

# Implications of Accounting Information for Security Pricing in the Nigerian Stock Market

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## Abstract

*Dividend decision involves the conflicting interest of different groups of shareholders whose interests need to be ignored but should be integrated into a firm's dividend policy. Depending on their individual disposition, some shareholders are interested in receiving cash dividend while some others are interested in growing their investment for the future. Therefore, while one school argues that information on dividend is critical to stock price movement, the other contends that earnings retention is the active force in stock price determination. Review of relevant literature, however, shows that both dividend and earnings retention are necessary decision-making variables, as each exerts a significant influence on stock price. Empirical studies have shown that dividend and earnings reports positively influence the movement of stock price. The quantum of available literature suggests that dividend ranks higher than earnings in the explanation of movements in share price. Distorted accounting information have led to business failures as the market values of stocks associated with them cannot be sustained, thus the reliability of accounting information need not be overemphasized. Information should also be timely and affordable. Variability in stock prices are sometimes not supported by the economic fundamentals in the respective organizations, implying that variables outside dividend and earning, may also account for stock price movement.*

## 1.0 Introduction

A general assumption is that investors are rational in the choice of investments they make and as such their investment decisions should be based primarily on economic considerations. The primary objective underlying investment decisions is to ensure the realization of some form of benefits or returns over some future period. To be better disposed to make such vital decisions, investors rely heavily on information: information as to costs (price) and information as to benefits (returns/profit). Investment decisions are very critical as they involve a commitment of present financial resources on the expectation of some returns in the future.

Investments could be in real assets, as plant and equipment, building etc or in intangible assets such as financial assets or securities. However, for the purpose of this study, emphasis shall be on investment in financial securities with a bias towards investments in equity or ordinary share capital. The equity or share capital of a company is broken down into units called ordinary shares in Nigeria or ordinary stock in the United Kingdom or common stock in the United States. Ordinary shareholders or ordinary stockholders therefore, may be used to refer to the same group of people: holders of equity or ownership interest in the real assets of the issuing company.

Transactions in financial securities are conducted within the framework of the financial system and within the financial system is the financial market. The financial market is divided into the money and capital markets. The money market creates financial claims of less than one year to perhaps less than five years of maturity using such instruments as treasury bills, commercial papers, bankers' acceptances, certificates of deposit, time deposits, call money, etc. The capital market, on the other hand, provides a framework for the creation of long

term financial assets such as shares, debenture stocks and mortgages. Anyafo (1999) defines the capital market as the segment of the financial market for raising long term funds to finance productive investments using debt and equity instruments of long term or perpetual maturities. The capital market, is made up of primary market institutions, such as issuing houses and secondary market institutions like the stock exchange. Primary market institutions offer arrangements for mobilizing and directing savings into new investments thereby creating financial claims or assets. The secondary or resale market on other hand merely provides a mechanism whereby the financial claims created above are not liquidated by the withdrawal of either of the parties, thereby offering liquidity to investors while ensuring that the organization continues in business as a going concern.

In Nigeria, the Securities and Exchange Commission (SEC) is the regulator of the capital market with the primary function of determining the timing and quantity of securities to be sold in the market among others. Though the market determines the price, SEC monitors price movements to ensure appropriate pricing. Variability in the prices of corporate stocks arising from such factors as demand for and supply of shares, etc is a regular feature of the stock market as well as an issue of grave concern to investors. However, there have been divergent views among scholars as to what actually drives the demand and thereby the price of such stocks in the market. There is the need therefore to seek a resolution of the above issue as it would not only help to explain investor behaviour but would assist policy makers in organizations in the formulation of optimum dividend policy. The policy issue confronting management therefore is the formulation of a dividend and retention policy that would maximize value or wealth of shareholders. This study therefore

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seeks to examine the implications of accounting information like dividend and earning reports for stock pricing in the Nigerian Capital Market.

The study is divided into five sections. Section one serves to introduce the subject. Section two presents an overview of the financial system. Section three deals with theoretical issues in stock valuation. Section four deals with the dividend policy, while section five concludes the work.

### 2.1 An Overview of the Financial System

The financial system is a catalyst for the economic development process of any society because it is the framework within which capital formation takes place (Odife: 1985). By this framework, the savings of some members of the society are made available to other members for productive investment. The financial system is made up of various institutions, markets, instruments and operators that interact to provide core financial services, notably intermediation. For effective and efficient intermediation to take place, the financial system employs the use of primary and secondary market institutions. The primary market institutions provide means for directing savings into new investments, thereby creating financial claims or assets whereas the secondary market provides a mechanism whereby the claims created in the primary market are not liquidated merely by the withdrawal of one of the parties. Primary market institutions include issuing houses; mortgage banks, commercial banks and secondary market institutions include the stock exchange, stockbrokers and the discount houses.

Encapsulated in the financial system is the financial market which serves as the channel for exchange transactions. The financial market is made up of the Money and Capital Markets. Whereas the Money Market provides a platform for trading in short-term financial instruments whose maturities are in the range of 1 year to or less than 5 years, the capital market offers a platform for trading in long term financial instruments. Examples of money market instruments include treasury bills, commercial papers, bankers acceptances, etc. Capital market instruments include shares, debentures and mortgages.

Within the platform or framework of the capital market are primary market institutions like the issuing houses and secondary market institutions like the stock exchange. The stock exchange regulates trading in stocks and shares but are themselves regulated by the Securities and Exchange Commission (SEC).

### 2.2 Historical Development Of The Nigeria Stock Market

Prior to the attainment of political independence in 1960, Nigeria had relied on the London Capital Market for raising long-term funds to finance such development projects as the Lagos-Kano Railway Line, Carter and Denton Bridges (Lagos), Iddo and Apapa Wharf, Port Harcourt – Jos Railway Line, Iddo Power Scheme, Ebute Metta Railway Workshop and Lagos Harbour works (Anyafu: 1999). Instances of loans

raised from London and the enabling statutory instruments include Loans Ordinances of: 1904 No. 23 for £2.0 million; 1908 No. 7 for £3 million; No.12 of 1911 - £3.5 million; No. 57 of 1917 - £2.0 million; No.24 of 1919 - £4.2 million; No. 16 of 1921 - £3.0 million.

Following series of purposeful discussions in business and academic circles in the 1950s about the establishment of an organized security market in the country, the Barback Committee was appointed in 1958 to advise the Government on its feasibility or otherwise. Following the report of the Committee, the Lagos Stock Exchange was incorporated on September 15, 1960 as a private company limited by guarantee with a share capital of £5000 divided into 500 shares, with its enabling legislation as the Lagos Stock Exchange Act No.14 of 1961. Following the recommendations of the Okigbo Committee, the Lagos Stock Exchange was re-named the Nigerian Stock Exchange on December 2, 1977 with head office in Lagos and decentralized trading floors in Port Harcourt and Kaduna. The Exchange now has 13 branches located across Nigeria: Port Harcourt, Kaduna, Kano; Onitsha, Abuja, Yola, Benin, Ibadan, Uyo, Abekokuta, Owerri, Ilorin and Bauchi. In the early years of its existence, operations on the exchange were manually conducted but with the advancement in the field of information technology, operations have been upgraded to world class standard and transactions are conducted on-line and service delivery is on real-time basis as all the trading floors/branches are linked to a central server. One prominent feature of the level of sophistication in the operations of the exchange was the launching of the trade alert facility in 2005 to alert investors of any dealings on their holdings thereby curtailing the incidence of unethical or unauthorized market practices.

The establishment of the Central Securities Clearing System (CSCS) on April 18, 1997 to serve as the central depository for share certificates and to render sub-registry and custodian services to local and foreign investors has positively impacted on service delivery as settlement and delivery time lag was reduced to 5 working days in line with international best practices of T+5 (Transaction day + 5 working days). By March 1, 2000, settlement cycle was further reduced to T+3, thus an improvement on the T+5 minimum transaction time recommended for all emerging markets by the World Federation of Exchanges (WFE). The Nigerian Stock Exchange has two tiers, effective April 1985: the first-tier or main stream and the second tier stock markets. The second tier market primarily provides a platform for small businesses to raise needed capital for their operations until they mature to tap the resources of the mainstream or first tier stock market.

Up to the mid 1980s, stock market operations were very thin and sluggish. The thinness refers to the number of listed securities while sluggishness refers to the unwillingness of Nigerian investors to speculate with their securities, preferring instead to buy and hold, thereby limiting the intensity and regularity of activities on the exchange. Another characteristic feature of the stock market up to 1976/77 was the dominance of the market by government or public owned securities. However, with the indigenization programme of 1972 and 1977, the privatization

and commercialization programmes of the Structural Adjustment Era (1986-1988), the bank consolidation exercise (2004-2005), the removal of tax on returns on all categories of bonds (Federal, sub-national, corporate, and supra-national bonds), private sector or corporate issues have increased significantly, thereby placing the private sector in its proper perspective.

To ensure compliance with international best practices, the stock exchange, though a self-regulatory body, is regulated by the Securities and Exchange Commission (SEC), established originally as Capital Issues Committee (CIC) in 1973. The CBN, as the apex regulator of the financial system, monitors developments in the market for policy compliance. In an effort to further her commitment to creating a regulatory environment that would make the domestic economy investor-friendly to both local and international entrepreneurs without compromising national interest/security, a number of government legislations and policies have been put in force to enhance the growth of the Nigerian Stock Market.

These include but not limited to:

- (i) The Income Tax Management Act No. 21 of 1961 which required Pension and Provident Funds managers to invest a substantial proportion of their funds in government stocks.
- (ii) The Trustees Investment Act No. 16 of 1957 (as amended in 1962 and 1990) required trustees to invest in government and industrial securities.
- (iii) The Insurance Act No. 19 of 1964 and subsequent amendments required insurance companies to invest a stipulated proportion of their premium in government securities.
- (iv) The now repealed Nigeria Enterprises Promotion Decree, 1972 and 1976 which required foreigners to relinquish sizeable proportions of their equity holdings to Nigerian citizens
- (v) The Nigerian Investment Promotion Commission Decree (Act) No. 16 of 1995 which liberalized the investment climate in the country by allowing unrestricted foreign interest in Nigerian quoted companies and foreigners same rights, privileges and opportunities in the Nigerian capital market as Nigerian citizens.
- (vi) Foreign Exchange Decree (Act) No. 17 of 1995 to further ease the mechanism of foreign investment flows.
- (vii) Investment and Securities Act 1999 as amended in 2007.
- (viii) Securities and Exchange Commission Act No 71 of 1979 as amended by Act No 29 of 1988 which vests the commission with the functions of determining the price at which initial issues of a company could be sold to the public and other related matters

**3.1 Theoretical Issues In Stock Valuation**

Okafor (1983) notes that the basic issue in stock valuation is to determine what constitutes the true index of value or common stock income which should be capitalized or discounted to derive its intrinsic value. In its earnings,

dividend, capital gains, net asset value or cashflow as each represents an aspect of equity stock income. Each of the approaches can be used to derive the intrinsic value of stocks but the choice of any particular approach must take due cognizance of the circumstances of the firm, the income orientation of the investor and his relative ability to influence decision making in the firm (majority or minority shareholding). For instance, a majority shareholder would very likely be interested in the earning potential (growing the asset base) rather than in the historical earnings of the firm. Similarly, a minority shareholder whose interest in the firm is measured by the *pro rata* share of income accruing from his investment is more likely to favour a valuation model that emphasizes dividend payment.

This study however emphasizes security valuation models derived from dividend and earnings reports. The basic valuation model states that the value of a security is equivalent to the discounted value of cash benefit expected from its ownership. Mathematically, this is represented as:

$$P = \frac{b_1}{1+r} + \frac{b_2}{(1+r)^2} + \dots + \frac{b_\infty}{(1+r)^\infty} \dots(1)$$

where:

- P = Stock Price
- b1.....b∞ = expected benefits from year 1 to ∞
- r = appropriate discount rate.

The stock valuation model which recognizes dividend as the critical variable is derived from the equation above.

$$P = \frac{d_1}{1+r} + \frac{d_2}{(1+r)^2} + \dots + \frac{d_\infty}{(1+r)^\infty} \dots(2)$$

where:

- P = Stock Price
- d1.....d∞ = expected dividends from year 1 to ∞
- r = appropriate discount rate.

Similarly, the stock valuation model derived from earnings is a replica of the basic model. The stream of expected earnings rather than dividends are considered critical here.

$$P = \frac{E_1 - I_1}{1+r} + \frac{E_2 - I_2}{(1+r)^2} + \dots + \frac{E_\infty - I_\infty}{(1+r)^\infty} \dots(3)$$

where:

- P = Stock Price
- E1.....E∞ = expected earnings from year 1 to ∞
- I1.....I∞ = expected retention from year 1 to ∞
- r = appropriate discount rate.

A cursory look at equations 2 and 3 shows a direct relationship because earnings minus retention (E - I) equals dividend, d. The models differ only in the accounting approach used. It is important to note that the above models relate to buy and hold investors (investors who buy and hold stocks in perpetuity). They expect no other income outside benefits accruing from their stockholding. The models would therefore be conceptually inappropriate for investors with limited time horizons. This group of investors buy and sell after sometime thereby earning an additional income at the end of the holding period when the stock is resold. Thus, the appraised value of equity stock is the sum of the present value of its stream of benefits (dividend or earnings) discounted at a rate, r, appropriate to the risk level of

the firm plus the present value of resale price of the stock at the end of holding period,  $t$ .

Values calculated using the above models are compared with the market prices to determine the appropriateness of the going or prevailing market prices. Mis-pricing can be due to over valuation or under valuation by the market.

Over valuation occurs when the intrinsic value is less than the market value and vice versa, Theoretical literature holds that under valued stocks hold better prospects for the future and should be bought while overvalued stocks should be sold off (Bello:1989). Bello, however acknowledged the difficulty in taking such decisions with a reasonable degree of accuracy as it is not easy to determine the points at which prices have risen sufficiently enough to sell before they crash or when they have fallen sufficiently enough to buy before they start rising again.

In a cross-sectional survey to identify relevant variables for the estimation of security price, Baker and Haslem (1974) discovered that dividend; future expectations and stability in earnings are relevant variables. They ranked dividend first, followed by expectations of the future and then by stability in earnings. Gordon (1992) supported this finding as he explains that some investors (basically from the low income class) prefer cash dividend on the assumption that it is less risky than capital gains from capitalized earnings (the bird-in-hand argument). Baker and Haslem further explained that investors with significant high stock holding emphasize expectations of the future more than cash dividend. Okafor (1983) explained that minority shareholders who exert limited influence on corporate management and policies reflect this bias (dividend supremacy) in their choice of equity valuation models.

### 3.2 Approaches To Security Valuation

The models/approaches are the fundamental approach, the technical approach and the efficient market approach or the random walk hypothesis.

Both the fundamental and the efficient market approaches agree that basic economic facts about the firm are relevant inputs in the valuation process. This position supports the basic valuation theory that the market price of a share is the discounted value of all future benefits (earnings or dividends) accruing therefrom using the appropriate discount rate. The efficient market theory advanced a step further to say that having established a base price using relevant economic fundamentals, successive changes in price do not follow any predetermined manner but rather occur randomly, thereby negating the premise or pillar of the technical approach which argues that successive price changes follow recurring and identifiable patterns, with the base price being assigned to the security by the market through the interplay of the forces of demand and supply. Though there are divergent opinions among analysts on the popular approaches, there is a general view however that even with inherent limitations each has offered relevant explanations that have advanced the frontiers

of knowledge in the area of stock valuation.

The models guide investors in their appraisal of stock market prices so as to enhance the quality of their decisions. However, they can only assist the investors in making informed and rational decisions if the requisite information is readily available and affordable.

### 4.1 Issues on Dividend Policy

Issues relating to payment of dividends are policy issues and are therefore treated at the highest level of management. Dividend decision is one of the basic policy decisions management have to contend with to attain the ultimate goal of maximization of the market value of the firm. The others are budgeting and financing decisions. However, they rank last because they are considered after budgeting and financing decisions have been taken and income earned.

Dividend policy concerns the decision by a firm on the appropriation of corporate profits between dividend and retained earnings. Dividend policy implies the broad policy or guidelines that management lays down with respect to sharing of corporate earnings (Bhalla: 2009). It is the strategic guideline or action plan of the Board governing the payment of dividend. It covers such issues as timing, type of dividend payments, and legal considerations. Dividend is the part of earnings that is distributed to share-holders whereas retained earning is that part of corporate profit that is ploughed back or reinvested in the business to take advantage of investment opportunities and thereby add to capital stock. A dividend usually takes the form of cash dividend but sometimes dividend can be paid in the form of shares (stock dividend) and the amount of the cash dividend payments made by a company has implications on retained earnings that would be used for internal financing (Olowe: 2009). Smart and Meggison (2008) categorized major sources of business finance as internal (through retained earnings) and external (through banks and capital market). When organizations resort to the use of retained earnings to expand their operations, they compensate investors though the issue of bonus shares or stock dividend. This is a second level compensation to shareholders when the organization is not in a position to pay cash dividends or there exists investment opportunities which the organization wished to tap or the organization is driven by the need to increase the capital base without diluting the structure of equity holding. Theoretically, the objective of dividend policy is to maximize a shareholder's return so that the value of his investment is maximized (Pandy: 2005).

Relevant considerations guiding the formulation of divided policy include:

- (i) Working capital position of a company so as not to undermine the strength of the enterprise.
- (ii) Availability of investment windows
- (iii) Income orientation of the shareholders
- (iv) Cost of floating new issues
- (v) Capital impairment provision/legal constraints
- (vi) Maintenance of ownership control of the firm
- (vii) Long-term capital requirements of the business and

- (viii) Tax considerations:- both to the enterprise and to shareholders
- (ix) Earnings position:- Current earnings have a significant and positive effect on dividend payment decisions. (Kirkulak and Kurt: 2010), Fama and French: 2001) and (Reddy and Rath:2005).

**4.2 Dividend Policy Schools of Thought**

An attempt to explain the factors behind the variability in stock price movement led to the emergence of two divergent opinions or schools of thought, each trying to explain stock price movement in its own way. While one group contends that dividend was the driving force, the other group argued that earnings motivate equity holders in their equity investments, thus a critical factor.

**4.2.1 The Dividend Supremacy Hypothesis or the Traditional School**

(i) The dividend supremacy school argues that dividend is of primary consideration in the pricing and purchase of equity shares.

The proponents of the relevance of the dividend hypothesis (also called the rightists) argue that dividend is an active decision variable. The founders of this school, Graham and Dodd (1934) had argued that a given amount of dividend has four times the impact on stock prices as the same amount of retained earnings and that the typical investor would most certainly prefer to have his dividend today and let tomorrow take care of itself. Other protagonists of the dividend supremacy argument include Williams (1938), Lintner (1956), Walter (1956&1963), Gordon (1959), Brittain (1964), etc. Williams in a rather sarcastic expression noted A cow for her milk. A hen for her eggs. And a stock, by heck, for her dividends. Walter (1956) argued that the choice of dividend policy affects the value of the firm. He argued that in order to maximize the wealth of the shareholders, the choice of dividend policy depends on the relationship between a firm's internal rate of return, R and cost of capital, K. He explained that declining firms, for instance, have no profitable investment opportunities as  $R < K$  and would therefore not undertake any investment but instead would distribute earnings as dividend to maximize market price per share. On other hand, growth firms have  $R > K$ , and being faced with profitable investment opportunities would pay no dividend preferring instead to retain all earnings and thereby maximize market price per share. For normal firms where  $R = K$ , market price per share would be independent of dividend pay out.

Mathematically Walter's model is stated as

$$S.P = \frac{DIV}{K} + \frac{R(EPS-DIV)/K}{K} \dots\dots\dots(4)$$

where:

- S.P = Share Price
- Div = Div. per share
- EPS = Earnings per share
- R = Firm's internal rate of return
- K = firm's cost of capital

The above model shows that share price is a function of the present value of infinite stream of dividends,  $DIV/K$ , and the

present value of infinite stream of capital gains,  $\frac{R(EPS-DIV)/K}{K}$

Walter's model has been criticized on the grounds that its validity depends largely on the certainty of its assumption. For instance, if the assumptions of no external financing, certainty of R and K, etc. do not hold, the model might give a questionable conclusion.

Gordon (1959) argued that the motive to pay dividends is to increase the market share prices of the companies and that the market price of a share is a function of present value of estimated cash flows realizable from the share. Mathematically, the model can be stated as: (for finite period, n)

$$P_0 = \frac{D_1}{(1+K)} + \frac{D_2}{(1+K)^2} + \dots\dots\dots + \frac{D_n+P_n}{(1+K)^n} \dots\dots\dots(5)$$

for infinite period:

$$P_0 = \sum_{t=1}^{\infty} \frac{D_t}{(1+K)^t} \dots\dots\dots(6)$$

where:

- $P_0$  = Current Market price per share
- $P_n$  = market price per share at the time of sale
- $D_n$  = Cash dividend receivable at period, n
- K = Cost of capital for the firm in year n.
- $\infty$  = Infinity
- t = time/period

Gordon's model and Walter's model derived from the basic valuation model shown in equation 1.

Gordon's model like Walter's has significant implications for dividend decisions and stock prices:

For growth firms ( $R > K$ ), the market price per share will increase as dividend decreases or retained earning increases. Increased retained earning leads to capital gains and thereby value appreciation.

For declining firms, since there are no profitable investment opportunities ( $R < K$ ), management will choose the option of paying dividend to achieve share price maximization.

For normal firms ( $R = K$ ), dividend policy is irrelevant.

Gordon's proposition has however been criticized on the grounds that it related the risk of a company to dividend payment rather than on the riskness of its earnings as determined by nature of its real assets. The model implies that a company that pays a high dividend is less risky than a company that pays a low dividend. Bhattacharya(1982), though not outrightly dismissing the relevance of dividend hypothesis, however, observed that available information on why corporations pay dividends was still unsatisfactory.

Nissim and Ziv (2001) observed that stock prices often move in the same direction as change in dividend policy. Osualla (2009) explained that stock market operators in emerging markets (like Nigeria), react significantly to dividend policy changes thereby suggesting that it (dividend policy) is very relevant in explaining movements in stock prices.

Odife (1985) noted, "notwithstanding that the Ex-Div price fully reflects the necessary adjustments to reduce the market price by the amount of cash dividend, the share price, usually,

does not move significantly when it is Ex-Div., thus reinforcing the relevance of cash dividend payment.

Using the absolute values of dividend and earning, Ofordile (2009) found that cash dividend and retention significantly impact stock price movement. In a 2011 study undertaken by this author on five companies operating in Nigeria using the relative values of dividend and earning (earning rate and dividend rate), it was observed that in some instances dividend payout significantly impacted on share price while in some others it was retained earning that influenced share price movement. The startling revelation of the study was that in one instance neither dividend payout nor earning retention had any significant impact on share price, hence the existence of other variables.

Proponents of the dividend supremacy argument further contend that:

- (i) If a firm pursues a perpetual profit retention policy, then shareholders have not evidence of when (or if ever) they are going to harvest their investment in the organization, thereby leaving them in a state of uncertainty. In spite of the fact that capital gains are associated with retention, they prefer the certainty which dividend payment offers. This is the certainty or Bird-in-hand argument.
- (ii) Dividend payment has an image-making potential and conveys this message to the investing public. To an average investor, the mere fact that a firm pays dividend is an indication that it is doing well and this perception is capable of influencing demand for the firm's shares and thereby price.
- (iii) Some people (widows, retirees, etc) invest in shares because they want assured income at certain intervals to meet anticipated spending habit or pattern they have designed for themselves.
- (iv) Theoretically, buy and hold investors expect nothing other than dividends from their investments and therefore do not ignore dividend payout and changes thereto in their investment decisions.

The dividend supremacy hypothesis has been largely criticized on the following grounds:

- (i) The existence of stock with low or zero dividend payouts enjoying high market prices or high payout stocks with depressed stock prices apparently punctures the dividend supremacy argument.
- (ii) Since dividends are, legally speaking, to be paid only out of profit or earnings, the antagonists argue that emphasis on dividends (dependent variable) rather than earnings (independent variable) is a misplaced one.
- (iii) In situations where maximum payout rates are prescribed as part of national income policy, a firm may be constrained to adopt a dividend policy inconsistent with its earning (profit) performance and cash flow.

**4.2.2 The Dividend Irrelevance School/Hypothesis**

The protagonists of the dividend irrelevance hypothesis argue that as long as there exists a market where the firms securities can be traded, the investment and consumption opportunities of the shareholders are not relevant to the firm's financial decisions as the decision of the firm to retain part or all of its earnings in no way imposes restrictions on the shareholders. Miller and Modigliani (1961) argued that investors would be indifferent as to whether corporate profits (earnings) were distributed as

dividends or retained in the company once the investment programme of the firm was specified. They contended that given rational economic behavior and an efficient capital market, a shareholder's consumption preference need not be affected by the dividend policy adopted by the firm because if a firm paid more cash dividend than the investor needed for immediate consumption, he could re-invest the surplus by buying additional units of shares in the firm. He could even invest in the securities of a more attractive firm. Also if the investor's immediate consumption exceeds the dividends paid, he could sell off some of his holdings to augment the shortfall. They argue that the value of the firm depends on the firm's earnings or its investment policy. They also argued that, though the shareholders would gain if earnings were distributed as dividends but it is at the expense of a reduction or loss in their relative shareholding in the firm. If internal investment programmes were pursued through the use of supplementary issues, the shareholders' relative interest in the firm is jeopardized but unaffected when they are funded through retained earnings. Retained earnings aside from maintaining the shareholders' relative interest in the firm leads to capital appreciation, thus their conclusion that changes in dividend policy do not affect an equity holder's interest in a firm.

Miller and Modigliani one period model for share price can be stated thus:

$$P_0 = \frac{D_1 + P_1}{1 + K} \dots\dots\dots(7)$$

- where
- P<sub>0</sub> = Current share price
- K = Cost of capital
- D<sub>1</sub> = Dividend per share in period, 1
- P<sub>1</sub> = Share price at period, 1

**Criticisms**

(i) The assumption of rational economic behaviour and efficient capital market are academically logical but may not always occur in real life. For instance, apart from economic considerations individuals may invest in shares for such other reasons as prestige. Investors in this category are simply motivated by the desire to be seen as shareholders or owners of XYZ Company. As restrictive as this motive may seem, it is still operative. Also the assumption of efficient capital markets may also not be very easy to achieve in real world, as there are always pockets of imperfections in market practices.

(ii) The hypothesis also presupposes that investors will have an insatiable appetite for increased equity holding without worrying about dividend. This may not always hold in the long run.

**5.1 Concluding Remarks**

Dividend decision should involve the resolution of the conflicting interests of different groups of shareholders by integrating such interests into a firm's dividend policy. In real life situations, much as the various schools have tried to explain the behavior of stock price, none has conclusively and exclusively been able to achieve that. However, both have continued to be relevant in the explanation of stock price movements. Each school primarily but not conclusively serves the needs of one group of shareholders. Theoretically, the dividend supremacy school serves the needs of minority shareholders because by reason of their meagre shareholdings, they lack the power of influence and control over the company. On the other hand, the dividend irrelevance school serves the needs of majority shareholders. In practice it may not exactly play out like this because of inherent limitations associated

with each school. For instance, the dividend irrelevance school presupposes that shareholders will keep increasing their equity holding without end. This may not hold in the long run. For instance, stock market crashes which have affected even the most developed stock exchanges may constrain shareholders to strike a balance between cash dividend and stock dividend. Also, some minority shareholders are in that category because they lack the resources to increase their shareholding. At their own level dividend received may not be quite significant. They may wish to have their dividend ploughed back into the business and thereby grow their stock to an appreciable level before reaping the returns/dividends.

To further support the above assertion, a 2011 study carried out by this author on five organizations in Nigeria revealed in one part that the dividend payout rate significantly impacted on the share prices of Union Bank of Nig. Plc. and Total Oil Nig. Plc. whereas earning rate is the critical factor in the movement of stock prices in United Bank for Africa Plc. and Mobil Nig. The result of the analysis however suggests that other variables outside earnings and dividend payment drive the share price of the organization as both variables show no significant relationship with the stock price movement, implying therefore that there is yet no conclusive evidence that either of dividend or retained earnings has sufficiently and exclusively explained the variability in stock price movement in the Nigerian Stock Market though both have remained relevant in the explanation of stock price movement. However, the quantum of available literature suggests that the dividend supremacy hypothesis ranked higher in the explanation of stock price movements. Examples of non economic variables with the potential to influence stock price include buying for prestige, rumour, sudden and unfavourable announcement by the government or introduction of a reform programme as happened on August 14, 2009 when the CBN sacked the Chief Executives of some banks in Nigeria.

It is important to note that stock price movements are sometimes not supported by economic fundamentals. The Chief Executive Officer of a company may, for instance, connive with external auditors to create a false value for the firm and among other abuses may even borrow to pay dividend contrary to the capital in payment provision. The 2006 scandal at Cadbury Nig. Plc. is a case in point.

Furthermore, following the recent reform of the banking sector, it was observed that some bank Chief Executives in active connivance with stock brokers created artificial scarcity and therefore artificial prices for shares. In the aftermath of the disclosure by the CBN, some banks have either lost their operating licences, nationalized or acquired by other banks.

In conclusion therefore accounting information, being the pillar on which stock market transactions rested, should be generated in such a manner as to ensure their reliability.

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