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DIVIDEND POLICY AND FIRM PERFORMANCE: A STUDY OF LISTED FIRMS IN NIGERIA

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
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ABSTRACT

This study basically investigates the relationship between the financial performance and dividend payout among listed firms' in Nigeria. It also looks at the relationship between ownership structure, size of firms and the dividend payouts. The annual reports for the period 2006-2010 were utilized as the main source of data collection for the 50 sampled firms. The regression analysis method was employed as a statistical technique for analysing the data collected. We find that there is a significant positive association between the performance of firms and the dividend payout of the sampled firms in Nigeria. The study also revealed that ownership structure and firm's size has a significant impact of the dividend payout of firms too.

 *Financial performance, annual reports, firms, ownership structure, dividend policy, dividend payout, Nigeria*

INTRODUCTION

The issue of dividend policy is a very important one in the current business environment. 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 (Alii *et al.*, 1993). 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 *et al.*,

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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 (Foong *et al.*, 2007).

The survival of any company is dependent on the continuous investment in facilities and the employment of internal financing, through the use of retained earnings from an integral part of the sources of finance to foot the investment needs (Bajaj & Vijh 1990; Osaze & Anao, 1990). Government fiscal policies tend to put some restrictions on the amount of dividend a company may pay. This invariably has forced part of the realized profits to be ploughed back. This was very obvious during the indigenization exercise of the seventies. The restriction is further strengthened by section 379 (2) of the company and allied matters act (CAMA) 1990, which provides that the general meeting shall have power to decrease the amount recommended. One of the reasons behind the dividend decision policy of the Nigerian government is to ensure that funds are available for continuous investment in assets, so that the companies will continue to operate on the going concern principle. The realization of the laudable goals of entrepreneurial investment in Nigeria has been inhibited by lack of sufficient funds. In fact the low level of investment capital available to most industrial organisations has accounted for the low capacity utilization.

The Manufacturers Association of Nigeria recently put this at below 30% (NigeriabusinessInfo.com). As one of the responses to the agony of capital shortage in the industrial sector, government initiated the deregulation of the capital market. The excess was to foster a developed capital market. However, irrespective of the various laudable efforts by the government, the Nigerian capital market is still at its emerging state. In the face of this looming shortage predicament, this paper will basically attempt to ascertain whether there is a relationship between the financial performance and dividend payout of listed firms in Nigeria. In addition, basically seeks to investigate the relationship between the financial performance and dividend payout of listed firms in Nigeria. To achieve this objective, the corporate annual reports for the period 2006-2010 were analyzed. In addition, using the judgmental sampling technique, the study considered a total of 50 listed firms in the Nigerian stock exchange market. The choice of these industries arises based on the size, market capitalization and the availability of the annual report of the sampled firms.

In the light of the aforementioned objective, the remaining part of this paper is structured as follows. Following the introductory section is the review of relevant literature and hypotheses development. The next sections then present the variables definitions, econometric model and the preliminary empirical evidence. Finally, the last sections summarize the main findings and conclusion of the study.

1. LITERATURE REVIEW

The behaviour of dividend policy is one most debatable issue in the corporate finance literature and still keeps its prominent place both in developed and emerging markets (Hafeez & Attiya, 2009). Many researchers have tried to uncover issues regarding the dividend dynamics and determinants of dividend policy but we still don't have an acceptable explanation for the observed dividend behaviour of firms (Black, 1976; Brealey & Myers 2005). Dividend policy has been analyzed for many decades, but no universally accepted explanation for companies' observed dividend behaviour has been established (Samuel & Edward, 2011). It has long been a puzzle in corporate finance. Miller & Modigliani (1961) argued that under certain simplifying assumptions, the dividend decision does not affect the value of a firm and is, hence, unimportant. Yet, traditional wisdom with changed postulations advocates that a properly managed dividend policy is vital to shareholders because it can affect share prices and shareholder's wealth. This argument is based upon two assumptions that there is no tax disadvantage to an investor to receiving dividends, and the second is that firms can raise funds in capital markets for new investments without bearing significant issuance costs. The proponents of the second school feel that dividends are bad for the average stockholder because of the tax disadvantage they create, which results in lower value. Finally, there are those in a third group who argued that dividends are clearly good because stockholders like them. Thus, despite voluminous research on dividends, corporate managers and financial economists still face what Black (1976) once described as a dividend enigma with pieces that just don't seem to fit.

Prior studies by Lease *et al.* (2000), Bierman (2001), Baker *et al.* (2002), Frankfurter *et al.* (2003) have described it as an appropriation of profits to shareholders after deducting tax and fixed interest obligations on debt capital. According to Olimalade & Adewumi (1987), it is seen as cash flows that accrue to equity investors. That is a form of return to shareholders on their investment, and the aim is to increase their confidence in the future of the company in which they have invested. Dividends are compensatory distribution to equity shareholders for both time and investment risks undertaken. Such distributions are usually net of tax and obligatory payments under debt capital and they represent a depletion of cash assets of the company (Lipson *et al.*, 1998).

Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders (Nissim & Ziv, 2001). The dividend policy decisions of firms are the primary element of corporate policy. Dividend, which is basically the benefit of shareholders in return for their risk and investment, is determined by different factors in an organization. Basically, these factors include financing limitations, investment chances and choices, firm size, pressure from shareholders and regulatory regimes. However, the dividend payout of firm's is not only the source of cash flow to the shareholders but it also offers information relating to firm's current and future performance. A considerable

number of papers, including Bhattacharya (1979; 1980), Linter (1956), Linter (1962), Miller & Rock (1985) suggest that firms dividend payouts policies are designed to reveal the earnings prospects to investors.

Related prior studies on the dividend payout policies of firms have produced a large body of empirical research, particularly following the publication of Miller and Modigliani (1961) on the dividend irrelevance hypothesis. Basically existing academic literatures presently on the determinants of dividend policy can be traced to the seminal paper of Lintner (1956) and Miller & Modigliani (1961). According to Lintner (1956), changes in earnings and existing dividend rates are the most important determinants of a firm's dividend policy decision. Miller and Modigliani (1961) while presenting the irrelevance proposition opined that in a perfect capital market company's dividend policy decision is not a thing of salient value at all. However, although investors agree on some key determinants of dividend policy of firms, the effect of dividend policy on firm value is largely challenged. Thus relating to the relationship between firm performance and dividend payout policy, many academic scholars have examined the effect of firm performance on dividend policy; still no general consensus has yet emerged after several decades of investigation, as scholars often disagree even about the same empirical evidence. This inconclusiveness of empirical findings has made the issue of dividend payouts more complex.

Kale and Noe (1990) in a related study opined that a firm's dividend basically indicates the stability of the firm's future cash flows. A review of related prior studies shows further that the main factors that influence a firm's dividend decisions include cash flow considerations, investment returns, after tax earnings, liquidity, future earnings, past dividend practices, inflation, interest, legal requirements and the future growth projection. This view however corroborates the suggestions of Brigham (1995) where a firm's dividend policy is seen as a major determinant for a firms' performance. Similarly, Zakaria and Tan (2007) also stressed the fact that investments made by firms' influences the future earnings and future dividends potential.

Likewise, Zeckhauser & Pound (1990) in a related study found out that there is no significant difference among dividend payouts with or without large block shareholders. In addition, Kouki and Guizani (2009), and Kumar (2006) also observed in their study that managerial ownership appears to have a visible and significant effect on dividend payout.

Nevertheless, while several prior empirical studies from developed economies have shed light on the relationship between firm performance and dividend payout, the same is not true in developing economies like Nigeria. This study therefore tends to fill this gap in literature by examining the relationship between the financial performance of firms and the dividend payout of listed firms in Nigeria. The study will in addition, attempted to find whether there is a relationship between ownership structure, firm size and the dividend payout of listed firms in Nigeria.

2. DEVELOPMENT OF HYPOTHESES

The hypotheses to be tested in this study are stated below in their null form:

H₁: There is no significant relationship between the financial performance and dividend payout of listed firms in Nigeria.

H₂: There is no significant relationship between ownership structure and the dividend payout of listed firms in Nigeria.

H₃: There is no significant relationship between firm size and the dividend payout of listed firms in Nigeria.

3. RESEARCH METHODOLOGY

To achieve the objectives of this study, the annual reports for the period 2006-2010 were analyzed. This is due to the fact that annual reports are readily available and accessible. However, using the judgmental sampling technique; a total of 50 listed firms operating in high profile industries in the Nigerian Stock Exchange were selected. This represents 20.5% of the total population. This is consistent with the propositions of Krejcie & Morgan (1970) where a minimum of 5% of a defined population is considered as an appropriate sample size in making generalization. The choice of the sampled firms was based on the size, market capitalization and the availability of the annual report of the sampled firms. Nevertheless, in testing the research hypothesis, the ordinary least square (OLS) was used in the estimation of the regression equation under consideration.

4. MODEL SPECIFICATION

The following model is used to examine the association between independent and the dependent variables of the listed firms in Nigeria.

$$DPO_{it} = f(ROE_{it}, OS_{it}, FSIZE_{it}, e_{it}) \dots \dots \dots (1)$$

This can be written in explicit form as:

$$DPO_{it} = \beta_0 + \beta_1 ROE_{it} + \beta_2 OS_{it} + \beta_3 FSIZE_{it} + e_{it} \dots \dots \dots (2)$$

Where:

DPO_{it} = Dividend Payout ratio is measured as the dividend per equity share divided by earnings per share

ROE_{it} = Return on Equity for firm i at time t (in years). Used as a proxy for performance and is measured as net profit after tax divided by shareholders equity.

OS_{it} = Ownership structure has been calculated by the percentage of shares held by board of directors divided by total numbers of shares

- $FSIZE_{it}$ = Firms size is proxied as total number of directors present in the Board of Directors.
 e = Stochastic or disturbance term.
 t = Time dimension of the Variables
 β_0 = Constant or Intercept.
 β_{1-3} = Coefficients to be estimated or the Coefficients of slope parameters.
 The expected signs of the coefficients (a priori expectations) are such that $\beta_1 - \beta_3 > 0$.

Table 1. Proxies and Predicted Signs for Explanatory Variables

Variable	Predicted Sign	Type	Scale
ROE	+	Independent	Measured as net profit after tax divided by shareholders equity
OS	+	Independent	Percentage of director's equity interest
FSIZE	+	Independent	Total number of directors present in the Board of Directors.

5. DISCUSSION OF RESULTS

Findings from our descriptive statistics as presented in table (2) present a mean dividend payout of about .43148 for the firms under consideration. This represents an averaged percentage distribution of about 43% for the period. On the other hand; return on equity, ownership structure and firm size maintains an averaged mean distribution value of about .33575, .14954 and .28200 respectively for the sampled listed firms in the Nigerian Stock Exchange market. However, a marathon review of empirical findings from the Pearson correlation analysis on the relationship between dividend policy and firm performance shows that there is a positive correlation between the performance of firms (proxied by ROE i.e. net profit after tax divided by shareholders equity) and the dividend payout of listed firms in Nigeria, and it is significant at 1% probability level with a correlation coefficient (r) of .44. In addition, the Pearson correlation analysis result shows that there is a positive correlation between the ownership structures of (proxied by OS represented by percentage of director's equity interest) and the dividend payout of listed firms in Nigeria and it is also significant at 1% probability level with a correlation coefficient (r) of about .597. Similarly, findings from table 3 further depicts that there is a significant positive correlation between firms' size and the dividend payout of listed firms. This is evident with a correlation coefficient of about (r) .805 and it is significant at 0.01 level.

Table 2. Descriptive Statistics

	N Statistics	Minimum Statistics	Maximum Statistics	Mean Statistics	Std. Statistics	Skewness Statistics	Kurtosis Statistics
DPO	50	.000	.995	.43148	.3155564	.380	-1.280
ROE	50	-.379	.955	.33575	.274688	.081	.286
OS	50	.001	.981	.14954	.285845	2.393	4.093
FSIZE	50	.010	.600	.28200	.150387	.386	-.986
Valid N	50						

Table 3. Pearson Correlations for Selected Firms in Nigeria

		<i>DPO</i>	<i>FSIZE</i>	<i>OS</i>	<i>ROE</i>
<i>DPO</i>	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	50			
<i>ROE</i>	Pearson Correlation	.441**	1		
	Sig. (2-tailed)	.001			
	N	50	50		
<i>OS</i>	Pearson Correlation	.597**	.158**	1	
	Sig. (2-tailed)	.000	.274		
	N	50	50	50	
<i>FSIZE</i>	Pearson Correlation	.805**	.260*	.471**	1
	Sig. (2-tailed)	.000	.068	.001	
	N	50	50	50	50

** Correlation is significant at the 0.01 level (2-tailed).

Table 4. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F change	df1	df2	Sig F Change
1	.873 ^a	.762	.747	.158761	.762	49.197	3	46	.000

a. Predictors: (Constant), *FSIZE*, *ROE*, *OS*

Table 5. ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	3.720	3	1.240	49.197	.000 ^a
	Residual	1.159	46	.025		
	Total	4.879	49			

a. Predictors: (Constant), *FSIZE*, *ROE*, *OS*

b. Dependent Variable: *DPO*

Table 6. Coefficients^b

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-.070	.052		-1.340	.187		
	ROE	.274	.086	.239	3.205	.002	.931	1.074
	OS	.297	.090	.269	3.298	.002	.777	1.288
	FSIZE	1.293	.175	.616	7.391	.000	.743	1.347

a. Dependent Variable: *DPO*

Firstly, the test for multicollinearity was done before analysing the regression model. According to Field (2000), this test is necessary because multicollinearity can affect the parameters of a regression model. Menard (1995) and Adeyemi and Fagbemi (2010) suggested that a tolerance value less than 0.1 indicates a serious multi-colinearity problem between the independent variables. Nevertheless, since all values are more than 0.10, there is no issue of multi-colinearity between the independent variables. Also, Myers (1990) suggested that a variance inflation factor (VIF) value greater than 10 calls for concern, however, for this study, the VIF values are less than 10.

Furthermore, findings from the regression analysis result for the selected firms as depicted in table (4) depicts that from the model, the R^2 which is often referred to as the coefficient of determination of the variables was .762. The R-Squared which is also a measure of the overall fitness of the model indicates that the model is capable of explaining about 76% of the variability of firms' dividend payout. This means that the model explains about 76% of the systematic variation in the dependent variable. That is, about 24% of the variations in dividend payout policies of the sampled firms are accounted for by other factors not captured by the model. This result is complimented by the adjusted R^2 (adjusted R-squared) of about .747%, which is in essence the proportion of total variance that is explained by the model. Similarly, findings from the Fishers ratio (i.e. the F-Statistics which is a prove of the validity of the estimated model) as reflected in table (5), presents a p-value that is less than 0.05 (p-value < 0.05); this invariably suggests clearly that simultaneously the explanatory variable (i.e. firm performance, ownership structure and the size of firm) are significantly associated with the dependent variable (dividend payout).

Similarly, consistent with our apriori expectations ($\beta_1 > 0$), further empirical findings provided in table (6) shows that there is a significant positive association between the performance of firms and the dividend payout of the sampled firms in Nigeria. This is evident in the t-statistics value of (3.205 and a p-value = .002). This outcome basically implies that the higher the financial performance of a firm, the more likely firms will be willing to payout dividends to its shareholders. In essence, the more profitable a firm is, the more such firm will be willing to improve on its dividend policies to its shareholders. Correspondingly, consistent with our apriori expectations (i.e. $\beta_2 > 0$), empirical findings from the regression analysis on the second hypothesis indicates clearly that a significant positive relationship does exist between ownership structure and the dividend payout of the sampled firms. This is evident in the t-statistics value of (3.298 and a p-value = .002). This implies that ownership structure of a firm has a direct impact on the dividend policy a firm operates. That is companies where more owners are present on the board pay more dividends. More so, we can infer that companies where more shareholders are sitting in the board, tries to influence their power in the decision making regarding dividend policy. Consequently, this result corroborates the propositions of Shleifer & Vishny (1986), Gugler & Yurtoglu (2003), Kouki &

Guizani (2006), Kumar (2003), Holder *et al.* (1998). They revealed that larger firms have better access to capital markets and find it easier to raise funds at lower costs, allowing them to pay higher dividends to shareholders.

Lastly, result on the third hypothesis shows that there is significant relationship between firm size and the dividend payout of listed firms in Nigeria; and this is evident with the in the t-statistics value of (7.391 and a p-value < .000). This outcome implies that larger companies tends to pay more dividend due to larger firms have easier access to external financing and rely less on internal capital. More so, larger firms are politically more sensitive and they prefer to decrease political costs by distributing dividend. More so, larger firms are likely to pay more dividends since they have better access to the capital markets and find it is easier for them to raise funds at lower costs, allowing them to pay higher dividends to shareholders. This result corroborates the work of Barclay *et al.* (1995), Holder *et al.* (1998), Fama & French (2001), Grullon & Michaely (2002), Al-Malkawi (2007) who opined that larger firms' have higher agency problems and therefore may pay higher dividends to mitigate such costs.

CONCLUSION

This study basically looked at dividend policy and firm performance in Nigeria. The study came up with findings that are of salient importance to scholars investigating dividend issues in the Nigerian context. Based on the first hypotheses, the study observed that that firm performance has a significant impact on the dividend payout of listed firms in Nigeria. That is, an increase in the financial well being of a firm tends to positively affect the dividend payout level of firms. Also, findings from the second hypothesis assert that there is a significant positive relationship between ownership structure and the financial performance of firms.

Finally, the findings from the third hypothesis validate the propositions provided in Barclay *et al.* (1995), Holder *et al.* (1998), Fama & French (2001), Grullon & Michaely (2002), Al-Malkawi (2007) where they suggested the fact that larger companies tends to pay more dividend due to larger firms have easier access to external financing and rely less on internal capital. More so, they are politically more sensitive and therefore prefer to decrease political costs by distributing dividend. Consequently, the paper concludes that while the ownership structure of firms terms of equity interest appear to have a visible and significant effect on dividend payout of firms, on the other hand, firm size tend to have a significant positive impact on firms dividend payout ratio since larger firms have better access to the capital markets and also can easily to raise funds at lower a costs. In addition, large firms tends to pay more dividend to reduce agency costs since they tend to face high agency costs as a result of ownership dispersion, increased complexity and the inability of shareholders to monitor firm activity closely. More so, due to the weak control in monitoring management in large firms, a large dividend payout increases the need for external financing, which, in turn, leads to

the increased monitoring of large firms by creditors. This may be a quality that is attractive to the shareholders.

An important limitation to this paper is the period for which the data is sampled. The sample horizon for this study is short compared to other samples in the literature. To address this limitation, future research can increase the sample size. Finally, it would be of interest if future research can investigate how ownership structure and dividend policy will be affected by changes in tax policy.

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*Appendix I. Averaged DPO, FSIZE, OS, and ROE
for the period 2006-2010*

S/N	FIRMS	DPO	ROE	OS	FSIZE
1	7UP BOTTLING COMPANY PLC	0.499397839	0.309970897	.088	0.31
2	FLOURMILL OF NIGERIA PLC	0.165004884	0.143451493	.013	0.11
3	HORNEYWELL FLOUR MILLS PLC	0	0.141420664	.001	0.18
4	NATIONAL SALT COMPANY (NIGERIA) PLC	0.99498747	0.590388429	.981	0.42
5	NESTLE NIGERIA PLC	0.864548376	0.275299588	.972	0.50
6	NIGERIAN BREWERIES PLC	0.149855665	0.09748278	.002	0.21
7	CADBURY NIGERIA PLC	0.36695	0.026221579	.098	0.32
8	PREMIER BREWERIES PLC	0.1588915	0.229242195	.023	0.12
9	NIGERIA BOTTLING COMPANY PLC	0.233005922	0.341407746	.033	0.13
10	INTERNATIONAL BREWERIES PLC	0.37083457	0.831725885	.044	0.22
11	GUINNESS NIGERIA PLC	0.712522703	0.646618596	.099	0.45
12	PRESCO PLC	0	-0.1134173167	.001	0.13
13	OKOMU OIL PALM PLC	0	-0.378711985	.001	0.17
14	OKITIPUPA OIL PALM PLC	0.75744	0.954602399	.099	0.34
15	LIVESTOCK FEEDS PLC	0	-0.006156585	.001	0.01
16	FTN COCOA PROCESSORS PLC	0.317428695	0.435806193	.075	0.44
17	ELLAH LAKES PLC	0	-0.036777701	.001	0.16
18	NIGERIAN WIRE INDUSTRIES PLC	0.198063028	.233465063	.001	0.10
19	NIGERIAN ROPES PLC	0.812241551	0.05323232	.073	0.42
20	LAFARGE CEMENT WAPCO NIGERIA PLC	0.372134039	0.010916935	.072	0.31
21	CEMENT COMPANY OF NORTHERN NIGERIA PLC	0	-0.08857862	.001	0.15
22	DANGOTE CEMENT PLC	0.289763314	.121646174	.064	0.21
23	ASHAKA CEMENT PLC	0.877219236	0.56350823	.097	0.44
24	PREMIER PAINTS PLC	0.76428555	0.498576683	.092	0.55
25	AFRICAN PAINTS (NIGERIA) PLC	0.96658462	0.28228832	.092	0.45
26	BERGER PAINTS PLC	0.17365269	0.266971456	.001	0.13
27	CAP PLC	0.278165294	0.229905415	.066	0.23
28	DN MERYER PLC	0.1588915	0.57292495	.013	0.12
29	IPWA PLC	0.33005922	0.23414046	.075	0.22
30	NIGERIAN GERMAN CHEMICALS PLC	0.198063345	0.03946505	.082	0.11
31	PAINTS & COATINGS MANUFACTURERS NIGERIA PLC	0.812241567	0.45532334	.894	0.45
32	PS MANDRIDES & COMPANY PLC	0.31742862	0.43634506	.072	0.32
33	BEVERAGES (WEST AFRICA) PLC	0.94587456	0.53456529	.978	0.37
34	COSTAIN (WEST AFRICA) PLC	0.85648376	0.21230588	.776	0.42
35	ARBICO PLC	0.16785665	0.34555785	.013	0.24
36	UNILEVER NIGERIA PLC	0.33330565	0.23454379	.074	0.16
37	GROMMAC INDUSTRIES PLC	0.14526915	0.25672195	.033	0.45
38	ACCESS BANK PLC	0.26485922	0.45677746	.025	0.23
39	AFRIBANK NIGERIA PLC	0.35823457	0.56755885	.057	0.21
40	BANK PHB PLC	0.77022703	0.29976596	.038	0.60
41	DIAMOND BANK PLC	0.33342314	0.45166174	.054	0.11
42	ECOBANK NIGERIA PLC	0.77821236	0.56350823	.087	0.33

Accounting and Management Information Systems

43	FIDELITY BANK PLC	0.86456555	0.45676683	.032	0.45
44	FIRST BANK OF NIGERIA PLC	0.88765462	0.56548832	.062	0.55
45	FIRST CITY MONUMENT BANK PLC	0.26785269	0.56971456	.011	0.12
46	W.A GLASS INDUSTRIES	0.27456794	0.94589905	.036	0.13
47	JAPPAUL OIL AND MARITIME SERVICES PLC	0.25445615	0.84524219	.023	0.22
48	INCAR NIGERIA PLC	0.42456522	0.23414033	.055	0.32
49	R.T. BRISCOE PLC	0.69456345	0.39423054	.052	0.21
50	DN TYRE AND RUBBER PLC	0.81234567	0.45453234	.844	0.55

Source: Annual reports (2006-2010)