dividends and that a dollar of dividends would have been worth considerably more than a dollar of capital gains. The paper finds that the relative value of dividends has significantly declined following the change. An analysis is then made of whether the decline in the relative value of dividends has led to decreases in dividend payout and how investors appear to have reacted to such decreases. Whilst dividend per share has declined, earnings per share has declined by more and the overall impact is an increase in the payout ratio.

Finally, an analysis of how investors have reacted to changes in dividends and earnings both prior to and following October 2007. There does not appear to a significant change in investors’ reactions even though the relative value of dividends has declined.

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