EVALUATION OF THE EFFECT OF DIVIDEND POLICY ON THE PERFORMANCE OF CORPORATE FIRMS IN NIGERIA

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Abstract

During the last fifteen years, dividend policy experts have enriched their empirical investigations with information that take into account parameters identified as variables that influence the dividend policy of firms in Nigeria. The objective of this paper is to evaluate the effect of dividend policy on corporate performance in Nigeria, using time series data generated from secondary sources through the publications of Nigeria Stock Exchange and financial statements of the companies under review. The study also employed OLS multiple regression analytical techniques to establish the relationships among the variables of dividend policy and the corporate performance of firms in Nigeria. The findings reveal that dividend policy in Nigeria still remains a function of strong dynamic variables such as return on investment(ROI), earnings per share(EPS)and dividend per share (DPS). An evolving knowledge of the true determinants of dividend policy as a necessary prerequisite should be a long term solution to the inconclusive nature of the debate on the relevance of dividend policy to corporate performance in Nigeria.

1. Introduction

The dividend policy of a firm refers to the views and practices of the management with regard to the distribution of earnings to the shareholders in the form of dividends. It can be said to be the trade-off between retained earnings on one hand, and cash distribution or securities on the other. The portion of earnings which is undistributed is retained earnings. The retained earnings are the major sources of internal financing to a business firm and are often the cheapest source of finance. The opportunity cost of retained earnings therefore is the dividend payment that is forgone (Pandey, 2011).

The corporate dividend policy has been the subject of intense theoretical modelling and empirical examination that has captured the interest of economists over the last few decades probably as a result of the position of dividend in stock valuation. These theoretical and empirical models of corporate dividend policy are divided based on the predictive ability of the effect of dividend payments on share price (Allen and Michaely, 1995). Also in the last fifty years many theories have been developed taking into account a number of different parameters that affect dividend policy (Modigliani and Miller, 1961). These parameters include the firm's objectives, the investors' desires and choices, the creditors' constrains and the country's institutional foundations (Frankfurter and Woods, 2002).

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Three schools of thought have emerged over the last century. One group sees dividend as attractive and a positive influence on stock price; that dividend payment is an active variable in the firm's valuation (Solomon, 1969). The second group believes that stock prices are negatively correlated with dividend payment levels while the third cluster of the oristsmainta in that firm dividend policy is irrelevant in stock price valuation (Modigliani and Miller, 1961). These theoretical and empirical models of corporate dividend policy are better divided into two broad schools: the dividend irrelevance theory group (Modigliani and Miller, 1961) and the dividend relevance theory group (Gordon, 1962).

Miller and Modigliani (1961) presents the so-called M&M hypothesis and the dividend policy irrelevance thesis, which shows that the value of a firm is unaffected by dividend. The authors argued that the effects so observed are the result of the information converged by the dividend changes, not due to the dividend itself. Miller and Modigliani (1958) posited that dividends were irrelevant. The dividend irrelevance theory as thus revealed by these authors involves the following criteria: that dividend policy has no effect on either the price of a firms stock or its stock or its cost of capital, and that the value of the firm depends on the income it produces from its assets and not by how this income is divided between dividends and retained earnings.

Some of the binding assumptions about investors and perfect capital markets in the real world practices may not hold. Thus, the M&M theory of corporate dividend policy has been subjected to considerable debate and criticism for over three decades. It has been found in the actual market practices that dividend policy does seem to matter. Reducing one or more of M&M's perfect capital market assumptions therefore, formed the basis for the emergence of rival theories of dividend policy. It was also found that the dividend relevance is a theory relating to the impact of dividends on organizations and individual investors. The theory advanced by Gordon (1962) and Lintner (1950, 1956) establishes that there is a direct relationship between a firm's dividend policy and its market value. Hence, investors respond to receiving actual cash returns. That forms the theoretical undergirding for this paper.

This paper attempts to test the M&M hypothesis on dividend policy and its irrelevance thesis against the actual workings dividend policy in Nigeria firms. In the light of this, the study seeks to determine the relationship between dividend per share and market price per share and identify the determinants of dividend policy in Nigerian firms. The study therefore hypothesizes that dividend policy has no significant impact on corporate performance in Nigeria.

2. Literature Review

2.1 Conceptual Issues

Pandey (2011) defines dividend as that portion of a company's net earnings which the directors recommend to be paid to the shareholders in proportion to their shareholdings in the company. It is usually expressed as a percentage of nominal value of the company's ordinary share capital or as a fixed amount per share. According to William and Scott (2006), dividend is referred to as a periodic cash payment that firms make to investors who holds the firms' preferred or common stock.

In developed countries, the decision between paying dividend and retained earnings has been taking seriously by both investors and management, and has been the subject of

considerable research by economists in the last four decades (Lintner, 1956; Britain, 1964; Modigliani and Miller, 1961; Black and Scholes, 1974; Dhillon and Johnson, 1994; Amihud and Murgia, 1997; Chariton and Vafeas, 1998;as cited in Adelegan (2001)). According to Van Horne (1971) dividend policy entails the division of earnings between shareholders and reinvestment in the firm. Retained earnings are a significant source of funds for financing corporate growth, while dividend constitutes the cash flows that accrue to shareholders.

There exist two divergent schools of thought with regard to these, the dividend policy and the retained earning policy. Dividend policy suggests a positive attitude, for it is a deliberate policy to maintain dividend at a certain level or increase it, with the ultimate aim of sustaining the price of the ordinary shares on the stock exchange. This is because capital markets are not perfect, and although shareholders are indifferent to the ratio between dividend and retained earnings due to market imperfections and uncertainty, they give a higher value to the current year dividend than the future dividend and capital gains. Thus the payment of dividend has a strong influence on the market price of the shares. Management might maintain a dividend level even at the expense of liquidity or be forced into borrowing to do so. Within this approach dividends are thought to be desirable from the shareholders' point of view, as increasing their current wealth and dividend level determines share price as well as indicates the prospect of profitability of the firm.

The second school of thought which promotes the profit retention policy tends to suggest a more passive residual attitude towards dividend as dividend payout reduces the amount of earnings to be retained in the firm and affects the total amount of internal financing. When dividends are treated as a financing decision, the net earnings of the firm may be viewed as a significant source of financing the growth of the firm. Dividends paid to shareholders represent a distribution of earnings that cannot be profitably reinvested by the firm. The approach to dividend is viewed merely as a residual decision. This theory is known as the residual theory of dividend and was first proposed by Miller and Modigliani in 1961. Investors prefer to have the firm retain and reinvest earnings rather than pay them out in dividend if the return on the investment earnings exceeds the rate of return the investors could themselves obtain on other comparative investment. Otherwise, the investors prefer dividend.

2.2. **Theoretical Frameworks**

Corporate dividend theory and policy are issues of growing interest and strong controversy in the financial literature. After the 1950s, a debate began on dividend policy. The debate can be summed up by the two major positions: Miller and Modigliani, (1961) otherwise known as M&M hypothesis with their dividend policy irrelevance thesis, and Gordon and Lintner, (1962)dividend relevance theory. Miller and Modigliani show that the value of a firm is unaffected by dividends. The authors further argue that the effects so observed are the result of the information converged by the dividend changes, not due to the dividend itself. The dividend irrelevance theory as propounded by these authors involves the following claims:
 (i) Dividend policy has no effect on either the price of a firms stock or its stock or its cost of capital.
 (ii) The value of the firm depends on the income it produces from its assets, and not by how this income is divided between dividends and retained earnings.
Some of the binding assumptions about investors and perfect capital markets in the real world practices may not hold. Thus, the M&M theory of corporate dividend policy has been

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subjected to considerable debate and criticism for over three decades. It has been found in the actual market practices that dividend policy does seem to matter and reducing one or more of M&M's perfect capital market assumptions would show that dividend matter in the real world. This formed the basis for the emergence of rival theories of dividend policy. The bird in the hand theory (a pre-M&Mposition) posits, in modern financial terminology, that in a world of uncertainty and information asymmetry, dividends are valued differently than retained earnings (capital gain).

Another school of thought holds that without Modigliani and Miller's restrictive assumptions, their argument collapses. Thus, dividend relevance is a theory relating to the impact of dividends on organizations and individual investors. The theory, advanced by Gordon and Lintner, establishes that there is a direct relationship between a firm's dividend policy and its market value. Hence, investors respond to receiving actual cash returns. Due to uncertainty of future cash flow, investors often tend to prefer dividends over retained earnings. Gordon (1962) argues that since investors operate in a world of brokerage fees, taxes and uncertainty, it is better to view the firm in the light of these factors. The leading proponents of the relevance of dividend theory, Gordon and Lintner, suggest that shareholders do have a preference for current dividends and that, there is in fact a direct relationship between the dividend policy of a firm and its market value. Gordon argues that investors are generally risk-averters and attach less risk to current as opposed to future dividends/capital gains. This 'birds in hand' argument suggests that a firm's dividend policy is relevant since investors prefer some dividend now in order to reduce their uncertainty. When investors are uncertain about their returns they discount the firm's future earnings at a lower rate therefore placing a higher value on the firm.

Another writer, Walter (1963) was of the opinion that dividend policies in most cases do affect the value of the firm. The author also debunks the dividend irrelevance theory of Miller and Modigliani on the grounds that it may not be a generally applicable principle. Also given the expression 'k-dr' as a growth function of the firm the effect of the optimum dividend policy on the relationship between the firm's internal rate of return (r) and its cost of capital (k) and current dividend (d) where r>k, shows that all earnings can be reinvested, hence, the firm is assumed to have simple profitable opportunities in order to maximize the value per share over and above the rate expected by shareholders. However, in a normal firm where r=k, dividend policy have no effect on the market value per share since the rate of return is equal to the cost of capital, and whereas in a declining firm the optimum payout ratio should be 100% to enable increase in the market value per share.

The Walter theory has been criticized because r and k are not constant in real life situations. Moreover, the non-existence of external financing makes it weak. The firm's r decreases as more investment occurs and k changes directly with the firm's risk. It should be understood here that Walter's model though weak, recognizes the fact that dividend policy is relevant (See also Samuels and Wilkes, 1975).

2.3 **Empirical Evidences**

The theories of dividend relevance and irrelevance are supported by research and this is reflected in the literature. Using a non- parametric method with interviews conducted with selected managers of various firms in developing countries, "Distribution of income and dividends among Corporations, retained earnings and taxes" (Lintner, 1950) shows a strong and positive effect of dividend policy on the distribution of income and dividends by the

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organizations. The study also strongly supports the earlier argument of dividend relevance models.

The study of Uzoaga and Alozienwa (1974) on the dividend policy in an era of indigenization was the first indigenous attempt to study dividend policy in Nigeria. The authors identified and described the conventional factors which guide a company's dividend policy but found little evidence on how these factors explain the rate of dividends declared by Nigerian firms. Thus, the study concluded that liquidity needs were the most relevant in all classified forces that determine dividend policy.

Soyode (1975) however, challenged the views of Uzoaga and Alozienwa by questioning the "fear and resentment" theory of dividend policy. He pointed out that the study of the duo "did not empirically determine the extent to which the classic forces have contributed to the changes in dividend policy". The author thus found that:

  i.   there was no clear evidence of a general upward movement in the level of dividend payments;
  ii. a substantially high dividend payment ratio in any one year (in this particular case, in 1972) cannot really be sufficient evidence of a sustained policy changed and
  iii. in any case, a situation of excess liquidity, which would be rationally expected to result from the infusion of the new capital, emanating from the process of implementing the indigenization decree, constitutes a valid basis (according to conventional theory) for making higher dividend payment.

Also, the general upward trends in the level of dividend distribution by the affected companies during the years immediately preceding the implementation of the indigenization decrees as found by Uzoaga and Alozienwa, (1974) and supported by Inanga (1975) was that "the dramatic change in dividend policy could not have been dictated by a corresponding improvement in earnings performance."

In 1979, Oyejide published his paper titled "Company Dividend Policy in Nigeria: An Empirical Analysis". Using time series data, he found that "although there was indeed an out-of-trend (or no usual) increase in the average level of dividend payments, this increase was not as important as some previous studies seemed to suggest". The study concluded that the available evidence strongly and unequivocally supported the conventional Lintner- type models as powerful devices for explaining the dividend behavior of Nigerian limited liability companies.

Thus, the major incompleteness of all theoretical models is largely due to a misconception of the nature of dividend payments over the years. This has made the debate over dividend policy an ongoing controversy in the field of finance. Ignoring behavioral and socioeconomic influences on managerial and shareholder activities by current models on corporate dividend policy has not help the matter as well.

3   Methodology

3.1 The Model and Analytical Techniques

The model specification adopted in this study is based on OLS multiple regression analysis which combines both the dependent and independent variables in order to establish the relationships among the variables of dividend policy and firm's corporate performance in

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Nigeria. The proxy for firms' corporate performance which is the dependent variable adopted in this study is the market price per share (MPS), while earnings per share, retained earnings per share, return on investment, and dividend per share are the independent variables. Market price per share was selected as study dependent variable based on the premise that it is a strong determinant of the market value of a firm's share and also a good measure of a firm's profitability. The various independent variables used in the model also determine and dictate the measure of dividend policy adopted by firms. The model follows the work of Crespo, Palokangas and Tarasyev (2013) which establishes a relationship among variables in a growth model. Thus, the model is captured in a schematic form as follows:

$$Y = f(x_1, x_2, x_3, x_4) \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 1$$
$$MPS = f(EPS, REPS, DPS, ROI) \dots\dots\dots\dots\dots\dots\dots\dots\dots 2$$
$$Y = \beta_0 + \beta_0 X_1 + \beta_0 X_2 + \beta_0 X_3 + \beta_0 X_4 + \varepsilon_t \dots\dots\dots\dots\dots\dots 3$$
$$MPS = \beta_0 + \beta_1 EPS + \beta_2 REPS + \beta_3 DPS + \beta_4 ROI + \varepsilon_t \dots\dots\dots 4$$

Where: MPS = Market Price per Share; EPS = Earnings per Share; REPS = Retained Earnings per Share; DPS = Dividend per Share; ROI = Return On Investment; β_1, β_2, β_3, β_4, = Parameters to be estimated; ε_t = Error Term

This paper focuses on three quoted firms with the view of assessing the effects of dividend policy on corporate performance in Nigeria. It involved the collection and gathering of times series data through secondary sources. The research design is descriptive and empirical in nature. OLS multiple regression was adopted as analytical techniques.

The variables relate to the trend and magnitude of dividend trends in Nigeria. We used time series data set of 10 years to explain the determinants of dividend policy(such as EPS,REPS,DPS,ROI) taking a different set of variables, which provide the basis for drawing conclusion based on concrete evidence deduced from the data collected after empirical investigation. This research made use of both dependent and independent variables as follows, market price per shares, earnings per share, retained earning per share, dividend per share and return on investment spanning 2005 – 2015.

3.2 Data Requirements and Sources

The research used the time series data generated from secondary sources through the publications of Nigeria Stock Exchange, financial statement of the companies under review, and other related financial journals in an attempt to establish the relationship between the dividend policies and corporate performance in Nigeria. It relied heavily on secondary data drawn from various annual financial statements of the respective firms under review. Data were sourced from three randomly selected firms, namely; Unilever Nigeria Plc, First Bank of Nigeria Plc, and Royal Exchange Assurance Plc, between 2005 and 2015 financial years.

4   Results and Discussion

The major focus of this section is to evaluate the effect of dividend policy operations on corporate performance in Nigeria. Since the key determinants of corporate performances are traceable to the variables which include market price per share as the dependent variable, while earnings per share, retained earnings per share, return on investment, and dividend per share are the independent variables.

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The result in the table below showed the ADF Unit Root Test. The result indicated that all variables MPS, ROI, REPS, & DPS were stationary at all levels. This implies that there were no unit root problems.

Table1: Unit Root Test

Variables	Stationary
MPS	I (0)
ROI	I (0)
EPS	I (0)
REPS	I (0)
DPS	I (0)

Source: Data Computation, 2015

The result in table 2, indicates that all indicators for dividend operations affect corporate performance, although earnings per share and retained earnings per share are not significant at 5% level. The economic implication is that the standard error of the market price per share and other independent variables are less than half of the coefficient.

Table 2: Ordinary Least Square Regression Result for Unilever Nigeria plc.

Variable	Coefficient	Standard Error	t-Statistics	Probability Value
Constant	23.66797	11.40573	2.075094	0.0345
ROI	51.75487	20.43225	2.532991	0.0007
EPS	34.67565	1147818	0.208396	0.8431
REPS	18.67753	8.50057	2.197201	0.4320
DPS	43.46716	17.26405	2.517785	0.0015

Source: Data Computation, 2015

MPS = 23.66797 + 34.67565EPS +18.67753REPS + 18.67753DPS + 51.75487ROI + ε_t
R^2 = 0.729, F- Statistics = 54.8344

This result is consistent with the proposition of Inanga (1975), that "the dramatic change in dividend policy could not have been dictated by a corresponding improvement in earnings performance." This model implies that retained earnings per share, return on investment, and dividend per share were very crucial and relevant for corporate performance. The result also showed that the R^2 is 0.729471 which is equivalent to 73%, indicating that the independent variables explained 73% of the systematic variation in the dividend policy of the firms over the observed years, while the remaining 27% is explained outside the unspecified variables, thus, exogenously explained. The adjusted R-squared showed that the variables exhibited a level of significance which stood at 63% why the remaining 37% are explained exogenously and not captured by the explanatory variables. Therefore, the available evidence strongly and unequivocally supported the conventional Lintner (1950; 1956) models as powerful devices for explaining the dividend behavior of Nigerian limited liability companies. In the case of First Bank PLC, the result of the findings indicates that not all indicators of dividend operations affect corporate performance but they are all necessary. This is also in line with literature as discussed above. The result on Table 4.3 show that earnings per share, retained earnings per share, and return on investment are not significant while dividend per share is significant at 5% level. The results also support the findings of Adelegan (2001) in the sense that capital markets are not perfect, and that shareholders are indifferent between dividend and retained earnings due to market imperfections and uncertainty. This gives a higher value to the current year dividend than the future dividend and capital gains.

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Table3: Ordinary Least Square Regression Result for First Bank Nigeria plc

Variable	Coefficient	Standard Error	t-Statistics	Probability Value
Constant	74.86939	48.46562	1.544794	0.0001
ROI	215.6831	60.37023	3.572672	0.0680
EPS	8.248499	4.001148	2.061516	0.6408
REPS	118.1455	56.30760	2.098215	0.0900
DPS	4.129129	1.052253	3.924084	0.0341

Source: Data Computation, 2015

MPS = 74.86939+8.248499EPS + 118.1455REPS + 4.129129DPS +215.6831 ROI + ε_t

$R^2 = 0.817679$, F- Statistics = 55.21693

Thus the payment of dividend has a strong influence on the market price of the shares. Management might maintain a dividend level even at the expense of liquidity or forced into borrowing to do so. The result in Table 2 also show that the R^2 is 0.817679 which is equivalent to 81%, this indicates that the independent variables explained 81% of the systematic variation in the performance of the firm over the observed years, while the remaining 19% is explained outside the unspecified variables. The adjusted R-squared showed that the variables exhibited a level of significance of0.671822, which is equivalent to 67% while the remaining 33% are explained exogenously and not captured by the explanatory variables. With this result, it holds that dividends are desirable from the shareholders point of view, as increasing their current wealth and dividend level determines share price as well as indicates the prospect of profitability of the firm.

The result in Table 4, with respect to Royal Exchange Assurance PLC, indicates that all indicators for dividend operation affect corporate performance, although returns on investment for Royal, unlike that of UNILEVER in Table2 is not significant at 5%.

Table4: Ordinary Least Square Regression Result for Nigeria Royal Exchange Assurance PLC

Variable	Coefficient	Standard Error	t-Statistics	Probability Value
Constant	443.6749	202.1395	2.194894	0.0282
ROI	321.1968	131.2663	2.446909	0.0667
EPS	2.987894	1.338586	2.232127	0.0017
REPS	396.0679	127.6967	3.101629	0.0046
DPS	9.974341	4.521459	2.206000	0.0079

Source: Data Computation, 2015

MPS = 443.6749 +2.987894EPS + 396.0679REPS + 9.974341DPS + 321.1968 ROI + ε_t

$R^2 = 0.817679$, F- Statistics = 55.21693

The result agrees with Van Horne (1971) that dividend policy entails the division of earnings between shareholders and re-investment in the firm, and that retained earnings are a significant source of funds for financing corporate growth while dividend constitutes the cash flows that accrue to shareholders. As the result also show, the R^2is0.734952 which is equivalent to 73%, indicating that the independent variables explained 73% of the systematic variation in the performance of the firm over the observed years, while the remaining 27% is explained outside the unspecified variables. The adjusted R-squared showed that the variables exhibited a 0.697086significance level, which is equivalent to 70% while the remaining 30% is exogenously explained in the model. Thus, the statistical implication of the result is that dividend policy impacts positively on corporate performance of firms in Nigeria as captured in the literature.

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5   **Conclusion**

The objective of this study was to assess the operations of dividend policy in Nigeria and to determine the relationship among the identified variables that influence the performance of corporate firms in Nigeria. All the reviewed variables in the literature provided some useful insights into dividend policy thrust in Nigeria.

Our findings establish that dividend policy in Nigeria is influenced by dynamic factors mentioned in the analysis while the knowledge of the true determinants of dividend policy is necessary to proffer a long term solution to the inconclusive nature of the debate on the relevance of dividend policy to corporate performance in Nigeria.   From the OLS analysis of the effect of the dividend policy on the performance of selected firms in Nigeria between 2005 and 2015, it was established that the dynamic factors which strongly determine the performance of the firms in Nigeria economy include increases in return on investment, earnings per share and dividend per share. The study also concludes that most variables are correlated, which means the activities of each variable are related to those of others. Moreover, there is a strong long relationship among the variables with slight variations. Therefore the summary of the conclusion from the study is that dividend policy exerts a significant influence on the performance of firms in Nigeria between the period specified.

Based on this conclusion, the study recommends that market forces be allowed to determine dividends, that policy formulators should not, for personal interest overrule the decision of the management; that an optimal dividend policy that maintains an appropriate balance between dividend earnings and retained earnings should be undertaken to promote financial health of the firm; that the firms should pay as at when due the dividend accrued to the shareholders in order to reward their patronage; that corporate bodies should pay attention to dividend payout in order to maintain and sustain their shareholders and attract prospective investors. Nigerian firms should also consider all the factors that affect dividend policy when formulating one, in order to have an optimal policy that satisfies their share holders and other stakeholders.

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