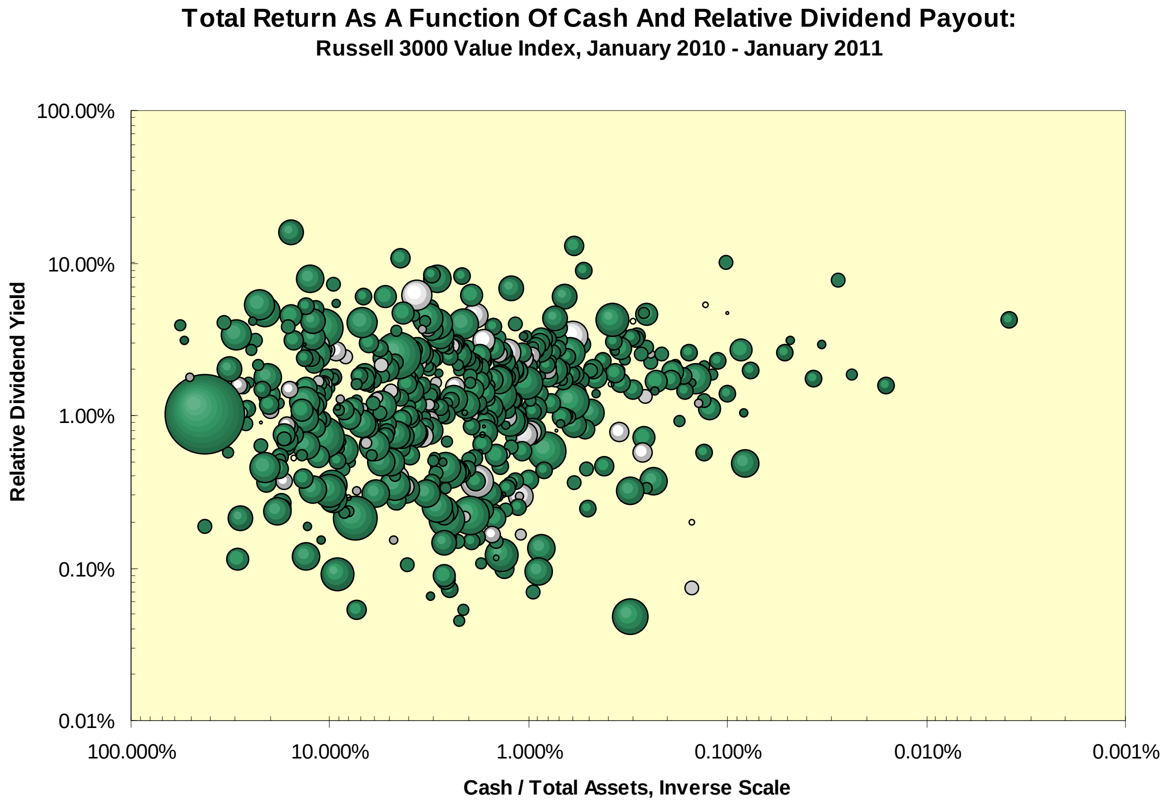
Cash Is Not Corporate Trash

I posed the titular question, "Should Corporate America's Excess Cash Be Returned to Shareholders?" in August 2010. In August, no one could tell you what the tax treatment of ordinary income, dividend income or capital gains were going to be in 2011; we had to wait until the weekend just after Thanksgiving to find out Congress was addressing the problem of the ballooning deficit by extending the Bush-era tax cuts and maintaining spending stimulus.

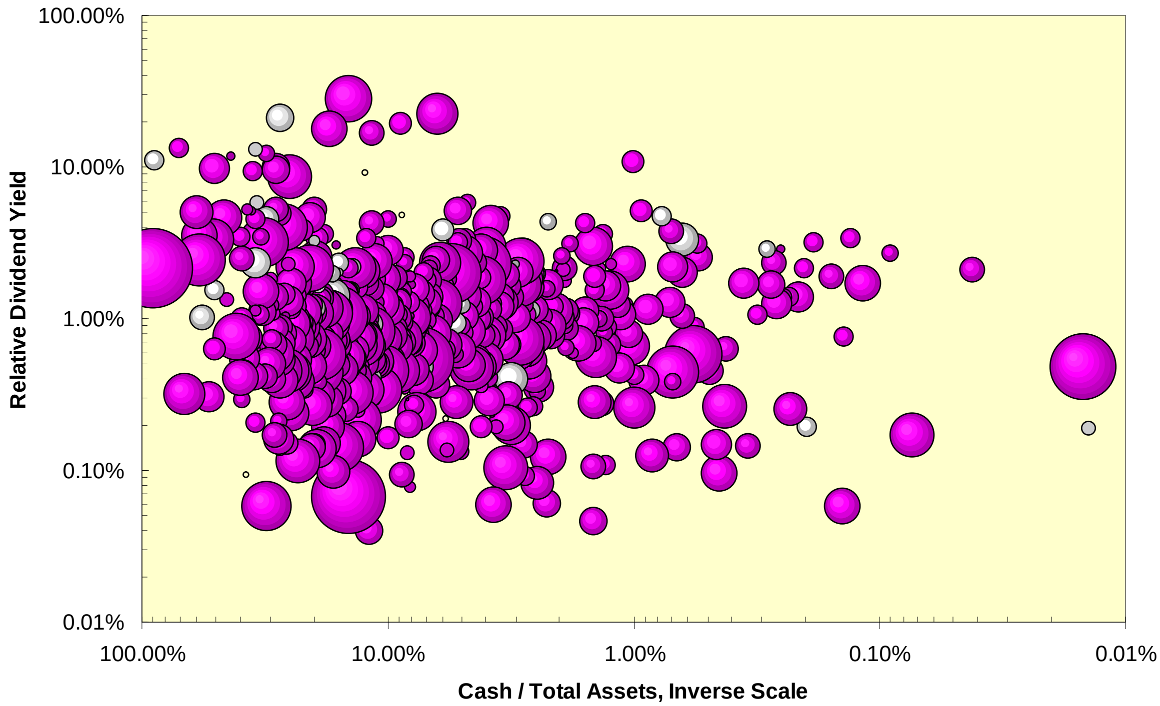
As least that is better than what the rapscallions did in my home state of Illinois where the lame-duck legislature put together an unholy deal to raise income taxes by 66.6% and do nothing to upset their public service union clients.

Now that shareholders know they can receive dividends at the preferred rates from the 2003 JGTRRA law (Jobs And Growth Tax Relief Reconciliation Act; the same people who write perfume ads moonlight as legislative aides whose sole mission is to name laws) will they demand a higher dividend payout from managers to prevent them from doing value-destroying mergers and acquisitions? Moreover, are total returns related in any way, shape, manner or form to either a firm's relative dividend payout or to the percentage of its asset base in cash?

The answers, for the last year at least, appear to be, "No and no." We can map the dividend yield of each stock in the Russell 3000 index relative to the average payout for the S&P 500 (as Donald Rumsfeld might say, you write with the data you have, not the data you want) against the percentage of each firm's assets held in cash. Total returns are represented by bubbles whose diameters correspond to the magnitude of return; negative returns are depicted in white. Two charts are presented, one for the Russell 3000 Value index and one for the Russell 3000 Growth index. A third, for those issues represented in portion in both indices, is not shown as its conclusion is identical.



Total Return As A Function Of Cash And Relative Dividend Payout:
Russell 3000 Growth Index, January 2010 - January 2011



If investors value high dividend payouts and low cash levels, the sort of grabby "give me my money and give it to me now" added posited by some commentators, we should see an aggregation of large colored bubbles in the northeast corners of these charts. We do not.

Moreover, if more of the Value stocks' returns come from dividend yields as opposed to price appreciation, we should see an aggregation of large colored bubbles in the top half of the Value chart and the opposite for the Growth chart. We see neither; moreover, neither dimension is a statistically significant explanatory variable for total return.

We are left, then, with one of the central tensions of corporate theory as described by Berle and Means in 1932: The battle between managements to use shareholders' cash for their purposes as opposed to the shareholders' purposes. Whenever you invest in a stock, any stock, you simply have to hope management is working as your agent and not as its own principal. Tales abound otherwise.

For this reason and this reason alone shareholders of cash-rich firms should ask for their money back and pay the tax thereon.