

# A Comment on 'A Theory of Dividends Based on Tax Clienteles'

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In Allen, Bernardo, and Welch (2000), we proposed a model in which dividends arise out of the desire of managers to attract a clientele of institutional investors, who either monitor or select better than retail clients. The model thus has two aspects:

1. Managers pay dividends in order to attract certain investors.
2. A particular class of managers ("good ones") attract a particular class of investors (institutions) for the services that they provide.

This model is plausible in many situations. For example, it is applicable to young firms seeking to attract more tax-exempt institutions and widen their appeal by paying dividends. We now believe the analysis can be adapted to other situations as well. In many older and larger firms there is evidence that managers are entrenched. These managers may well desire to attract passive investors. Such a clientele may be a large diffuse number of retirees, who not only suffer from a collective action problem, but who care relatively more concerned about steady dividend payments than aggressive value maximization. Such investors are unlikely to push management to undertake even more profitable activities instead.

It turns out that our model is largely isomorphic in this aspect. By changing the objective function from that of value maximization by the firm to utility maximization by the manager, and the identity of dividend-preferring institutions to dividend-preferring diffuse retail investors, the first aspect of our hypothesis reemerges: Managers pay dividends in order to attract certain investors.

This interpretation of our model raises one additional economic question, however: Does paying dividends primarily attract institutional investors for younger and small firms, and primarily attract diffuse investors for older and larger firms? This is plausible, but not necessary. The empirical evidence will have to shed more light on this question.

## References

Allen, Franklin, Antonio E. Bernardo, and Ivo Welch, 2000, "A Theory of Dividends Based on Tax Clienteles," *The Journal of Finance* 55-6, 2499-2536.