AMERICAN JOURNAL OF SOCIAL AND MANAGEMENT SCIENCES
ISSN Print: 2156-1540, ISSN Online: 2151-1559, doi:10.5251/ajsms.2013.4.2.71.77
© 2013, ScienceHuβ, http://www.scihub.org/AJSMS

Dividend Policy and Corporate Performance in Nigeria

Adediran S. A. and Alade S. O.

Department of Accounting Igbinedion University, OKADA

Zenith International Bank, Plc, Ondo Branch

ABSTRACT

Dividend policy occupies a major role in the financial management of an organization. Dividend policy serves as a mechanism for control of a managerial opportunism. The objective of the study is to ascertaining the relationship between dividend policy and corporate profitability, Investment and Earning Per Shares. Data for the study were extracted from annual report and accounts of twenty five quoted companies in Nigeria. These data were subjected to regression analysis, using e-view software and the findings indicate that; there is a significant positive relationship between dividend policies of organizations and profitability, there is also a significant positive relationship between dividend policy and investments and there is a significant positive relationship between dividend policy and Earnings Per Share. It is recommended that Organizations should ensure that they have a good and robust dividend policy in place because it will enhance their profitability and attract investments to the organizations.

INTRODUCTION

So many factors affect the performance of corporate organizations and one of those factors is dividend policy. Dividend policy serves as a mechanism for control of a managerial opportunism. Empirical studies show that firms in developing Countries (e.g. Nigeria) smooth on their income and therefore, their dividends. The pattern of corporate dividend policies not only varies over time but also across countries, especially between developed, developing and emerging Capital markets. If the value of a company is the function of its dividend payments, dividend policy will affect directly the firm's cost of capital. But is there any significant relationship between dividend policy and corporate performance in form of profitability investment and Earning per Share? This is the question this research study intends to answer

Objectives of the study: The main objective of this study is to empirically examine the possible impact a firm's dividend policy may have on its performance. The secondary objectives of the study include:-

(i) To ascertain if there is any significant relationship between dividend policy and corporate profitability.
(ii) To determine the impact of dividend policy on Investment.
(iii) To determine if there is any significant relationship between dividend policy and Earning

Per Share of Companies.

Dividend is the return that accrues to shareholders as a result of the money invested in acquiring the stock of a given company (Eriki and Okafor 2002). While dividend policy on the other hand is concerned with division of net profit after taxes between payments to shareholders (ordinary shareholders) and retention for reinvestment on behalf of the shareholders (Kempner 1980). A difficult decision for both public and private limited companies is to determine the appropriate level of dividend to be paid to shareholders, and to decide whether or not to offer non-cash alternatives such as scrip dividends According to Davidson (1990). The existence of some share price reactions on dividend announcement prompts an analysis of the evidence for both shareholder clienteles and possible interaction of firms' dividend policies with key activities such as internal investments. An aspect of the theory of dividend policy is part of a continuum of control allocations between managers and investors, and hence cross-sectional variations in dividend policy are driven by an underlying factor. The allocation of controls between the manager and investors is important not because of agency or private information problems, but because of its potentially divergent beliefs that can lead to a disagreement about the value of project available to the firm. This underlying factor is "Corporate Performance".'Corporate performance is at the heart of the managerial function of an organization' (Samuel 1989). Analysis of corporate performance is mainly concerned with the development of a

modeling methodology to help in the diagnosis of past performance and thus provide a framework for evaluating the effect of changes in operating parameters as a guide for future planning. The performance of an Organization is measured by the choice of the management form of wealth to be held. If the performance of an organization is good there will be little or no disagreement between the management and the shareholders. (Ghosh and Subrata, 2006)

In evaluating Corporate Performance, the emphasis is on assessing the current behavior of the organization in respect to its efficiency and effectiveness. To measure overall corporate performance goals are set for each of these perspectives and specific measure for achieving such goals are determined. Each of these perspectives is critical and must be considered simultaneously, to achieve overall efficiency and effectiveness, and to succeed in the long-run. If any area is either over-emphasized or underemphasized, performance evaluation will become 'unbalanced'. In this way, the aim of the concept is to establish a set of measures both financial and non-financial, through which, a company can control its activities and balance various measures to effectively track performance.

Modigliani and Miller (1961) observed that 'The theoretical principles underlying the dividend policy and its impact on firms can be described either in terms of dividend irrelevance or dividend relevance theory'. Therefore, dividend policy is irrelevant for the cost of capital and the value of the firms in a world without taxes or transaction cost. This shows that when investors can create any income pattern by selling and buying shares, the expected return required to induce them to hold firm's shares will be invariant to the way the firm packages its dividend payments and new issues of shares. It is to be observed that a firm's assets, investments opportunities, expected future net cash flows and cost of capital are not affected by the choices of dividend policy.

Agrawal and Jayaraman (2004) observed that Dividend payments and leverage policy are substitute mechanism for controlling the agency cost of free cash flow hence, improves performance. If a firm's policy is to pay dividend each year end to shareholders, the level of activity in the organization will increase to obtain more income and have excess retained earnings to meet the standard set.

Brockington (1987) observed that 'Dividend policy has the effect of destabilizing dividend as only a prolonged increase or decrease in profits will affect the average sufficiency to have any appreciable effect on the size of the distribution'. Since it is a conservative dividend policy-in the long run, only one half of all profits will be distributed and there will be substantial buildup of retained earnings. This will certainly reinforce further, the consistency of dividends, which could for a while, be maintained even in the face of actual losses. It may also relieve the company of having recourse to external sources of finance. The retention under this policy bears no relationship to the availability of profitable investment opportunities. The risk is that projects yielding less than the true cost of capital will be undertaken in order to absorb funds which would otherwise lie idle. Samuels and Wilkes (2005) stated that the shareholders are entitled to a revenue stream of dividends. The value of the share corresponds to the present value of this stream of dividend payments.

Obviously, there is considerable uncertainty surrounding the size of future dividend. Indeed, it is as a result of change and, expectations about future dividends that share prices fluctuate. The owner considers his returns as accruing not just from dividend payments, but from the additional gains from capital appreciation on the share. Normally, he does not intend to hold the share in perpetuity, but wishes to sell the shares and obtain capital gains. When he sells the shares, the buyer is also simply purchasing a stream of future dividend expectations. The reason the capital gain expectations arise is because of the future dividend stream rise between the time the investor purchased the shares and when he sells them. This can be demonstrated thus, suppose an investor or shareholder buys a share with expectation to hold it for two years, the value of the share to him is the present value of the two years dividend payments, plus the discounted value of the price he expects to receive on selling the share.

If Po – price of share today

P2 - price of share at the end of the 2nd year

D1 - Dividend per share to be received at the end of 1st year

i - Discount rate; and

D2 – Dividend at the end of the 2nd year

Then

$$Po = \underline{D1} + \underline{D2} + \underline{P2}$$

(1+i) 2 (1+i) 2 (1+i) 2

Source: Odife (1999)

The shareholder/investor who buys the share at the end of the 2nd year pays P2 for it and expects to hold it for two further years. So, looking at it from time 0 (zero), it will give

$$\frac{P2}{(1+i)\ 2} \quad \frac{D3}{(1+i)\ 2} \quad \frac{D4}{(1+i)\ 2} \quad \frac{P4}{(1+i)\ 2}$$

Porter (2010) observed from the basic statement that 'the objective of a publicly owned company should be to maximize the return in two ways: from dividends and from appreciation in the market value of their holdings. To demonstrate that, stock dividend, like any bonus issue, has no intrinsic value to shareholders, and consequently should result in no change in the total value of the company'.

Determinants of Dividend Policy: Most firms quoted on the Nigerian Stock Exchange have clearly defined dividend policies that are based on the general dividend practice in the industry. In our model, higher agreement between the manager and the investors implies a higher stock price. So the model predicts leverage and dividend payout ratio to be inversely related to the firm's stock price.

However**,** Lintner, (1996) in a study of dividend policies of large Industrial Corporation in the United States suggested that in the majority of cases, current dividend decisions are intimately related to previous decisions. In the study, he concluded that management takes the existing dividend decision as a question of whether or not to change this rate in the current period. However, other views on the issues suggest that the dividend rate should be related to current earnings and must reflect changes in business conditions. The question therefore is how and why, a company should select a particular payout ratio and determine its rate of adjustment towards that particular rate? At this point, it is pertinent that we consider the factors affecting dividend policy of an organization.

Lintner (1996) developed a model to study the determinants of the dividend behavior of American corporations by assuming that the dividend payout is a function of net current earnings after tax (PAT) and dividend paid during the previous year his findings revealed that payout a fixed proportion of their net profits as dividend to common stockholders especially when they are well-known for stable dividends policy and may try to achieve the target level of dividend or targeted payout ratio even whenever profit changes.

The main determinants of dividend policy of a firm can be classified into:

Dividend payout ratio: Dividend payout ratio refers to the percentage share of the net earnings distributed to the shareholders as dividends.

Stability of dividends: Dividend stability refers to the payment of a certain minimum amount of dividend regularly.

Legal, contractual and internal constraints and restrictions: Legal stipulations do not require a dividend declaration but they specify the conditions under which dividends must be paid. Such conditions pertain to capital impairment, net profit and insolvency. Important contractual restrictions may be accepted by the company regarding payment of dividends when the company obtains external funds.

Owner's Considerations: Dividend policy is also likely to be affected by the owner's considerations of the tax status of the shareholder, their opportunities of investment and the dilution of ownership.

Capital Market Considerations: The extent to which the firm has access to the capital markets also affects the dividend policy. In case the firm has easy access to the capital market, it can follow a liberal dividend policy. If the firm has only limited access to capital markets, it is likely to adopt a low dividend payout ratio. Such companies rely on retained earnings as a major source of finance for future growth.

Inflation: With rising prices due to inflation, the funds generated from depreciation may not be sufficient to replace obsolete equipment and machinery. So, organizations may have to rely on retained earnings as a source of fund to replace those assets. Thus, inflation affects dividend payout ratio in the negative side.

Legal Framework: The Companies and Allied matters Act 1990 part II (379-382) provides the basis which dividends can be paid

Factors Influencing Dividends Policy in Companies: As high-risk financial assets, stock investors suffer from high investment risks and share the company's operating results. This is the main purpose of investors investing in stocks. The more companies distribute dividends, the higher the dividend payout ratio, the more attractive to investors, the more conducive to establishing a good corporate reputation and the market value of the company

stock. Luke (2011) states that a significant part of returns investors can realize from putting money into stocks comes from dividends paid by companies. The amount of money a company pays in form of dividends varies significantly from one business to the other. Companies use dividend policy to determine how much they will distribute.

There is a connection between dividend policy and retention policy. Retained earnings are important sources of finance for the Nigerian Companies and the factors that encourage retaining the profit instead of dividend payment includes:

a. Dividend policy is determined by Directors. They are, therefore, attractive source of finance for developmental project without resources to outsiders for extra funds.
b. The belief that there is no cost associated with the use of retained earnings although not true. It does not lead to cost involving payments of cash.
c. In periods of prosperity, the management may not be liberal in dividend payments because of availability of larger profitable investments opportunities.
d. In periods of depression, the management may retain a larger part of its earnings to preserve the firm's liquidity position.
e. Retained earnings avoid issue cost.

A company must satisfy shareholders minimum requirement and if looking for extra funds, should not be seen by investors to be paying generous dividend or salaries to owners-Directors.

Theoretically, the assumption is that:

1. Market value of a company's share depends on:
   i. The size of dividends paid
   ii. The growth rate in dividends; and
   iii. The shareholders required rate of return.
2. Growth rate in dividends depends on the money re-invested in the company and the rate of earning retention.
3. Shareholders will expect their company to pursue a retention policy that maximizes the value of the shares.

It has been determined empirically that a variety of factors are taken into consideration by the Directors of companies when establishing the level of dividend or planning a long-term dividend policy. Such factors include liquidity; stability of earnings; the market reaction; Dividend policy of similar companies and statutory regulation. So long as they are acting in good faith and reasonable within the ambit of the law, the Directors can determine what is paid out as dividend from the company's earnings. These factors influence company's dividend policy:

Liquidity: if the dividends are to be paid by cash, of course, cash must be available to pay the dividend declared.

Stability of earnings: earnings are subject to varying degrees of risk and the greater the variability, the greater the likelihood of reduced dividend due to sudden drop in earnings.

Taxation: income distribution and capital gain have different tax implications for investors. This will affect the relative desirability of dividend and retained earnings. Hence the marginal rate of tax of the dormant shareholder can be an important consideration in determining dividend policy.

a. **Dividend policy of similar companies:** since a firm does not operate in isolation, it is proper to study the trend in the industry to ensure that the policy is within the industrial norm.
b. **Statutory Regulation:** the information content of dividend payout conveys a lot of massage to investors. Therefore, firms re-evaluate their dividend policy to tackle such factors and to convey a positive posture.
c. **Rate of business expansion:** dividend is either defended or reduced to undertake business expansion with the shareholders being expectant of future growth.

Forms of Dividend: Dividend originally is a distribution of profits earned by a joint stock company, among its shareholders. Mostly, dividend is paid in cash, but there are also other forms of dividend which are **C**ash Dividends, Stock Dividend, Script Dividend, Bond Dividend and Property Dividend

METHODOLOGY

The data for this study are secondary data generated from annual reports and accounts of twenty five randomly selected companies quoted on the Nigeria stock exchange. The data were then analyzed using multiple regression analysis with the aid of e-view software. The model for the regression analysis is stated below;

DIVP = f (ROCE, FIXA, EPS)

Specifying in econometric format; we have;

$DIVP = a_o + a_1ROCE + a_2FIXA + a_3EPS + u_t$

Where: DIVP, $a_{0,}$ $_{a1}$ $_{,}$ a_2, a_3, u_t represent dividends paid to shareholders, intercept term, impact on ROCE, impact on FIXA, impact on EPS and error term respectively.

ROCE, FIXA and EPS represent Return on Capital Employed, fixed Assets and Earnings Per Share respectively.

Definition of Variables

1. Dividend (DIVP): It is distribution, generally of assets, made by a corporation to its stockholders. The formula is given as: $\frac{Total\ ordinary\ dividend}{No\ of\ Ordinary\ share}$

2. Return on Capital Employed (ROCE): This is a summary measure of operating efficiency and management performance. It is calculated as; $\frac{Operating\ profit}{capital\ employed}\ x\ 100$

3. Fixed Asset (FIXA): These are assets purchased for a long-term use and are not likely to be converted quickly into cash.

4. Earnings per Share (EPS): This is the portion of a company's profit allocated to each outstanding share of common stock**.** It is calculated as; $\frac{Profit\ after\ tax}{No\ of\ ordinnary\ share\ in\ issue\ and\ ranking\ of\ \ dividend}\ x\ 100$

The data obtained from the various financial statements in their financial year end of 2010 are presented in table 1.

Table 1: Variables Extracted and Computed from Financial Statements

S/N	Name of Company	Dividend Per Share (N/K)	Return on Capital Employed (%)	Earnings Per Share (N/K)	Fixed Assets (N)'000
1	Okomu Oil Plc.	1.00	33.6	23.58	13,976,234
2	NESTLE Nigeria Plc.	1.50	72.81	403.50	12,567,832
3	Nigeria Breweries Plc.	3.00	89.45	94.89	21,875,467
4	Paints and Coatings Plc.	0.08	31.8	0.89	15,987,647
5	Access Bank Plc.	0.50	9.68	5.50	34,756,544
6	UAC-Nig. Plc.	0.65	15.8	9.91	9,234,675
7	Guaranty Trust Assurance	0.08	6.0	1.47	18,389,354
8	Afro media Plc.	0.0025	14.29	0.50	11,128,648
9	STANBIC IBTC Plc.	0.10	18.97	7.45	26,320,289
10	Total Nig. Plc.	7.00	64.77	132.34	41,564,738
11	Fidelity Bank Plc.	0.14	9.12	1.36	14,322,987
12	Mobil Oil Nig. Plc.	5.00	96.02	117.16	15,904,124
13	United Bank for Africa	1.00	10.24	3.16	19,204,563
14	Dangote Sugar Refinery	0.30	39.50	3.75	22,446,874
15	SKYE Bank	0.25	6.51	3.70	34,453,467
16	Large Cement WAPCO	0.75	17.53	43.12	9,456,876
17	NEM Plc.	0.05	2.21	0.05	6,125,986
18	Dangote Cement Plc.	1.25	102.96	110.22	10,756,986
19	RT BRISCOE plc.	0.10	5.57	1.24	8,344,863
20	International Breweries Plc	4.00	236.44	34.20	7,578,984
21	Nigerian Aviation Handling Plc.	0.25	23.58	6.59	31,865,146
22	Custodian Allied Insurance Plc.	0.08	3.25	1.54	12,865,765
23	GT Bank Plc.	100	13.06	127	1,006,503,718
24	Continental Reinsurance Plc.	90.0	2.86	150	158,052,582
25	MRS Oil Nigeria Plc.	125	12.6	7.27	18,579,292

Source: Nigeria Stock Exchange Fact book and annual Reports and Account 2010.

The data were analyzed in line with the above model using the e-view software. The result of the analysis is presented below in table 2;

Table 2: Iterative Regression Method

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.653247	3.368612	-1.381354	0.1832
ROCE	0.021953	0.019774	1.110180	0.2808
FIXA	6.56E-08	5.83E-09	11.25369	0.0000
EPS	0.013386	0.012564	1.065397	0.3000
AR(1)	1.659286	0.130175	12.74662	0.0000
R-squared	0.940729	Mean dependent var		14.21177
Adjusted R-squared	0.928251	S.D. dependent var		35.49828
S.E. of regression	9.508569	Akaike info criterion		7.525316
Sum squared resid	1717.845	Schwarz criterion		7.770743
Log likelihood	-85.30379	F-statistic		75.39051
Durbin-Watson stat	1.983739	Prob(F-statistic)		0.530000

Source: E-View Output.

Specifying in econometric format, we have;

DIVP = -4.653247 + 0.021953ROCE + 6.56FIXA + 0.013386EPS

T-Ratio = (-1.381354) (1.110180) (11.25369) (1.065397)

R-Squared = 0.940729, R – Squared Adjusted = 0.928251

D.W Stat =1.983739 f-stat = 75.39051

From the result presented above, we can see that autonomous DIVP is negative when all other variables are held constant. Consequently, a unit change in DIVP will result into a positive change of about 0.021953 units in ROCE less the autonomous component when all other variables are held constant. Also a unit change in DIVP will result in a positive change of about 6.56 units in FIXA less the autonomous component and all other variables held constant.

Furthermore, a unit change in DIVP will result in a positive change of about 0.013386 units in EPS less the autonomous component and all other variables held constant.

Using the T- ratio to test for their statistical significant, we find out that the FIXA variable is statistically significant. This is due to the fact that it's observed T-value is positive and more than the 'rule of thumb' of 2. The other variables are not statistically significant because their observed t -values are less than the rule of thumb of 2. From the R- squared of 0.940729, the regression co-efficient indicate that about 94% of the changes in the dependent variable is explained by the changes in the independent variables. The D.W statistic of 1.983739 indicates the absence of auto – correlation since it is in the neighborhood of the rule of Thumb of 2.

Test of Hypotheses

The hypotheses are stated below;

Ho_1: There is no significant relationship between dividend policy and corporate profitability.

Ho_2: There is no significant relationship between dividend policy and investment.

Ho_3: There is no significant relationship between Earning Per Share and Dividend policy.

The hypotheses above were tested by considering the f - tabulated and f- calculated values.

Decision Rule: Reject the null hypothesis if the f-calculated is greater than the f –critical (table value) at 5% level of significance.

Decision: A comparative analysis of both the f - calculated value of 75.39051 and f- tabulated of 0.5300 shows that the f- calculated is higher than the f-tabulated. We therefore reject the null hypotheses and accept the alternate hypotheses which mean that there is a significant positive relationship between dividend policies, corporate profitability, investments and Earnings Per Share of organizations. The

findings of the study can therefore be summarized as follows;

1. There is a significant positive relationship between dividend policies of organizations and profitability.
2. There is a significant positive relationship between dividend policies of organizations and investments.
3. There is a significant positive relationship between dividend policies of organizations and Earnings Per Share.

SUMMARY AND CONCLUSION

This study was embarked on in order to determine the impact of dividend policies on the performance of corporate organizations in Nigeria. In order to achieve the objectives of the study, data were obtained from 2010 financial year of twenty-five companies quoted on the Nigerian Stock Exchange. From the data obtained, various variables were extracted and computed to enable adequate analysis to be carried out. From the result of the analysis, it was discovered that the dividend policies of organizations have a significant positive relationship with profitability, investments and Earnings Per Share of corporate organizations. We can therefore conclude that dividend policies of organizations are vital in enhancing the profitability and investment of organizations.

RECOMMENDATIONS:

Based on the findings of this research study, the following recommendations are made;

1. Organizations should ensure that they have a good and robust dividend policy in place. This will enhance their profitability and attract investments to the organizations.
2. Directors of corporate organizations should be made to update the records of shareholders including their next-of-kin to avoid a deliberate diversion or undue retention of unclaimed dividend warrants. Due procedures for the recognition and utilization of profit arising from investment of unclaimed dividend should be effected and properly accounted for.
3. A more stringent level condition should be established to compel directors to only invest in profitable ventures, report the utilization of retention earnings through notes to the accounts.
4. Government should set up a body that will help to manage unclaimed dividends and also ensure that situations that give rise to such are minimized.

REFERENCES

Agrawal and Jayaraman (2004): Mechanism of Dividend Payment and Leverage Policy. *Journal of Accounting Research* 21(2)

Azhagaiah R. (2008): “The Impact of Dividend Policy on Shareholders Wealth” *Research Journal of Finance and Economics. PP 53-92*

Brockington (1987): “Dividend Policy in Perspective” *Journal of Finance, June.*

Companies and Allied Matters Act (CAMA)1990 as amended to date.

Davidson .T. (1990) Corporate Financial Analysis, Business Publication Ltd, Illinious.

Eriki, O and Okafor, C. (2002) “Dividend and Stock Prices on the Nigerian Stock Exchange” *Accounting: The Nigeria Perspective* (Ed) Ezegeiwe A.C and Okoye A.E.

Ghosh and Subrata (2006): “Management and performance measurement in Organization”. *Journal of Business London.*

Kempness .T. (1980) A handbook of Management, Penguin Book United Kingdom.

Lintner (1956): “Distribution of Income of Corporations among Dividend, Retained Earnings and taxes”. *American Economic Review.*

Lintner, J. (1964): ‘Optional Dividend and Corporate Growth under Uncertainty’. *A Quarterly Journal of Economics. February. PP 49-95.*

Luke (2011): “Company Dividend Policy in Nigeria: An Empirical Analysis” *The Nigerian Journal of Economic and Social Studies.*

Modigliani and Miller (1961): “Dividend Policy, Growth and the Valuation of shares”. *Journal of Business. PP 411*

Odife D.O (1999) Understanding the Nigeria Stock Market. Vantage Press Inc New York.

Nigeria Stock Exchange Fact Book 2011

Porter .R. (2010) Financial Management Richard Irwin Inc. London.

Samuel and Wilkes (2005): Dividend and Retention Policy. MCGraw Hill Company Chicago

Samuel Elion (1989): **“**Capital structure and Corporate Performance in Nigeria”. *Nigeria Journal of Economic and Social Studies* 10(1).

1 AMERICAN JOURNAL OF SOCIAL AND MANAGEMENT SCIENCES ISSN Print: , ISSN Online: , doi: /ajsms , ScienceHuÎ², Dividend Policy and Corporate Performance in Nigeria Adediran S. A. and Alade S. O. Department of Accounting Igbinedion University, OKADA Zenith International Bank, Plc, Ondo Branch ABSTRACT Dividend policy occupies a major role in the financial management of an organization. Dividend policy serves as a mechanism for control of a managerial opportunism. The objective of the study is to ascertaining the relationship between dividend policy and corporate profitability, Investment and Earni 2.2 Institutional Ownership and Dividend Policy. Institutional investors are corporate investors who are different corporate entities like financial institutions, banks insurances, pension funds and other corporate institutions (Koh, 2003).Â H3: Block-holders ownership has significant relationship with dividend policy of listed conglomerate companies in Nigeria. 2.5 Control Variable Free Cash Flow (FCF). Free cash flows of the firm determine its debt employing capacity.Â Block share purchases and corporate performance. Journal of Finance, 53(2)Â Ownership concentration, firm performance, and dividend policy in. Hong Kong. Pacific-Basin Finance Journal, 13, 431â€“449. doi:10.1016/j.pacfin.2004.12.001.