CANVAS®
An investment service of O'Shaughnessy Asset Management, LLC

Dividends: A 400-Year-Old Practice

May 2021

DECLARING A DIVIDEND.

INTRODUCTION

This week we announced a new suite of dividend focused strategies available on Canvas® (Press Release).

The history of dividends stretches back four centuries to the first issuance by Dutch East India Company (VOC) management. Since then, dividends have provided meaningful income for investors, but also played an important role in identifying responsible management teams. This post provides a *short* overview of dividend's *long* history.

FIRST DIVIDENDS: THE DUTCH EAST INDIA COMPANY

The modern stock market began in 1602 on the Amsterdam Stock Exchange when shares of the Dutch East India Company first traded. Yet, despite the company's incredible monopoly on trade and incessant demands from shareholders, the VOC did not pay a dividend until 1610. Even still, this first dividend was paid in spices. Shareholders received *"mace at a value of 75% of the nominal capital"*. It was not until 1612 that the company finally paid investors a *cash* dividend.[1]

The VOC issued these first dividends in response to incessant criticism from shareholders over management's poor allocation of capital and dividend policy. This shareholder movement stemmed from campaign of Isaac Le Maire, the world's first short seller. Beginning in 1609, Le Maire, published a pamphlet levying three primary criticisms against VOC management: Rising debt levels preventing dividend payouts, the board's unwillingness to hear investor complaints, and board directors "*enriching themselves to the detriment of shareholders".*[2]

While Le Maire had a controversial relationship with the VOC, the company's decision to issue dividends yielded a definitive victory for the short seller. Despite this temporarily satisfying shareholders, however, the pamphlets and petitions persisted. In 1622, a group of disgruntled shareholders criticized management for wasting capital:

[1] Matthijs de Jongh, 'Shareholder Activism at the Dutch East India Company 1622-1625', *Origins of Shareholder Advocacy*, (2010)
[2] Oscar Gelderblom, Abe de Jong, Joost Jonker, *An Admiralty for Asia: Isaac Le Maire and Conflicting Conceptions About the Corporate Governance of the VOC* (2010)

> *"That route, however, does not lead through the Strait of Magellan,* ***where they wasted the capital of the company****… Each of the directors sells something [to the company] in order to maximize his profits….* ***But why, my dearest Gentlemen, doesn't the company organize a public auction, why doesn't it purchase the goods from anybody who is willing to accept the lowest price? This may save one third of the construction costs of the ships."***
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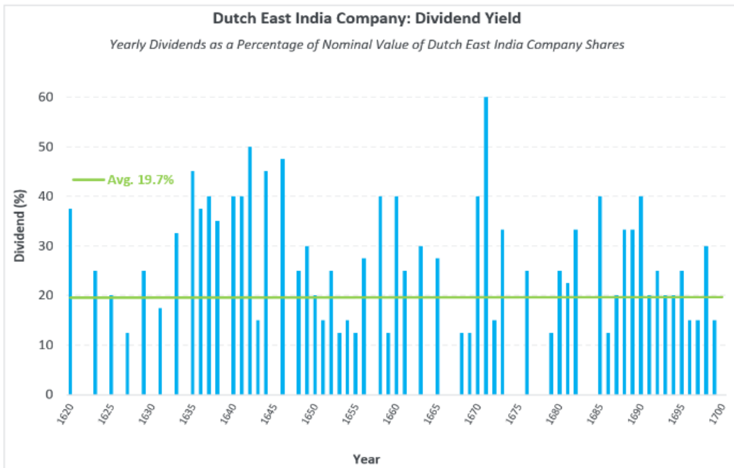
> **– Dissenting Shareholders (1622)**[3]

As a result, the company's new charter in 1623 ceded increased oversight, regular audits, and a more frequent dividend payout to satisfy investors.[4]



DIVIDENDS & VALUATION

For financial historians, 1720 is an infamous year because of two wildly speculative manias that occurred in a matter of months: The South Sea Company & Mississippi Company Bubbles. We will not cover these episodes in detail here but suffice it to say that this period was not known for rational investment behavior. The following anecdote epitomizes this sentiment:[5]

> *"Starting on Friday, December 18, 1719,* ***the Daily Post carried for several days an ad for an 'extraordinary scheme for a new insurance company to be proposed'…*** *with 'permits to subscribe' offered for £0.05 each.* ***No names of projectors, nor details of the scheme were cited."***

Even though no crucial details on the company were provided (like what it did, who was involved, etc.), investors enthusiastically submitted their subscriptions:

> ***"The sale of the 'permits' took place on Thursday, December 24. Two days later, this same paper had an ad which offered refunds for the 'several hundred' of those permits that had been sold*** *and explained that* ***the whole thing was a hoax designed to show how easy it was to 'impose upon a credulous multitude'."***

[3] De Jongh, 'Shareholder Activism'
[4] L. O. Petram, 'The World's First Stock Exchange: How the Amsterdam Market for Dutch East India Company Shares Became a Modern Securities Market' (2011)
[5] Andrew Odlyzko, 'An Undertaking of Great Advantage, But Nobody to Know What It Is', *MOAF (Winter 2020)*

Amidst all this speculative fervor, however, historical records reveal a *few* savvy and long-term oriented investors that recognized how dividend yields acted as a useful tool for equity valuation:[6]

"The main principle on which the whole science of stock-jobbing is built, viz. ***that the benefit of a dividend is always to be estimated according to the rate it bears to the price of the stock, because the purchaser is supposed to compare that rate with the profits he might make of money, if otherwise employed****."*

- 'Remarks on the Celebrated Calculations' (1720)

The 19th and Early 20th Centuries

Until the 1920s Wall Street boom, investors in both the United Kingdom and United States primarily focused on dividend payments to assess the merit of a given stock. One reason for this emphasis on dividends was due to the amount of information available on companies' finances.

In this period, investors were not privy to the level of transparency and regular reporting schedule enjoyed today. Early equity analysts had to use dividends and other limited financial information to deduce the company's overall financial state.[7]

"By the late 19th and early 20th centuries, a number of benchmarks were used to analyze dividend yields. First, the dividend cover was of relevance. How protected was the dividend by earnings? For example: 'James Book & Co (1915) offered preference shares covered five times by profits'.

Analysts adopted the same approach for equities and, quite early on, compared dividend yields with earnings yields…"

CONCLUSION

Since they were first issued in the early 1600s to now, dividends remain the same in two ways. First, they still provide a useful mechanism for returning capital to shareholders. Second, they continue to serve as important proxies for identifying strong management teams that allocate capital efficiently.

Over the last century there has been a proliferation of strategies that utilizing dividends as a key selection factor (dividend growth, dividend quality, etc.). While the types of strategies have evolved through time, the underlying notion that dividends provide investors with useful insights about companies has not changed over hundreds of years.

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[6] Janette Rutterford, *From Dividend Yield to Discounted Cash Flow: A History of UK and US Equity Valuation Techniques* (2007)
[7] *Ibid.*

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- The hypothetical performance does not reflect the reinvestment of dividends and distributions therefrom, interest, capital gains and withholding taxes.
- Accounts managed by OSAM are subject to additions and redemptions of assets under management, which may positively or negatively affect performance depending generally upon the timing of such events in relation to the market's direction.
- Simulated returns may be dependent on the market and economic conditions that existed during the period. Future market or economic conditions can adversely affect the returns.
- Composite Performance Summary

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For the full composite performance summary of this strategy, please follow this link: http://www.osam.com

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