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THE IMPACT OF DIVIDEND POLICY ON SHAREHOLDERS VALUE: EVIDENCE FROM NIGERIA

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ABSTRACT

This paper focuses on the impact of three dividend policy mechanisms i.e. dividend pay-out, dividend per share and earnings per share) on shareholder's value as measured by (Market price per share) of a sample of thirteen firms from the banking and oil industries between 2008-2012. Using panel methodology and OLS as a method of estimation (the cross sectional regression analysis for banks and oil companies), the results provide evidence of a positive relationship between the dividend policy mechanisms (DPS, PAYR, and EPS) and MPS. The results further reveal that EPS and PAYR has positive impact on MPS at 5% level of significance, whereas PAYR for oil companies reveal that the relationship is negatively related to MPS at 1% level of significance. There exist a positive insignificant relationship between DPS and MPS. The implication of this is that firms should strive to formulate a dividend policy that ensures continuity and stability in dividend payment as this impacts on the value of the firm, hence the wealth of the shareholders.

Keywords: Dividend policy, Dividend per share, Payout ratio, Earning per share, market Price per share, Shareholders value.

1. INTRODUCTION

The subject matter of dividend policy remains one of the most controversial issues in corporate finance. For more than half a century, financial economists have engaged in modelling and examining corporate dividend policy. Black (1976) hinted that, "The harder we look at the

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dividend picture, the more it seems like a puzzle, with pieces that don't fit together". Dividend policy remains one of the most important financial policies not only from the viewpoint of the company, but also from that of the shareholders, the consumers, employees, regulatory bodies and the government. For a company, it is a pivotal policy around which other financial policies rotate (Alli, Khan and Ramirez 1993).

Dividend decision is one of the fundamental financial decisions which corporate organizations, banks inclusive have to make on continuous basis. This involves the determination of the proportion of earnings to retain and the proportion to distribute to shareholders. This concern has prompted many studies on dividend policy. These studies focused on the nature of dividends and such areas as the relevance or irrelevance of dividend policy to the value of a firm; theories and the determinants of dividend yield and dividend payout rate. Despite extensive debate and research, the actual motivation for paying dividends remains a puzzle (Baker & Powell 2001).

Dividend or profit allocation decision is one of the four decision areas in finance. Dividend decisions are important because they determine what funds flow to investors and what funds are retained by the firm for investment (Ross, Westerfield and Jaffe 2002). More so, they provide information to stakeholders concerning the company's performance. Firm investments determine future earnings and future potential dividends, and influence the cost of capital.

Various firms adopt dividend policies depending on the company's articles of association and the prevailing economic situation. Some make high pay out, while others make low pay out and yet others pay stock dividends (bonus issue) in lieu of, or in addition, to cash dividend while others pay cash only. Dividend policy suggests a positive attitude for, it is a deliberate policy to maintain or increase dividend at a certain level with the ultimate aim of sustaining the price of the ordinary share on the stock exchange. This is because capital markets are not perfect, although shareholders are indifferent between dividend and retained earnings due to market imperfections and uncertainty, but 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 share price. Management might maintain a dividend level even at the expense of liquidity or be forced into borrowing to do so. With this approach it holds that dividends, on the other hand, are desirable from the shareholders point of view, as increasing their current wealth and consequently dividend level determines share price as well as indicates the prospect of profitability of the firm.

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2. LITERATURE REVIEW

The financial need of the company may be in conflict with the desires of shareholders. Managerial prudence requires giving more weight to the financial needs of the company.

However retained earnings should be used as a source of financing only when the company has profitable investment opportunities, where shareholders have better investment opportunities, the earnings should be distributed to them so that they may be able to maximize their wealth. Dividend is payment made out of firm's earnings, usually current earning, to its shareholders in form of cash or stock. Dividends are periodic cash payment made by companies to their shareholders.

Dividend policy, also called dividend decision, on the other hand is a decision that determines the amount of earnings to be distributed to shareholders and the amount to be retained by the firm. Preference share dividends are usually fixed by the terms of issue and are therefore not subject to policy decision of management. However, payment of dividends to ordinary shareholders is a matter of company policy to be decided by the Board of Directors. It is an observable fact that the proportion of earnings paid out as dividend to ordinary shareholders can vary quite considerably from company to company.

The ability of a company to pay dividend will be related both to profitability and liquidity. There must be distributable profit from which to pay dividend and cash available to make actual payment. Within these constraints dividend policy will be determined by the directors of the companies, who may decide to recommend distribution of either high or low proportion of profits. The policy adopted should be aimed at maximizing shareholders wealth in line with corporate objectives.

There have been various studies on dividend policy with emphasis on diverse interests depending on the persuasion of the researcher. In their study, Brealey and Myers (1996) stated that "dividend policy" means different thing to different people. Therefore an appropriate starting point for a discussion on dividend policy is a conceptualization of the subject matter.

They went on to summarize the views on dividend policy into three as follows:

(1) The view that relate dividend policy to a firm's financing and investment decisions;
(2) The view that relate dividend policy to level of dividends;
(3) The view that relate dividend policy to dividend stability.

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Dividend decision can be considered as a passive decision variable. Passive decision variable implies that, dividend is only to be paid out if a firm cannot make better use of its fund for the benefit of its shareholders. This implies that earnings are retained to the extent that they are required to finance a firm's optimal capital budget. Dividends are paid only if more earnings are available than are needed to support the capital budget. This is referred to as the "Residual theory of dividend" (Brealey and Myers, 1996).

Currently, three opposing theoretical views have emerged on dividend policy. The first is the view of the rightists advocated by Gordon (1976) and was supported by Adelegan (2000) and Akuezuilo (2003). The rightists posit that a policy of paying out more cash dividends, all things being equal, will tend to increase the share price of a firm. This is based on the assumption that rational investors are risk-averse and will prefer dividends now to future dividends. The second view is that of the leftists supported by Lichtenberger and Ramaswamy, (1979 and 1982). The Leftists position is that a high dividend payout is bad since it tends to reduce the share price of a firm where dividends are taxed more heavily than capital gains. In-between the two extremes is the middle-of-the-road party represented by Miller and Modigliani (1961). They maintain that the share price of a firm is not affected by its dividend payout policy. This is because as long as investment and borrowing policy are held constant, a firm's overall cash flows are the same regardless of payment policy. This is particularly true in a world without taxes, transaction costs and other market imperfections.

These three schools of thought offer contradictory advice to firms. The rightists urge firms to pay high dividend because it increases the wealth of the shareholders. The leftists' advice firms to pay low dividend since dividend is often taxed more heavily than capital gains. The middle of the roaders encourages firms to vary dividend payment since it does not matter whether dividend is paid or not.

In practice, retained earnings are usually considered as the most significant source of long-term fund required to finance the firm's long-term growth. However, a firm is made up of a coalition of members with somewhat conflicting interests. Three members of the coalition are considered as the most prominent in a firm's dividend decision. These are the firm (itself), the owners (shareholders) and creditors (bondholders and others). This implies that a firm's decision to retain a large proportion of its earnings will adversely affect the two other coalition members. A high retention ratio will result in low payout ratio, which implies less current dividends. A high retention ratio will also imply lower net cash flow because of the relationship between dividend payment and cash flow. A lower net cash flow reduces a firm's solvency, that is, its ability to pay its debts as and when due. Thus, a firm must strike a proper balance between these conflicting interests.

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In a related study by Linter (1956) some questions were asked such as, what are the choices of management that influence the firm size, shape, and timing of dividend policy? After the Linter's contribution in determining dividend policy decisions Miller and Modigliani (1961) conducted research in dividend policy decisions and presented the theory of dividend irrelevance which showed that the dividend policy does not affect the stock prices.

Many researchers evidenced the dividend irrelevance theory through their studies like Black & Scholes (1974), Chen, Firth, & Gao (2002), Adefila, Oladipo & Adeoti (2000), Uddin & Chowdhury (2005), Denis & Osobov (2008) and Adesola & Okwong (2009).

On the other hand many researchers supported dividend relevance theory. They said dividend policy do affect the firm's value and market price of the shares.

Gordon (1963) presented his view by supporting the dividend relevance theory. Studies conducted by Travlos, Trigeorgis, & Vafeas (2001), Baker, Powell & Veit (2002), Myers & Frank (2004), Dong, Robinson & Veld (2005) and Maditinos, Sevic, Theriou, & Tsinani (2007) support dividend relevance theory.

Gul, et al (2012) investigated relationship between dividend policy & shareholder wealth in Pakistan. For this purpose they used sample of 75 listed companies & data collected from State Bank of Pakistan & Karachi Stock Exchange 100 index for period of 2005 to 2010.Shareholders Wealth dependent variable measured by market price per share & dividend policy independent variable measured by dividend per share & multiple regression & stepwise regression model used in this research for data analysis. The result of this study showed that dividend policy significantly influence shareholders wealth as far as dividend paying companies are concerned & also found out that the difference in average market value relative to book value of equity is high between dividend paying companies & non dividend paying companies.

Okafor & Mgbame (2011) conducted a study to analyse dividend policy & share price volatility in Nigeria by taking sample of 4 banks & 2 firms each from food & beverages, petroleum & brewing sectors. Stock & financial related data of these firms are collected over 8 year period from 1998-2005. Major sources of data collection are the annual reports and fact book of Nigerian Stock Exchange.

Dependent variable price volatility & independent variable dividend yield, payout ratio, assets growth & earning volatility. The relationship between ordinary stock price volatility & dividend policy has been analyzed utilizing multivariate least square regression.

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The result of their study showed that general effect of dividend yield on price volatility observed at higher significant levels, led to the acceptance of null hypothesis, which states that measure of dividend policy vary inversely with ordinary share price volatility over time.

Azhagaiah & Priya (2008) conducted study on the impact of dividend policy on shareholder wealth in South India. Secondary data was used which was collected from Center for Monitoring India Economy. Sample of 28 companies in chemical industry was selected from 114 listed companies in Bombay Stock Exchange using multi stage random sampling techniques for period of 1997 to 2006. Multiple regression & stepwise regression models were used for data analysis. Dividend per share, retained earnings per share, lagged price earnings ratio & lagged market price independent variables & market price per share dependent variable. There is a significant impact of dividend policy on shareholder wealth in organic chemical companies while shareholders wealth is not influenced by dividend payout as for as inorganic chemical companies.

Habib et al, (2012) conducted study on dividend policy & share price volatility evidence from Pakistan to draw & establish relationship between dividend policy & shareholder volatility with focus on Pakistani Stock Exchange. Dividend yield, payout ratio, size, debt, earning & growth were the independent variables& share price volatility as the dependent variable. Cross sectional regression was used to analyze the relationship of share price with dividend yield &payout ratio. The result of the study showed that dividend yield & share price are positively related but payout ratio is negatively related.

Hashemijoo et al (2012) conducted the study of dividend policy on share price volatility in stock market of Malaysia. The aim of this study was to find the relationship between dividend policy and share price volatility on consumer product company in Malaysian Stock Market. They have taken a sample of 84 listed companies from the period of six years in 2005 to 2010. In the study, share price volatility was the dependent variable while dividend yield and payout ratio as the independent variables. Multiple Regression model was used in the study to analyse the results. The results of the study showed that the dividend yield and dividend payout have negative effect on share price volatility.

Zulkifli et al (2012) explained that the impact of dividend policy in share price volatility in construction and material companies of Malaysia. The basic purpose of the study was to check the relationship between dividend policy and market price of share. The sample of 77 out of the 106 constructions and material companies was selected for the period of six years in 2005 to 2010. Share price volatility as the dependent variable and dividend yield, dividend payout ratio, leverage, growth, size and earnings volatility are the independent variables. Least square

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regression model was used to interpret the results of the study. The result showed that the positive effect on the dividend yields in share price volatility.

Pani (2008) introduced the dividend policy and stock price behaviour in corporate sector of India. The aim of the study was to check the relationship between the dividend and stock return volatility. They used the sample of 500 listed companies for the period in 1996 to 2006 and the sample was taken from six different sectors which are electricity, food and beverage, non-metallic, mining, textile and service sector. Fixed effect model and pooled OLS model were used to elaborate the results. In the study, market value of the firm was the dependent variable and the size of the firm, dividend to retained earnings ratio and debt to equity ratio were the independent variables. The study explained that the dividend paying companies are large, profitable and growth rate of the firm does not seems to deter the dividend payment. Net profit, dividend and retention ratio remain significant in other services, textile and mining industries.

Khan (2012) conducted research on the dividend effects on stock prices. The purpose of the study was to improve the dividend policy decisions adopted by the companies. The study helped to explain how dividend policy impacts on shareholders wealth by taking the data from two important sectors chemical and pharmaceutical industry of Pakistan. A data sample of twenty nine companies was taken for the period 2001 to 2010. Price volatility was taken as the dependent variable which is calculated by using Parkinson (1980) method of extreme values while earnings per share, profit after tax and return on equity were taken as the independent variables. Fixed and random effect models were applied on panel data to conclude the results. The experimental estimation based on the fixed and random effect model showed the significant positive relation between stock dividends, earnings per share and profit after tax to stock market prices while return on equity and retention ratio have negative and statistically insignificant relationship to stock market prices.

3. METHODOLOGY

In conducting this study, samples were drawn from firms listed on the floor of the Nigerian Stock Exchange (NSE). A non-probability sampling technique was adopted as only firms with the required information were selected in the study. A total of thirteen (13) firms comprising banks and oil companies were finally used as sample. Data was collected from the period of 2008-2012. The choice of sample firms was based on the size, market capitalisation and availability of the annual reports of the sample firms. The annual reports and accounts of these companies were succinctly analysed looking at the key variables of dividend policy and share holders value. This study is mainly done by using the secondary data which were collected from audited annual reports and accounts, NSE fact books.

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A cross-sectional regression model was adapted in the study to show the relationship between dividend policy and share holders value {which is in line with what is mostly found in the literature such as Mohammad Sarwar (2013) and Azhagaiah R. and Sabari Priya (2008)} is given as:

$$MPS_{it} = \beta_0 + \beta_1 EPS_{it} + \beta_2 DPS_{it} + \beta_3 PAYR_{it} + e_{it}$$

Where:

MPS: Market Price per Share
EPS: Earnings per Share
DPS: Dividend per Share
PAYR: Pay-out Ratio

Based on the statement of hypotheses of the study, we define the following variables:

i. Dependent Variable

Shareholders value is the dependent variable which is measured with market price per share.

ii. Independent Variable

Dividend policy is taken as the independent variable which is measured with the help of four ratios namely earnings per share, dividend per share, payout ratio and retained earnings ratio.

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4. RESULT AND DISCUSSION

DIVIDEND POLICY AND BANKS SHAREHOLDERS VALUE

Dependent Variable: D(MPS,1)
Method: Least Squares
Date: 04/08/14 Time: 10:32
Sample(adjusted): 2 29
Included observations: 28 after adjusting endpoints
Weighting series: PAYR
White Heteroskedasticity-Consistent Standard Errors & Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.056088	1.002080	-1.053896	0.3024
D(DPS,1)	3.234367	2.340470	1.381931	0.1797
D(EPS,1)	2.859746	1.578216	1.812011	0.0825
D(PAYR,1)	4.565793	2.020919	2.259265	0.0332
Weighted Statistics				
R-squared	0.526654	Mean dependent var		0.486158
Adjusted R-squared	0.467486	S.D. dependent var		5.882794
S.E. of regression	4.292884	Akaike info criterion		5.883358
Sum squared resid	442.2926	Schwarz criterion		6.073673
Log likelihood	-78.36702	F-statistic		8.423700
Durbin-Watson stat	1.955545	Prob(F-statistic)		0.000533
Unweighted Statistics				
R-squared	0.273561	Mean dependent var		-0.596071
Adjusted R-squared	0.182757	S.D. dependent var		5.902646
S.E. of regression	5.336082	Sum squared residual		683.3704
Durbin-Watson stat	2.879004			

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Dependent Variable: D(MPS,1)
Method: Least Squares
Date: 04/08/14 Time: 14:35
Sample(adjusted): 2 27
Included observations: 26 after adjusting endpoints
Weighting series: EPS
White Heteroskedasticity-Consistent Standard Errors & Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-33.78355	21.37819	-1.580281	0.1283
D(DPS,1)	3.278027	6.753973	0.485348	0.6322
D(EPS,1)	2.213675	0.373950	5.919715	0.0000
D(PAYR,1)	-182.8113	61.04138	-2.994875	0.0067
Weighted Statistics				
R-squared	0.728348	Mean dependent var		35.15915
Adjusted R-squared	0.691305	S.D. dependent var		272.3134
S.E. of regression	151.2982	Akaike info criterion		13.01702
Sum squared resid	503605.4	Schwarz criterion		13.21057
Log likelihood	-165.2213	F-statistic		10.02709
Durbin-Watson stat	2.996732	Prob(F-statistic)		0.000231
Unweighted Statistics				
R-squared	-0.170696	Mean dependent var		-6.920385
Adjusted R-squared	-0.330337	S.D. dependent var		88.57077
S.E. of regression	102.1577	Sum squared residual		229596.4
Durbin-Watson stat	2.051771			

The above regression analysis shows that the intercept is not relevant and insignificant in this model. This is expected as no rational investor will invest in any share if dividend per share, earning per share, and other incentives to invest are zero.

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The regression result further reveals that dividend per share over the cross sectional data of universal banks as well as for oil companies over the years have positive but insignificant relationship with market price per share. The positive relationship is consistent with the a priori expectation. It can be interpreted that a kobo rise in dividend per share leads on average to a rise in the market price per share by N3.23 and N3.27 for banks and oil companies respectively. However, the value of t-statistics depicts that the coefficients are not significantly different from zero, i.e. not reliable. Needless, to say that some companies like eterna oil have not paid dividend for almost five years to their shareholders.

Earnings per share (EPS) is directly related to the shareholders' value i.e. market price per share (MPS). The regression result is consistent with a priori expectation at 5% and 1% significant level respectively for banking sector as well as oil companies.

The regression result can be interpreted that market price per share (MPS) will be rising across board by N2.86 and N2.21 if banks and oil companies earnings per share (EPS) are respectively increasing by one kobo. It should be noted that many shareholders' are more concern about current dividends than the earnings ability of firms. This is because the firm will have more capital to finance growth. The salient point here is that a shareholder in the banking sector maximizes dividend policy than that of oil &gas sector given the value of average earning per share in the cross sectional regression analysis.

At 5% level of significance for banking sector, the pay-out ratio has positive impact with market price per share. It implies that one percent rise in pay-out ratio leads on average to N4.56 rise in market price per share. This is consistent with a priori expectation. Harkavy (1999) presents a statistical analysis of the relationship between retained earnings and common stock prices. He concludes that while common stock prices vary directly with dividend payout ratios at any given time, their degree of appreciation over a period of time is associated with the proportion of earnings, which are retained. Only a brief reference is made to the fact that the crucial consideration is the profitable utilization of investors' funds. However, the payout ratio for oil sector reveals that the relationship is negatively related at 1% level of significant. It should be noted as mention earlier that some oil companies like eterna oil have not paid dividend to her shareholders for the past five years that this analysis covers.

From the regression result, the value of R-square is 0.527 and 0.728 for both the banking sector and oil sector respectively; this implies that about 52.7 and 72.8 percent of variation in the dependent variable i.e. market price per share is explained by the explanatory variables, i.e. this shows that the model is perfect and of good fit. The value of adjusted r-squared further reinforces the fact that the included explanatory variables explain or capture greater percentage of variation in the market price per share.

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Furthermore, the value of F-statistics which is a proxy for analysis of variance ANOVA, also reveal that the model is well explained and captured by the assumed explanatory variables given the low value of its probability value.

More so, the test for the first order serial correlation implies that the model is free from auto or serial correlation considering the value of Durbin- Watson (DW) stat of 1.95 for the banking sector which falls within the region of acceptance of no serial correlation. However, the cross sectional regression analysis shows that there is a first order autocorrelation for the oil sector. This is not unconnected to the non-random and non-systematic behaviour of Eterna oil dividend policy.

5. CONCLUSION

There has been a renewed interest within academic circles as well as amongst policy makers in the need to strengthen dividend policy decisions to ensure that managers and directors take appropriate measures to protect the interest of a firm's shareholders.

Based on the forgoing discussion, the following conclusions can be drawn from the study.

Dividend policy impacts on shareholders' value firm performance and that this relationship is strong and positive. It therefore shows that dividend policy is relevant and therefore affects the firm's value to its shareholders hence its performance contrary to theories that view dividend policy as irrelevant. The findings of this research also showed that cash dividends were the most commonly used form of dividends among listed firms in Nigeria. Majority of firms did not therefore employ other forms of dividend but prefer not to pay or lower their dividends when there was no cash.

The research findings also show that the major factors that affect the dividend policy of listed firms are; profitability, pattern of past dividends, legal rules, financial leverage, investment opportunities, growth stage and capital structure. Other factors such as ownership structure, shareholder's expectations, tax position of shareholders, industry practice growth stage capital structure and access to capital markets can also be considered in designing a dividend policy though they affect dividend to a moderate extend.

Current dividend and earnings per share or earnings are significant in explaining the observed differential share market prices of companies. The fact that the magnitude of the impact of earnings or earnings per share on share market prices is greater than that of dividend payment suggest that the main determinant of market share value for Nigeria firms is no longer dividend but earnings for recent data.

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The Nigerian market capitalizes the estimates of cash flows receivable by shareholders as dividend and hence that share market price is a representation of market valuation of dividends. The empirical result of positive and significant effect of dividend payments on share market prices for the sample of Nigerian Companies indirectly cast some doubt on the empirical validity of Modigliani and Miller's preposition of dividend irrelevance in the context of Nigerian business environment.

Generally, higher dividend increases the market value of the share and vice versa. Shareholders preferred current dividend to future income so, dividend is considered as an important factor which determines the shareholders' value. This is normally true in case of salaried individuals, retired pensioners and others with limited incomes. Dividend has information content and the payment of dividend indicates that the company has a good earning capacity. The wealth of the shareholders is greatly influenced mainly by five variables viz., Growth in Sales, Improvement of Profit Margin, Capital Investment Decisions (both working capital and fixed capital), Capital Structure Decisions, Cost of Capital (Dividend on Equity, Interest on Debt) etc. As far as the dividend paying companies are concerned, there is a significant impact of dividend policy on shareholders' value in the banking and oil industries.

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