

# DETERMINANTS OF DIVIDEND PAYOUT OF FINANCIAL INSTITUTIONS IN NIGERIA: A STUDY OF SELECTED COMMERCIAL BANKS

Bassey, Nsikan Edet\*,

Department of Agricultural Economics and Resources Management Akwa Ibom State University, Ikot Akpaden, Mkpata Enin, Akwa Ibom State, Nigeria

Corresponding Author's E-Mail: [nebass2005@gmail.com](mailto:nebass2005@gmail.com)

Elizabeth A. Atairet

Department of Agricultural Economics and Resources Management Akwa Ibom State University, Ikot Akpaden,

E-Mail : [lizzyatairet@gmail.com](mailto:lizzyatairet@gmail.com)

Asinya, Francis Anoka

Department of Business Administration, Cross River State University of Technology, Ogoja Campus, Cross River State, Nigeria

E-mail : [frankanoka@yahoo.com](mailto:frankanoka@yahoo.com)

## ABSTRACT

*The study examined the various determinants of dividend payout of selected Commercial Banks in Nigeria. Secondary data collected from 1989-2010 were analyzed using the Ordinary Least Squares (OLS) regression technique. The findings revealed that while current earnings, lagged dividend and lending rate were the major determinants of cash dividend payout in these banks, Inflation rate and liquidity ratio failed to explain the variation in dividend payout. Also, these banks have a lower Average Marginal Propensity (AMP) to pay out of current earnings of 30.67%. This implies a profit retention of 69.33% during the period, indicating the conservative nature of management of these banks. The paper recommend that if informed Nigerians are to be encouraged to buy more shares in the banking sector, management of such banks should strive to reduce their retained earnings. This is necessary due to the axiom of time value of money. Since money invested in shares is part of individual investments, shareholders should have maximum returns on their investment such as dividend.*

**Key words:** Commercial banks, Dividend Payout, Determinants, Nigeria, Current Earnings

## 1.1 INTRODUCTION

The need to receive dividend forms part of the primary motive why shareholders buy shares. In subscribing for a firm's shares, investors always take into consideration a host of factors such as the dividend track record of the firm, the stock price at the floor, profile of Board of Directors as well as nature of firm's investment. As a result, management strives to command a fair price for her stocks, while ensuring prompt payment of dividend. As the earnings record of a company improves, increase in cash dividend is expected to follow. The amount of dividend received by shareholders will depends considerably on the dividend policy of such organization. Dividend policy implies the payout policy that management adopts in deciding pattern of cash distribution to shareholders over time. It indicates the share of Company's earnings that are paid out to investors in cash.

The study of dividend policy is increasingly becoming interesting for several reasons. First, it affects the capital structure of the firm and also changes the firm's stock value (Nikolaos, 2005). Secondly, announcement of dividend signals information to investors about the firm's efficiency in terms of profitability, liquidity and investment opportunity (Alli et al, 1993). Thirdly, through cash dividend policy, managers reduce principal-agent relationship costs (Brigham and Gapenski, 2002). Since the pioneering work of Miller & Modigliani (1958) in their seminal article, series of empirical and theoretical research in dividend policy have emerged and increased tremendously, some relaxing the assumptions of the M & M and offering theories and building models to guide managers formulate their dividend policy decisions. However, empirical evidences from these studies vary considerably (See Gordon, 1963; Litner, 1962; kawal & Sujata (2008), Allen & Michaely, 1995; Litzenberger & Ramaswamy (1979), Alli et al (1993), Lyold et al (1985), Keown et al (2002), Nikotaos (2005), Baker & Wangler (2002) etc. Some suggest that increase in dividend payout increases the firm's market value; others posited that increase in dividend payout decreases the firm's value, while some argue that dividend policy does not affect the market value of the firm.

In spite of the continuous and increasing theoretical and empirical debate on dividend policy, there is still no generally accepted standard on how firms actually pay out dividend to shareholders at a given time period. Hence, this study aimed at

determining those factors that affect cash dividend disbursement of two commercial banks in Nigeria. A cash dividend model would be developed that would help explain the variation in cash dividend for the selected banks.

The paper is divided into six sections, following the introduction, the next section provide an overview of the Nigerian banking sector. Section three is the determinants of dividend policy. Section four is the research methodology, while section five presents the empirical results and analyzed. Finally, section six is the concluding remarks.

## **2.1 Overview of the Nigerian Banking Sector**

Commercial banks commenced operations in Nigeria by 1892, with the establishment of two British banks by the Colonial Masters. At Independence, the country had a total of twelve banks with 160 branches across the country (Adamu, 2009). Activities of commercial banks in Nigeria came into public scrutiny during the 1995 to 1999 era, a period where distress and financial crisis had rocked the banking sector. Numerous banks were liquidated at this period by Nigerian Deposit Insurance Corporation (NDIC). Since then, the banking system has undergone remarkable changes in terms of ownership structure, conduct and performance (branch networks as well as nature of operations). As at 2004, there were about 89 deposit money banks in Nigeria with the largest bank having a capital base of US\$ 240 million compared to US\$ 526 million for the smallest banks in Malaysia (Soludo, 2004). Central bank of Nigeria's ratings of Nigerian banks as at 2004 showed that 62 banks were sound and satisfactory, 14 marginal, 11 unsound while 2 did not render any return during the period. According to Soludo,(2004), the ailing banks were characterized by weak capital base, overdependence on public sector deposit, non publication of annual accounts, poor corporate governance and high incidence of nonperforming loans. This informs the series of reforms that have taken place in the Nigerian banking Industry till date. For instance, such reforms according to Soludo, (2004) include minimum recapitalization of 25 billion which resulted in the emergence of 24 banks in 2007, adoption of a risk focused and rule-based regulatory framework, adoption of zero tolerance in all regulatory framework, the automation process for rendition of returns by banks, establishment of a hot line ,confidential internal address, strict enforcement of the contingency planning framework for systemic banking distress, establishment of an asset management company , promotion and enforcement of dormant laws, especially those relating to financial crisis and issuance of dud cheques. In fact, the last bank audit by Central Bank of Nigeria which resulted in the outright dismissal of most bank Directors and CEOs supported the fact that Nigerian banks were in a bad state. Surprisingly, most of these banks were still paying dividend to shareholders during the crisis period, in spite of the provision of Section 381 of Company and Allied Matters Act of 1990 (CAMA 1990),which places a restriction on dividend payment by banks except all liabilities have been settled. It was not clear whether the dividend paid by these banks were as a result of positive turnover or false declaration of profits.

## **3.1 DETERMINANTS OF DIVIDEND POLICY**

Different theories have been proposed by researchers on the determinants of dividend policy of firms. Factors affecting dividend policy can be grouped into internal and external. Internal factors are firm specific such as profitability, liquidity, investment opportunities, stage of growth of firm etc while external factors include government policies, technology, stability of earnings, willingness to dilute ownership, nature of shareholders, dividend payout of rival firms etc.

### **(a) Internal factors**

Firm size is one of the major determinants of cash dividend payout. Larger sized firms have easier access to capital market. This reduces their rate of dependency on internally generated revenue and hence, fosters prompt payment of higher rate of dividend (Vogt, 1994). Studies by Gaver and Gaver (1993) also supported a positive relationship between firm size and dividend payout.

Firm earnings have long been established to influence dividend payout. A study by Litner (1956) showed that dividend payment pattern of a firm is influenced by the current earnings and previous year dividend. Corroborating this is Baker and Powell (2000) who posited that dividend policy is determined by a combination of industry specific factors and anticipated level of future earnings.

Liquidity and cash flow position of the firm is also a vital consideration. This arises from the fact that dividend payout entails huge cash flows. Hence, a firm encountering liquidity challenges would find it difficult to pay higher dividend. Empirical evidence from Alli et al (1991), Ahmed et al (2008) reveal that dividend payout depends more on cash flow, which reflect the company's ability to pay dividend rather than on earnings which are often influence by accounting practices.

Stage of development and growth of the firm have also been found to have implication in dividend payout. According to Higgins (1981), there exist a direct link between growth and financing needs. He explored further that rapidly growing firm have more external financing needs because working capital needs usually exceed the incremental cash flow from sales. Beside, a growing firm needs more capital for expansion than already established firm.

Empirical evidences from studies such as Llyod et al (1985) and D'souza (1999) suggest that firms with larger level of market risk is associated with low rate of dividend payout. Kanwal and Sujata,(2008) on their study on information technology in India found a positive significant relationship between systematic risk ( beta) and dividend payout.

In terms of presence of investment opportunities, Easterbrook (1984) and Jensen (1986) all supported the fact that firms with many investment opportunities pay fewer dividends. In their opinion, announcement of cash dividend shows that the firms have less investment opportunities. Firms with large investment plan that are characterized by huge capital flow commitments will pay less or no dividend.

#### **(b) Inflation Rate**

During inflationary periods, companies usually retain huge part of their earnings so as to avoid a reduction in their scale of operation and to compensate for the fall in purchasing power, hence, would not be able to pay much dividend. If this occurs, the relationship between inflation rate and dividend payout would be negative. On the other hand, shareholders on their part would advocate for higher dividend due to the fall in purchasing power. Given this, the relationship between dividend payout and inflation rate would be negative.

#### **(c) Dividend Policy of Rival Firms.**

If the dividend payout of competitors within the banking sector is high, the firm would increase its dividend payout. If not, its share prices would drop drastically, leading to loss of confidence by shareholders and an increase in likelihood of replacement of the management team by shareholders. Hence, managers strive not to ignore persistently the dividend policy of rival firms so as to avoid risking their jobs.

#### **(d) Willingness to dilute ownership and control**

Every dividend payout by a firm reduces the firm's cash reserve. Accordingly, fresh capital has to be sourced from the capital market either through IPO or right issue. Sourcing for extra fund requires dilution of ownership of the firms because more shares would be held by the public.

#### **(e) Nature of shareholders**

Shareholders in the right income group would prefer capital gains that are usually associated with low tax than paying high taxes on dividend received. Hence, such shareholders would favor high retention. The reverse, however, remains the case for shareholders within the low income bracket.

#### **(f) Restrictions on debt contract.**

Most protective covenants in a loan agreement at times incorporate a restriction in dividend payout. The essence of such a restriction is to focus the firm's attention on servicing the debt; hence, such restriction when incorporated by lenders would affect the dividend policy. On the other hand, managers at times canvass for such restriction to be incorporated by lenders so as to justify their nonpayment of dividend to shareholders.

### **4.1 RESEARCH METHODOLOGY**

The study made use of secondary data collected from Annual reports and Statements of Accounts of the selected banks for various years, Publications of Central bank of Nigeria, Federal Bureau of Statistics as well as the Nigerian Deposit Insurance Corporation (NDIC). Two banks; First Bank of Nigeria Plc and United Bank for Africa (UBA) were chosen for the study. Time series data on Earning Per Share (EPS), Deposit Per Share (DPS), Liquidity Ratio (LR), Inflation rate (IFR) and Lending rate (LeRT) were collected from 1989 to 2010 and used for the study.

#### **4.1.1 Model Specification**

The data collected were analyzed using the Ordinary Least Square (OLS) regression technique. Dividend Per Share (DPS) was regressed against a set of explanatory variables using the modified Litner's (1956) Model. The original Litner's model was specified as;

$$D_{it} = a_{it} + bP_{it} + d D_{i(t-1)} + U_{it}$$

Where:

$i$  = the subscript identifying the individual company

$D_{it}$  = cash dividend paid by individual firm at time  $t$  on equity shares

$a$  = the constant term

$P_{it}$  = net profit for the current period  $t$  for the individual firm

$U_{it}$  = Stochastic error term

$b$  = short term marginal propensity to distribute out of current earnings

$d$  = coefficient of cash dividend paid in previous year.

$b=cr$

$C$  = adjustment rate,  $r$  = target payout ratio and  $d = 1-c$

The modified form of the Litner's model that was used for the study is stated econometrically as;

$$DPS_{it} = b_0 + b_1EPS_{it} + b_2DPS_{i(t-1)} + b_3LR_{it} + b_4IFRT_{it} + b_5LeRT_{it} + U_{it}$$

Where

$DPS_{it}$  = Cash Dividend Per Share at time  $t$  for bank  $i$

$b_0$  = Constant term

$EPS_{it}$  = Earnings Per Share for bank  $i$  in time  $t$

$DPS_{i(t-1)}$  = Cash Dividend Per Share paid in proceeding year

$LR_{it}$  = Liquidity ratio of bank  $i$  in time  $t$

$IFRT_{it}$  = Prevailing Inflation rate for bank  $i$  in time

$LeRT_{it}$  = lending rate for firm  $i$  in time  $t$ .

$b_1$ - $b_5$  are the coefficients of the parameters to be estimated

$U_{it}$  = Stochastic error term that is assumed to be uniformly distributed.

Note:  $b_1$  is Marginal Propensity to Pay (MPP) out of current earnings.

On a priori ground, we expect that

$b_1, b_2, b_3$  and  $b_5 > 0$  and  $b_4 < 0$

Based on the a priori expectation, the sign of  $b_1, b_2, b_3, b_4$  and  $b_5$  are expected to be positive while  $b_4$  would be negative.

## 5.1 PRESENTATION AND ANALYSIS OF RESULTS

This section presents the regression results for the two banks and discussed the findings. Of the four functional forms (Linear, Cob Douglas, exponential and semi log) that were used to carry out the regression, the linear functions was chosen as the lead equation in the two banks.

### 5.1.1 Regression Estimates for First Bank of Nigeria

Table 1 presents the regression result for First Bank of Nigeria Plc; of the four functional forms that were used to run the regression, the linear form was chosen as the lead equation due to the significance of the variables and the high  $R^2$  value. From the result, three of the estimated coefficients; Earning Per Share ( $EPS_{it}$ ), Dividend Per Share in the preceding year ( $DPS_{i(t-1)}$ ) and lending rate ( $LeRT_{it}$ ) all carry a positive sign. Only Earning Per Share and Dividend Per Share in the preceding year and Lending rate were significant at the 5% level of significance, showing that they are strong predictors of dividend per share. It further implies that a 1% increase in Earnings per Share ( $EPS_{it}$ ), Dividend per Share in the preceding year ( $DPS_{i(t-1)}$ ) and lending rate ( $LeRT_{it}$ ) will increase Dividend Per Share ( $DPS_{it}$ ) by 0.2872 and 0.343 and 0.2699 respectively. Beyond this, the positive but non significant value of liquidity ratio highlights the fact that though liquidity ratio has a positive relationship with dividend per share, it is not an important determinant of dividend payment pattern in First Bank of Nigeria. This finding contradicts that of Dhrymes and Kurz (1967) who reported a negative relationship between liquidity ratio and dividend payout. It also contradicts that of kanwal and Sujata (2008) and Ahmed and Carlos (2008), who reported Liquidity ratio to be a major determinant of dividend payout on their study in Greece and USA respectively.

The inflation rate coefficient was negative and insignificant. This implied that managers of these banks do not pay dividend during inflationary periods. This might arise because relatively more profit will be retained in order to compensate for the loss in purchasing power. The coefficient for Lending rate was positive and significant at the 5 percent level. The plausible explanation for this is that in the face of higher lending rates, shareholders would advocate for more dividend payment.

$R^2$  value of 0.83604 implies that about 83.6% of the variability in dividend per share (DPS) is explained by the changes in explanatory variable. The bank has a marginal propensity to pay out of current earnings of 0.2872 as reflected by the value of  $b_1$ . This translated into profit retention of 71.28%, showing the conservative attitude of Management of this bank. The Durbin Watson Statistics of 2.19 shows absence of auto correlation. The F value (21.67%) is found to be significant at 5% level of significance suggesting overall applicability of the existing model.

**Table 1: Regression Estimate for First Bank of Nigeria**

Variable	Coefficient	Standard Error	T-value
Constant	0.0126	0.3353	0.0376
$EPS_{it}$	0.2872	0.0887	3.2370***
$DPS_{it}$	0.3431	0.1399	2.4524**
$LR_{it}$	0.2699	0.2311	1.1679
$IFR_{it}$	-0.0193	0.2860	-0.0068
$LeRT_{it}$	0.0297	0.0118	2.5169**

\*\*, \*\*\* indicate significant at 5 and 10 % respectively

The cash dividend equation for First bank of Nigeria is :

$$Y = 0.012618 + 0.2872EPS_{it} + 0.3431DPS_{t-1} + 0.2699LR_{it} - 0.0193IFR_{it} + 0.0297 LeRT_{it} + U$$

(0.3353) (0.0887) (0.1399) (0.2311) (0.2860) (0.0118)

$$R^2 = 0.83604 \quad F(4, 17) = 21.67, \quad DW = 2.19$$

### 5.1.2 Regression Estimate for United Bank for Africa

Table 2 presents the regression result for United Bank for Africa. The linear form of the model was chosen out of the four that were estimated due to the significance of the estimated coefficients and higher  $R^2$ . From the Table, Earning Per Share ( $EPS_{it}$ ), Dividend Per Share in the preceding year ( $DPS_{(t-1)}$ ) and liquidity ratio (LR) all carry a positive sign. Only Earning Per Share ( $EPS_{it}$ ) and Dividend Per Share in the preceding year ( $DPS_{(t-1)}$ ) were significant at 5% level showing that they are major determinants of dividend per share in this bank. The coefficient of liquidity ratio (LR), inflation rate (IFR) and Lending rate were not significant meaning they were poor predictors of dividend per share. The negative and insignificant coefficient of inflation rate implies that management of this bank do not pay much cash dividend during inflationary period, instead prefer to retain earnings with view of ameliorating the inflationary effect on the value of money.

The  $R^2$  value of 0.21158 shows that about 21.1% of the variability in Dividend Per Share (DPS) is explained by the explanatory variables. The implication is that there are other variables affecting DPS which are not included in the model.

Also, the bank has a marginal propensity to distribute out of current earnings of 0.0957, translating into profit retention of 90.43%. The Durbin Watson value of 1.77 shows the presence of auto correlation in the model. The F statistics was significant.

**Table 2: Regression Estimate for United Bank for Africa Plc (UBA)**

Variable	Coefficient	Standard Error	T-value
Constant	0.0183	0.2041	0.0897
$EPS_{it}$	0.0957	0.0398	2.4045**
$DPS_{t-1}$	0.0177	0.0048	3.7060***
$LR_{it}$	0.3197	0.2730	1.1701
$IFR_{it}$	-0.0697	0.2153	-0.324
$LeRT_{it}$	0.1185	0.0871	1.3605

\*\* , \*\*\* indicate significant at the 55 and 10% respectively.

The cash dividend equation for United Bank For Africa Plc is :

$$Y = 0.0183 + 0.0957EPS_{it} + 0.017730DPS_{t-1} + 0.3197 LR_{it} - 0.069750FR_{it} + 0.1185LeRT_{it} + U$$

$$(0.2041) \quad (0.0398) \quad (0.0048) \quad (0.2730) \quad (0.2153) \quad (0.0871)$$

$$R^2 = 0.619 \quad F(4, 17) = 6.741, \quad DW = 1.7$$

## 6.1 CONCLUDING REMARKS

We have examined the various determinants of dividend policy in two Commercial banks in Nigeria. Evidence suggests that current earnings per share, dividend per share in previous year and lending rate were the major determinants of cash dividend for the study period. Inflation rate was negative, implying that management of these banks prefers to retain profit during inflationary period. Also, both banks had a lower marginal propensity to pay cash dividend. It is evidenced from these findings that only current earnings, lagged dividend and lending rate forms the major determinants of cash dividend policy in these banks. Excess liquidity of these banks and inflation rate did not influence the amount of cash dividend paid. The paper recommends that if informed Nigerians are to be encouraged to buy more shares in the banking sector, management of these banks should strive to increase their marginal propensity to pay out cash dividend by reducing their retained earnings. This is imperative given the axiom of time value of money. Since money used to procure shares is investment, shareholders should have maximum returns on their investment, such as dividend.

## References

- Adamu, B.I (2009): Financing Gap for Small and Medium Enterprises (SMEs) in the post Consolidated Banking sector in Nigeria, In Bullion Publication of the Central bank of Nigeria Vol.33, No.3 July- September, Espee Printing and Advertising, Abuja, pp.38-52
- Ahmed, H. J and Carlos, J. O (2008). The financial factors influencing cash dividend policy; A sample of U.S manufacturing companies. Inter Metro business Journal 4(2), pp 23

- Allen, F. and R. Michaely (1995). Dividend Policy, in *Hanbooks in Operations Research and Management Science*, Vol.9, Finance, R.A Jarrow, V. Maksimork and W.T Ziemba (eds.), North Holland, pp.793-837.
- Alli, K. L, Khan, A. Q and Ramirez, G.G (1993). Determinants of Corporate dividend policy: a factorial analysis. *The Financial Review*, 28(4) 523-547
- Baker, H. K and Garry, E. P (2002). Determinants of corporate dividend policy: a survey of NYSE firms. *American Economic Review* 46,pp 97-113
- Baker, M and Wurgler, J.(2002).A Catering Theory of Dividend.NBER,November 7,1-61
- Brigham,E.F and Gapenski, L.C (2002). *Financial Management: Theory and practice* (10<sup>th</sup>ed.)United State; Thompson Learning, Inc.
- Dhrymes, D.J and Kurz, M. (1964).On the dividend policy of Electric utilities.*The Review of economics and statistics*. 46, 76-81
- D' Souza, J (1999). Agency Cost, Market risk, Investment opportunities and dividend policy- an International perspective. *Managerial Finance*, Vol.25 No.6. pp 35-43
- Easterbrook, F. H 91984).Two agency-cost explanation of dividends. *The American Economic Review* 74(3) 650-659
- Gaver, J.J and gaver, K. M (1993). Additional evidence on the association between the investment opportunity set and corporate financing, dividend and compensation policies. *Journal of accounting and Economics*, January/April/July, 125-160
- Gordon, m. J (1963).Optimal Investment and Financing policy. *Journal of Finance*, May, pp.264-272
- Higgins, R. C (1981).Sustainable Growth under Inflation. *Financial Management*, Vol.10,pp 36-40
- Jensen, M. C (1986). Agency costs of free cash flow, corporate finance and takeover. *American Economic Review*, May, 659-665.
- Kanwal, A. and Sujata, k. (2008).Determinants of Dividend Payout Ratios- a study of Indian Information Technology sector. *International Research Journal of finance and Economics*, Issue 15.
- Keown, A. J, Martin, J. D, petty, J. W and Scot, D. F (2002) *Financial Management: Principles and Applications* ( 9<sup>th</sup> ed.) New York, NJ; Prentice Hall
- Litner, J. (1962). Dividend, earnings, leverages stock price and the supply of capital to Corporations. *Review of Economics and Statistics*, August, pp 234-269
- Lintzenberger, R. H and K. Ramaswanmy (1979).The Effects of Personal Taxes and Dividends on Capital Asset Prices. *Journal of Financial Economics*, June, pp 163-196
- Lloyd, W. PO, Jahera, J. S and Page, D. E (1985).Agency Costs and Dividend- Payout Ratios. *Quarterly Journal of Business and Economics*, summer, 19-29
- Modigliani, F and Miller, M, H (1958). The Cost of Capital, Corporation Finance and the theory of Investment. *American Economic Review*, 20 (48) pp 261-293
- Nikolaos, E (2005). The Effect of Distributed Earnings and Size of the Firm to its dividend Policy: Some Greek data: *International Business and Economics Journal*- Vol., 4 No.1 pp 67-74
- Soludo, C.C. (2004).Consolidating the Nigerian banking Sector Industry to meet the Development Challenges of the 21<sup>st</sup> Century. A keynote address delivers to the special meeting of the Bankers' Committee held on July, 6, 2004 at the CBN Headquarter, Abuja, Nigeria.
- Vogt, S.C (1994). The cash Investment relationship: Evidence from Us manufacturing firm. *Financial Management*, summer 3-16