

**TITLE**

**PROFITABILITY AND DIVIDEND POLICY OF DEPOSIT MONEY  
BANKS IN NIGERIA**

**BY**

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**BEING A PROJECT SUBMITTED TO DEPARTMENT OF ACCOUNTANCY,  
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HIGHER NATIONAL DIPLOMA (HND) IN ACCOUNTANCY.**

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## DECLARATION

I declare that the work in this thesis entitled “Profitability and Dividend Policy of Deposit Money Banks In Nigeria ” has been carried out by me in the Department of Accounting under the guidance and supervision of **Aliyu Abubakar** The information derived from the literature has been duly acknowledged in the text and a list of references provided. No part of this project thesis was previously presented for another degree or diploma at this or any other Institution.

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## CERTIFICATION

This is to certify that this research work “Profitability and Dividend Policy of Deposit Money Banks In Nigeria” is an original work undertaken by Ahmed Abdulmalik Oluwamayowa with Reg. No. KPT/CBMS/19/47064 and has been prepared in accordance with the appropriate norms, procedure, rules and regulations governing the preparation and presentation of project in Kaduna Polytechnic, Kaduna.

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## **DEDICATION**

This project is dedicated to Almighty Allah (S.W.T) who gave me the grace to finish this course successfully.

## **ACKNOWLEDGMENTS**

My immeasurable appreciation goes to Allah (S.W.T) for His protection and support directly and indirectly throughout my life. I fully acknowledged and believed that without Allah's (S.W.T) mercy and support, I would not achieve what I have already achieved now.

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## ABSTRACT

*This study investigated the relationship between financial performance and dividend policy for a sample of fifteen deposit money banks quoted on the Nigeria Stock Exchange between 2010 and 2019. The statistical methods used for the analysis are descriptive statistics, correlation results, and panel least square. The study revealed that there is a positive but no significant relationship between financial performance and dividend payout ratio; and there is a positive but not significant relationship between financial performance and dividend yield. The study recommended since financial performance is not affected by dividend yield and dividend payout, investigations should be made to ascertain other factors that affect financial performance in the banking sector. Also firms should focus attention on increasing their profitability through capturing more market size to have sufficient fund for paying dividend, when necessary firms should only undertake ventures that increase the positive net present value of the firm. That firm should strive to maintain constant and healthy dividend policies; this could be attained by investing in projects that give positive net present values, thereby generating huge earnings, which can be partly used to pay dividends to their equity shareholders.*

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1. Background to the study**

In corporate finance, dividend policy is one of the core topics that generated interesting debate among researchers. Various theories and uncountable empirical evidence have been established by many researchers since Miller and Modigliani (MM) presented dividend irrelevance theory in 1961. Black (1976:17) argues that “the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don’t fit together”. This opinion of Black (1976) led to the emergence of a handful of competing theoretical and empirical research to explain why companies pay or do not pay dividends. However, according to Gustav and Garatjon (2012), researchers are yet to arrive at uniform answer to the question of dividend payout ratio. In addition, Brealey and Myers (2013) cited in Luvembe, Njangiru and Mungami (2014), after decades of non-stop research, dividend policy is still listed as one of the top ten crucial unresolved issues in the world of finance in which no consensus has been reached.

Dividend represents a distribution of earnings to the shareholders of a company. Dividend or profit allocation decision is one of the four decision areas in finance. The other three are financing, investment, and working capital management decisions or liquidity. As noted by Ross, Westerfield and Jaffe (2012) companies view the dividend decision as quite important because it determines what funds flow to investors and what funds are retained by the firm for investment. Dividend policy can also provide information to stakeholders concerning the company’s performance. According to Foong, Zakaria and Tan (2017), the investments made by a firm determine the future

earnings and future potential dividends; and dividend policy influences the cost of capital. In making these interrelated decisions, the goal is to maximize shareholder wealth.

Ibenta (2015) asserted that equity capital entitles shareholders to dividend payment. The financial management has the responsibility of ensuring equity and fairness in apportionment of any benefit to the various shareholders. Dividend decision entitles striking a balance between future growth of the firm and payment of current dividend to firm's shareholders.

Extant literatures as presented in the Literature review, suggests that firms are always at a cross road in satisfying the two conflicting prones. That is, satisfying the shareholders' immediate cash needs and ensuring the sustainable growth of the firm. These are inseparable objectives that the finance manager must keep an eagle eye on. Cash is needed to pay dividend and to finance capital project of the firm. By law, firms are not permitted to pay dividend out of the company's capital (section 379-385 of CAMA 1990 as amended).

Due to the fact that banks are companies, their shareholders as rational investors usually expect to receive some income as return on their investments. The ability of a bank like any other company to pay dividends will depend to a large extent on its financial performance. Lasher (2010) has observed that a decrease in dividend is taken as terrible news and it generally comes after a sustained reduction in earnings. There have been a number of studies on dividend policy especially in developed countries. Many of the studies examined dividend policy in general without focusing on a particular sector as seen in studies conducted by Mutie (2011), Murekefu & Ouma (2012), Gul, Khan,

Iqbal, Razzaq, and Sajid (2012), Ijaiya, Sanni, Amuju, and Sulieman (n.d.) and Farsio, Geary, & Moser (2011). Also, many of the literatures on dividend policy use data from non-financial institutions as spotted in the study conducted by Yegon, Cheruiyot and Sang (2014) to mention but a few, with very few on financial institutions. Many studies as regards to dividend policy and financial performance have considered dividend policy as a function of financial performance. This work is geared towards establishing the relationship between dividend policy and financial performance with dividend policy dependent on financial performance.

Any business entity is in the world of business to prosper to greater heights. Prosperity of any entity normally relates to its performance in monetary terms. Business entities can gauge the survival of the businesses by analyzing their overall output in monetary terms to determine how they have effectively and efficiently employed their resources to maximize the returns for the shareholders. For the business entities to know their worth in terms of growth they can employ either modern performance measures or traditional measures to measure the performance by employing comparative methodologies or historical measures to ensure the returns for the stakeholders are maximized. Therefore, the financial performance can be assessed through the efficiency, effectiveness and adaptability (Ochieng, 2012). Return on Equity can be termed as the average income divided by the equity of the stakeholders. These can be derived from an organization's financial statements can as the financial measures of performance. However, in order to fully measure financial performance, it proves important to incorporate the non-financial measures of performance also. This includes

the efficiency in operations, flexibility in services offered and the dependability of the organization.

The financial performance can be measured by profitability ratios, liquidity ratios and gearing measures. Majority of business entities have always used profit as the basis for business prosperity. However, the real determinant of business growth show efficiently the business entities have been in the employment of the capital in the business. Due to the shortcomings of the traditional approaches, the experts in the finance field devised the profitability ratios to measure the financial performance (Wood, 1998).

## **1.2. Statement of the Problem**

The assertion by Black (1976:17) that “the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don’t fit together” has propelled numerous studies by scholars and other academicians for different motives, all related to dividend policies. One of such areas where researches have been carried out in relation to dividend policy is financial performance.

The two major theories of dividend (dividend relevance and irrelevance theory) have been proposed to ascertain whether there is the need for dividend payment and by extension firms value (including financial performance), but there have not been any consensus to this. Modigliani and Miller (1961) for instance objected to the relevance of dividend policy, and thus, concluded that it does not affect firm value or financial performance. A study by Amidu (2017) shows that dividend policy influences firm performance measured by its profitability. The results showed a positive and significant relationship between return on assets, return on equity, growth in sales and dividend policy. Howatt (2019) also stated that positive changes in dividends are allied with

positive future changes in earnings per share. However, Lie (2015) argues that there is limited evidence that firms that pay dividend experience successive performance improvements.

Haven reported by Ekwere (2012), as stated that some banks quoted on the Nigerian Stock Exchange have failed to meet the requirement of paying dividend on a yearly basis for a number of years, and also considering the fact that based on the statutory requirement of CAMA (1990) as amended, payment of dividend should be on the basis of net profit for the period, the questions that raise are; is it that the financial status of these organizations do not favour the payment of dividend during these periods? Is there any relationship existing between the financial performance and the dividend policies made by banks in Nigeria? These questions, which have given a brief insight on what this study is all about will be the basis for carrying out this research work. This study therefore comes in to fill the void by establishing whether there is a relationship between financial performance and dividend policy among listed Deposit Money Banks in Nigeria as many studies as regards to dividend policy and financial performance have considered dividend policy as a function of financial performance, unlike this work which is geared towards the opposite direction, by establishing the relationship between financial performance and dividend policy. That is considering financial performance as a function of dividend policy.

### **1.3. Objectives of the Study**

The main objective of this study is to examine the relationship between financial performance and dividend policy of Deposit Money banks. The specific objectives are;

- i. To examine the relationship between financial performance (return on equity) and dividend payout ratio.
- ii. To analyse the relationship between financial performance (return on equity) and dividend yield.

#### **1.4. Research Questions**

The research questions are;

- i. Is there any significant relationship between financial performance (return on equity) and dividend payout ratio?
- ii. Is there any significant relationship between financial performance (return on equity) and dividend yield?

#### **1.5. Research Hypotheses**

This study is guided by the following null hypotheses:

**H01:** There is no significant relationship between financial performance (return on equity) and dividend payout ratio.

**H02:** There is no significant relationship between dividend yield and financial performance (return on equity).

#### **1.6. Significance of the Study**

This study however focuses on examining the relationship between financial performance and the positive or negative response they trigger on the enterprise in terms of dividend policy. The study will be of help to various groups as follows:

It will serve as a reliable reference for corporate finance managers when at cross road or faced with difficulties on issues bordering on dividends. It will guide them in policy formulation.

This work will be of relevance to both prospective and current investors. Current investors will need to discern if dividends are a signal that dividends will continue to flow in the future. The relationship between dividends and financial performance of the firm will help the investors make informed decision on whether to dispose their shares or to buy more so as to benefit in future from the firm. The result of this research will also help potential investors in making decisions on where to invest their money. In case of positive relationship between dividend policy and financial performance of the firm, potential investors will pursue investments in companies that have been paying out huge dividends. In addition, the relationship obtained between dividend policy and financial performance will be of importance to economists seeking to understand and appraise the functioning of the capital markets. This work will also assist financial analysts in giving timely and relevant advice to their clients. The financial analysts will be able to advise their clients on companies to invest in and those not to invest in. They will also be able to advise companies whether or not to pay dividends and if to pay, how the payments are to be made.

### **1.7. Scope of the Study**

This study is aimed towards establishing the relationship that exists between financial performance and dividend policy of the deposit money banks. The study covered the period of 2010 to 2019, and based on 15 out of 21 deposit money banks quoted on Nigeria stock exchange as at 2010. The choice of the 15 banks is based on the ability to obtain comprehensive and complete data that will be used for this research work. The Deposit Money Banks quoted on the Nigerian Stock Exchange used for this research include: Access Bank Plc, Eco Bank Plc, Fidelity Bank Plc, FCMB, First Bank Plc, Guarantee Trust Bank Plc, Stanbic IBTC Plc, Skye Bank Plc, Sterling Bank Plc, UBA, Union Bank of Nigeria, Unity Bank Plc, Wema Bank Plc and Zenith Bank Plc.



### **1.8. Limitations of the Study**

Some of the limitations of this study include, the study only focused on the banking industry, and as such, the results may not hold for other industries. Also, the entire population was 21 Deposit Money Banks operating in Nigeria as at 2010, but this research studied 15 Deposit Money Banks based on the availability of data. Also, a limitation is the fact that this study is based on the Nigerian economy alone and as such the findings may not hold for other economies. Lastly, the proxy used for financial performance was limited to return on equity (ROE) and proxies for Dividend policy were limited to dividend payout ratio (DPR) and dividend yield (DY). In the course of further studies, there may be other proxies that other researchers may come up with, which was not reported in this study.

### **1.9 Definition of Operational Terms**

**Dividend:** Dividend in my own understanding is defined as that proportion of profit not retained by an organization, but paid to shareholders of the company.

**Policy:** policy is a set of ideas or plans that is used as a basis for making decisions, especially in politics, economics, or business.

**Dividend Policy:** Dividend policy is simply a formal promulgation on how matters of dividend should be handled.

**Financial Performance:** This simply denotes how well a company or organization is doing. It looks at the extent to which their financial values are appreciated or depreciated using certain statistical ratios for analysis.

**Financial Accounting:** the branch of accounting concerned with the classifying, measuring and recording the transactions of a business.

**Financial Statements:** the annual statement summarizing company activities over the last year.

**Accounting:** This is the classification and recording of the monetary transaction of an entity in accordance with established concepts, principles, accounting standards and legal requirements and their presentation by means of Profit or Loss Account, Statement of financial Position and Statement of Cash flow statement during and at the end of an accounting period.

## **CHAPTER TWO LITERATURE REVIEW**

### **2.1. Introduction**

The main objective of this study is to examine the relationship between dividend policy and financial performance of Deposit money banks. This chapter reviews the extant literature related to the phenomenon of interest. In particular, the chapter presents the conceptual and theoretical framework. It also reviews selected prior studies related to the subject matter.

### **2.2 Conceptual Framework**

Dividend policy has been a subject of debate among academics and practitioners of corporate finance for decades, but no consensus has been reached (Baker and Powell, 1999). Many theoretical predictions have been put forward and empirically tested in order to explain why firms pay dividends, despite the difference in taxes on dividends and capital gains (Brennan, 1970; Elton & Gruber, 1970; Rozeff, 1982; Fama & French, 2011). One indicator of how challenging it is to understand dividend policy decisions is evident in a comment by Black (1976) dividend payments in Nigeria.

Usually, dividends can either be paid by cash, shares or share buybacks (Arnold, 2018). Nigeria's financial system did not allow for share buyback until a recent amendment within the Companies and Allied Matters Act 2014, which empowers firms to buy back its shares under stringent conditions<sup>7</sup> and specifies the categories of people whom they can buy from, in order to protect the debt holders and avoid dilution of the company's capital. Accordingly, Section 187 of this Act provides for the payment of the share

buyback from the distributable profits of the firm. Also, Section 380 of the Act stipulates that firms can pay dividends from their revenue reserves, profits arising from the sale of its fixed assets or profits arising from the use of its properties. It also states that directors of the company may pay dividends either in the form of cash or bonus issues as they deem fit. The Act did not mandate companies to pay dividends, as seen in most developed countries; instead, they are allowed to decide when to pay and only if they would not wound-up after payment of cash dividends (see Companies & Allied Matters Act, as amended 2014).

The researcher seeks to examine the determinants of dividend payouts on Nigeria listed companies and to consider the implications when compared with prior empirical evidence documented in developed markets.

The concept of dividend policy has been viewed by many researchers in different dimension due to its behavior to firms' performance. Dividend policy is the regulations and guideline according to Nwude (2013) cited in Anike (2014) and Nissim and Ziv (2011) that a firm uses to ascertain the portion of a company's net profit after taxes to be payout as divided to residual shareholders. On the other hand, dividend represents benefits in form of returns from capital invested on stocks and distributed to the shareholders of a company, usually declared at the annual general meetings (AGM) and paid to shareholders of record (Adediran & Alade, 2013; Velnampy, Nimalthasan & Kalaiarasi, 2014). Chin, Mei, Loo, Tin and Won (2015) added that the board of directors in considering how much dividend to payout must consider both the past and current financial performance. Seneque (2012) added that the board of directors must

also consider cash flows, incidence of taxation financial needs of the firm, contractual and legal constraints, and inflation rate.

Therefore, firms' dividend policy can affect financial performance of firms because dividends are payout from the profit made by the firm after interest and tax. However, the firm may decide to retain portion of the profit for expansion of the company and the shareholders can as well reinvest part or the total of his dividend on stock in the same firm.

In other definitions, Clark (1999) defined dividend as a benefit or income out of the profit of a company. Bannock (1998) noted that a dividend is expressed as a percentage of the nominal value of a share or an absolute amount per share. Richard and Stewart (2013) noted the direct compensation and servicing of share capital involved in dividend paid to shareholders, adding that dividend policy is a trade-off between retained earnings and paying out cash as well as issuing new shares. Where there is no cash, a scrip issue or bonus share is given. Chandra (2012) sees dividend policy as that which determines the proportion of earning paid to shareholders by way of dividends and what proportion is ploughed back in the firm for reinvestment purpose. Owualah (2013) sees dividend policy of a firm as determining the division of its earnings between payment to shareholders and what it retains for its future operations. Lasher (2010) defined dividend policy as the rationale under which a firm determines what it will pay in dividends. It encompasses both the amount paid and the pattern under which changes in amount occur over time. That is, it entails striking a balance between future growth and payment of current dividends to firm's shareholders.

### **2.2.1 Dividend Policy**

Dividend policy is the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders. Some evidence suggests that investors are not concerned with a company's dividend policy since they can sell a portion of their portfolio of equities if they want cash. It is a measurement policy that deals with either to pay dividend or not and when such dividend should be paid. Dividend policy refers to the decision to distribute all or part of the company's profit in the form of dividends to the shareholders or plough a proportion of the company profit back to the business (Al-Malkawi, 2013).

### **2.2.2 Profitability**

Grimsley (2014) believes that profitability determines whether a firm stays in business. He posited that profitability is the ability of a business to earn a profit. Therefore, a profit is the left-over of business revenue after paying all expenses related to the revenue in a given period.

### **2.2.3 Financial Leverage**

Financial leverage is the debt ratio calculated as total liabilities divided by total assets. Since firms with more debt should be more cash constrained and have lower ability to pay dividends, the relationship between dividend payout ratio and LEV is predicted to be negative (Khan 2016).

**2.2.4 Financial crisis:** This refers to global financial crisis of 2007 of which the effect is felt in many countries. This financial crisis started in United State of America and extended to Nigeria and many other countries across the globe. It paralyzed the activities in the capital market and many operators in the Nigerian financial system are

yet to recover from the shock. This informs the reason for the inclusion of this variable as a control parameter which influences dividend policy. The variable is captured by a dummy (indicated as 1) factor and appears to have been tested in the literature on dividend policy. However, this variable stopped featuring in the model in year 2015 (Alade, 2013).

**2.2.5 Political factor:** This covers various shocks that are politically motivated which affect the operations of many companies' particularly deposit money banks in Nigeria. Political factor limits the operation of the commercial banks and make business environment unfriendly to the shareholders. Thus, this variable is represented by dummy and influence dividend policy of deposit money banks (Adederin, 2014).

## **2.2.6 Dividend Pay-out and**

## **2.2.7 Profitability**

Firm performance can be measured by the earnings generated by the company in terms of profitability. There is substantial literature on the relationship between dividend policy and profitability. Dividends are important to shareholders and potential investors in showing the earnings that a company is generating. Healthy dividends pay-outs thus indicate that companies are generating real earnings rather than cooking books (DeAngelo 2016). A study by Zhou and Ruland (2016) revealed that high dividend pay- out firms tend to experience strong future earnings but relatively low past earnings growth despite market observers having a contradicting view. The findings of another study done by Arnott and Asness (2013) also revealed that future earnings growth is associated with high rather than low dividend pay-out. They concluded that historical evidence strongly suggests that expected future earnings growth is fastest when current

pay-out ratios are high and slowest when pay-out ratios are low. Their evidence contradicted the view that substantial reinvestment of retained earnings would fuel faster future earnings growth. Their study was done to investigate whether dividend policy of the U.S. equity market portfolio, forecasts future earnings growth. The study comprised companies in the S&P 500 which tend to be large and well established firms in advanced economies Zhou and Ruland, (2016). Empirical studies need to be done in developing capital markets or for newly listed companies which tend to be, less profitable and more growth oriented. Arnott & Asness, (2013), suggested that the positive relationship between current dividend pay-out and future earnings growth is based on the free cash flow theory. Low dividend resulting in low growth may be as a result of suboptimal investment and less than ideal projects by managers with excess free cash flows at their disposal. This is prominent for firms with limited growth opportunities or a tendency towards over-investment. Paying substantial dividends which in turn would require managers to raise funds from issuance of shares, may subject management to more scrutiny, reduce conflicts of interest and thus curtail suboptimal investment. That is based on the assumption that suboptimal investments lays the foundation for poor earnings growth in the future whereas discipline and a minimization of conflicts will enhance growth of future earnings through carefully chosen projects. Therefore, paying dividends to reduce the free cash flows enhances the performance of a company since managers will have less cash flow thus avoiding suboptimal investments. (Arnott & Asness, 2013).



### **2.2.8 Concept of Corporate Performance**

Corporate performance management is the area of business intelligence involved with monitoring and managing an organizations' performance. Corporate performance is measuring the results of an organizational policies and operations in monetary terms. These results are revealed in the organization's return on assets, return on equity, and profit after tax, earnings per share, dividend per share, net assets per share, value added, etc. Getting on top of financial measures of a firm, performance is an important part of running a growing business, especially in the present economic condition. Many business fails because of poor financial management or planning stemming from firm's management and financial managers. Corporate performance through profitability is one of the most important areas of focused by shareholders as well as debt holders if the firm is using debt for operation. (Yiadam, 2011)

### **2.2.8 Nigeria Deposit Money Banks**

Banks as financial institution has the major role of greasing the gears assisting the economic operations of a nation. The major role in banking system is to move funds from the saving units to the spending units.

If a financial system is efficient, there will be improvements in their profitability, increasing in the availability of funds flowing from saver to borrowers, and provision of better and quality services for the consumers. Banks as the financial intermediaries play an important role in the operation of an economy. Moreover, stability of Banks is of great importance being the sole dealer of funds to the financial system. In the literature of banks, the determinants of profitability are empirically well explored although the

proxy of profitability differs among studies. Some employed, Return on Asset, Return on Equity, Net Interest Margin, Return on Average Asset and so on. The Nigerian banking sector is mainly regulated by two bodies. The first is Central Bank of Nigeria, (CBN) which has the larger regulatory power, and then, the Nigerian Deposit Insurance Company (NDIC), and external auditors (EA). These bodies, were used by the government to standardize and supervise the Banking sector. (Agyei, 2014)

### **2.2.9 Dividend policy and agency conflicts**

Dividend policy may be one indicator of conflicts of interest between minority investors, owners and managers. Agency problems may lead to overinvestment, excess resource consumption of various kinds and inflated salaries by managers. It is possible for smart insiders to keep dividend high as a visible signal of good faith to the minority investors while they behave more selfishly in other respects. With respect to common stock investment, shareholders' interest is simply to increase the value of their shares by receiving high dividends. But the managers are interested in high retentions so as to engage in continued growth of the company as well as to satisfy other stakeholders thereby indirectly providing personal benefits to them (Khan, 2012).

One of the biggest conflicts of interest between shareholders and managers is usually in the payout policy in companies. However, payout can be used to self-impose discipline. Easterbrook (1984), Jensen (1986) have suggested that equity-holders can minimize the cash that management controls and thereby reduce their opportunity to go on (unmonitored) spending sprees or investing in negative NPV projects. They argue that

one way to remove surplus cash from the firm is to increase payout. The payment of dividends has been proposed as useful in minimizing manager-shareholder agency conflicts. Moreover, dividend payout has been viewed as containing both bonding and monitoring characteristics (Easterbrook 1984, Rozeff,1982).As bonding mechanism, dividend policy will not only decrease agency cost of equity, reduce the opportunity for managers to use firm cash flow for perquisites activities but also decrease their ability to pursue new investment opportunities (Megginson,1997) .

#### **2.2.11 Factors affecting dividend payout policy**

Corporate decisions that border on payout policy are function of many factors such as: Legal constraint, earnings cash flow and liquidity, shareholders expectation, availability of profitable investment opportunities, shareholders tax bracket, management control and contractual constraints. Other factors include: business cycles, government policies, attitude of management, shareholders' income needs, age of the corporation, stability in dividend payment over time (Keown 1996, Brigham & Houston 2014, Pandey 2015, Aregbeyen,2015). Firm characteristics also influence dividend policy (Aivazian, Booth & Cleary, 2013, Allen & Michaely, 2012). Dividend payouts are found to be negatively related to profitability and leverage, but positively related to asset tangibility and market-to book. Pecking order theory suggests that profitable firms in determining financing choices will seek to retain free cash flow and hence lower dividend payments (Myers & Majluf, 1984). It follows that dividend payout is inversely related to the firm's profitability. Ramli (2010) finds that size of the company and profitability levels are positively and statistically significantly related to dividend ratio. These results agree

with Fama & French (2011) and Truong & Heaney (2017). However, investment opportunities of Malaysian companies (INV) have no significant influence on the level of companies' dividend payout.

## **2.3 Theoretical Framework**

The theory of dividend policy comprises of irrelevant dividend policy developed by (Miller and Modigliani 1961). They argued that dividend policy is independent of shareholder wealth. Relevant dividend policy suggested that dividend policy significantly influence shareholders wealth. On the strength of relevant dividend policy, different arguments emerged such as information content of dividend policy which contends that dividend policy signals the performance of the firm (Van Horn 2012), birds in the hand argument noted by Linter (1962) and Gordon (1963), posit that dividend is more certain than future capital gain. Agency cost of dividend policy emphasis on the conflict of interest between the principal and the agent but suggests reduction of free cash flows in the hands of the agent through payment of cash dividend (Rozeff, 1982; Somoye, 2011). Clientele effect noted that portfolio choice is influenced by investor's decision between dividend and capital gain (Miller & Modigliani 1961; Bishop, Harvey, Robert & Garry, 2010; Ross, Westerfield & Jaffe, 2012). Hence, this

theory underpins this study because it examines the various factors that determine the dividend policy.

### **2.3.1 Theories of Dividend**

The main theories underpinning dividend studies which are discussed are, firstly, dividend irrelevance theory, and then dividend relevance theory, information content (signaling) theory, followed by the bird-in-hand theory, clientele effects theory, tax

preference theory, and agency cost theory. Finally, there is a summary of other dividend theories not directly related to the study but worth mentioning, such as catering theory, the maturity hypothesis and the residual theory of dividends (Alaeto, 2020).

### **2.3.2 Relevance of Dividend Policy**

The proponents of dividend relevance theories believe that dividend policy affects the value of the firm. Gordon (2013) argued that in a world of uncertainty and imperfect markets, dividends matter and they are valued differently to capital gains. Therefore, he asserts that investors would prefer a current income to future income, because of uncertainty. Some of the supporters of dividend relevance theory include (Gordon, 1962; Elton & Grubber, 1970; Watts, 1973; Bhattacharya, 1979; Asquith & Mullins, 1983; Easterbrook, 1984; Benesh, Keown & Pinkerton, 1984; John & Williams, 1985; Miller & Rock, 1985).

Furthermore, dividend supremacy theories are discussed below.

#### ***Walter's Model***

Professor James E. Walter argues that the choice of dividend policies almost always affects the value of the enterprise. His model shows clearly the importance of the relationship between the firm's internal rate of return ( $r$ ) and its cost of capital ( $k$ ) in determining the dividend policy that will maximise the wealth of shareholders.

Walter's model is based on the following assumptions:

1. The firm finances all investment through retained earnings; that is debt or new equity is not issued;
2. The firm's internal rate of return and its cost of capital are constant;
3. All earnings are either distributed as dividend or reinvested internally immediately.

4. Beginning earnings and dividends never change. The values of the earnings pershare (E), and the divided per share (D) may be changed in the model to determine results, but any given values of E and D are assumed to remain constant forever in determining a given value.

5. The firm has a very long or infinite life.

Walter's formula to determine the market price per share (P) is as follows: P

$$= D/K + r(E-D)/K/K$$

The above equation clearly reveals that the market price per share is the sum of the present value of two sources of income:

i) The present value of an infinite stream of constant dividends,  $(D/K)$  and

ii) The present value of the infinite stream of stream gains.  $(r$

$(E-D)/K/K)$

### ***Gordon's Model***

One very popular model explicitly relating the market value of the firm to dividend policy is developed by Myron Gordon.

Gordon's model is based on the following assumptions.

1. The firm is an all Equity firm
2. No external financing is available
3. The internal rate of return (r) of the firm is constant.
4. The appropriate discount rate (K) of the firm remains constant.
5. The firm and its stream of earnings are perpetual.
6. The corporate taxes do not exist.

7. The retention ratio (b), once decided upon, is constant. Thus, the growth rate (g) = br is constant forever.

8.  $K > br = g$  if this condition is not fulfilled, we cannot get a meaningful value for the share.

According to Gordon's dividend capitalisation model, the market value of a share (P<sub>q</sub>) is equal to the present value of an infinite stream of dividends to be received by the share.

Thus:

$$P_0 = \frac{E_1 (1 - b)}{K - br}$$

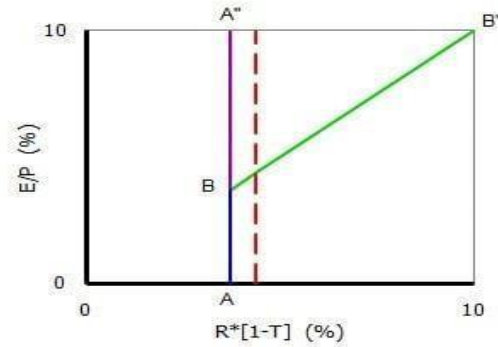
The above equation explicitly shows the relationship of current earnings (E<sub>1</sub>), dividend policy, (b), internal profitability (r) and the all-equity firm's cost of capital (k), in the determination of the value of the share (P<sub>0</sub>).

### ***Capital Structure Substitution Theory***

Capital structure substitution theory (CSS) describes the relationship between earnings, stock price and capital structure of public companies. The CSS theory hypothesizes that managements of public companies manipulate capital structure such that earnings per share (EPS) are maximized. Managements have an incentive to do so because shareholders and analysts value EPS growth. The theory is used to explain trends in capital structure, stock market valuation, Dividend policy, the monetary transmission mechanism, and stock volatility, and provides an alternative to the Modigliani–Miller theorem that has limited descriptive validity in real markets.

The CSS theory is only applicable in markets where share repurchases are allowed.

Investors can use the CSS theory to identify undervalued stocks.



The CSS theory assumes that company managements can freely change the capital structure of the company – substituting bonds for stock or vice versa – on a day-to-day basis and in small denominations without paying transaction costs. Companies can decide to buy back one single share for the current market price  $P$  and finance this by issuing one extra corporate bond with face value  $P$  or do the reverse. In mathematical terms these substitutions are defined as

$$\left[ \frac{\partial D}{\partial n} \right]_{x,t} = -P_{x,t}$$

Where  $D$  is the corporate debt and  $n$  the number of shares of company  $x$  at time  $t$ . The negative sign indicates that a reduction of the number of shares  $n$  leads to a larger debt  $D$  and vice versa. The earnings-per-share change when one share with price  $P$  is repurchased and one bond with face value  $P$  is issued:



1. The earnings that were ‘allocated’ to the one share that was repurchased are redistributed over the remaining outstanding shares, causing an increase in earnings per share of:  $E / n$

2. The earnings are reduced by the additional interest payments on the extra bond.

As interest payments are tax-deductible the real reduction in earnings is obtained by multiplying with the tax shield. The additional interest payments thus reduce the EPS by:  $P \cdot R \cdot [1 - T] / n$

Combining these two effects, the marginal change in EPS as function of the total number of outstanding shares becomes:

$$(\partial E / \partial n)_{x,t} = -E_{x,t} / n + P_{x,t} R_{x,t} (1 - T) / n$$

Where:

$E$  is the earnings-per-share

$R$  is the nominal interest rate on corporate bonds

$T$  is the corporate tax rate

EPS is maximized when substituting one more share for one bond or vice versa leads to no marginal change in EPS or:

$$E_{x,t} / P_{x,t} = R_{x,t} (1 - T)$$

This equilibrium condition is the central result of the CCS theory, linking stock prices to interest rates on corporate bonds.

### ***Bird-in-Hand Theory Another***

View in support of the dividend relevance theorem is the bird-in-hand theory. According to this theory, in a world of uncertainty and imperfect markets, a dividend is valued differently to capital gains. Therefore, investors will prefer the dividend payment (a 'bird in the hand') today rather than the 'two in the bush' (capital gains) because of uncertainty. Gordon and Shapiro (1956) suggest that shareholders will prefer a cash dividend payment to capital gains, and firms with high dividend payout ratios will have a higher market value. The rationale behind the theory is that, high dividend payout ratios are positively correlated with the market value of the firm. However, the- bird-in-hand theory has been challenged. For example, Miller and Modigliani (1961) argued that a firm's risk is determined by the riskiness of its operating cash flows rather than the pattern in which earnings were distributed. Consequently, they disagreed with the theory by labelling it the 'bird-in-the-hand fallacy'. Likewise Bhattacharya (1979) shares the same view as Miller and Modigliani (1961), by suggesting that the logic

behind the bird-in-the-hand theory is fallacious. He went on to argue that firm dividend payouts are influenced by risk associated with cash flows, but any increase in dividend payouts would not reduce a firm's risk. In conclusion, dividend payout decreases whereas the firm's risk increases, which is inconsistent with the bird-in-the-hand theory.

### **2.3.3 Irrelevance of Dividend Policy**

There are many theories on dividends. But the most famous dividend theory was proposed by two American professors; Merton Miller and Franco Modigliani in their seminal work titled Dividend Policy, Growth and the Valuation of Shares and published

in the Journal of Business (2016). According to them, the dividend policy of a firm does

not affect the firm's value, because once an investment decision has been made for the present and future period, any surplus earnings may be distributed as dividends to the shareholders. They further argued that it does not matter to a shareholder (he is indifferent to) whether he receives a cash dividend or sells part of his shares to raise cash, for with a perfect market and condition of certainty; he can decide what is important to him (either dividends or capital gains) based on his needs. A shareholder who is in need of cash could dispose (borrow) of part of his holdings (homemade dividend) to raise cash or lend a dividend if he so desires to defer consumption. In conclusion, the dividend irrelevance theorem was based on the premise of a perfect capital market where investors are assumed to be rational and dividend policy does not matter to the value of the firm. The dividend irrelevance theorem is supported by scholars such as Black and Scholes (2012) & Miller & Scholes (2014).

Furthermore, Irrelevance of dividend theories are discussed below.

### ***Residuals Theory***

Residuals theory assumes common shareholders to be the real owners of a business. It follows that accountants and corporate managers must also adopt the perspective of shareholders.

Under this theory, preferred stock is a liability for common shareholders rather than part of the firm's equity. After subtracting preferred shares, only common shares remain as the residual equity. This is the basis of residual equity theory, and common shareholders can be thought of as residual investors.

Dividends paid to shareholders amounts to what profits are left over after the company has paid for its capital expenditures (CapEx) and working capital costs.

Companies that use a residual dividend policy fund CapEx with available earnings before paying dividends to shareholders. This means the dollar amount of dividends paid to investors each year will vary.

The theory suggests that investors are indifferent to which form of return they receive from a company—whether it be dividends or capital gains. Under this theory, the residual dividend policy does not affect the company's market value since investors value dividends and capital *gains equally*.

### ***Modigliani and Miller's Theory***

According to Modigliani and Miller (M-M), dividend policy of a firm is irrelevant as it does not affect the wealth of the shareholders. They argue that the value of the firm depends on the firm's earnings which result from its investment policy.

Thus, when investment decision of the firm is given, dividend decision the split of earnings between dividends and retained earnings is of no significance in determining the value of the firm. M – M's hypothesis of irrelevance is based on the following assumptions.

1. The firm operates in perfect capital market
2. Taxes do not exist
3. The firm has a fixed investment policy

4. Risk of uncertainty does not exist. That is, investors are able to forecast future prices and dividends with certainty and one discount rate is appropriate for all securities and all time periods. Thus,  $r = K = K_t$  for all  $t$ .

Under M – M assumptions,  $r$  will be equal to the discount rate and identical for all shares. As a result, the price of each share must adjust so that the rate of return, which is composed of the rate of dividends and capital gains, on every share will be equal to the discount rate and be identical for all shares.

Thus, the rate of return for a share held for one year may be calculated as follows:

$$r = \frac{D + (P_1 - P_0)}{P_0} = \frac{\text{Dividends} + \text{Capital gains (on loss)}}{\text{Purchase price}}$$

Where  $P^0$  is the market or purchase price per share at time 0,  $P_1$  is the market price per share at time 1 and  $D$  is dividend per share at time 1. As hypothesised by M – M,  $r$  should be equal for all shares. If it is not so, the low-return yielding shares will be sold by investors who will purchase the high-return yielding shares.

This process will tend to reduce the price of the low-return shares and to increase the prices of the high-return shares. This switching will continue until the differentials in rates of return are eliminated. This discount rate will also be equal for all firms under the M-M assumption since there are no risk differences.

From the above M-M fundamental principle we can derive their valuation model as follows:

$$P_0 = \frac{D_1 + P_1}{(1+r)} \quad P_0 = \frac{D_1 + P_1}{(1+k)} \quad r = k$$

Multiplying both sides of equation by the number of shares outstanding (n), we obtain the value of the firm if no new financing exists.

$$V = nP_0 = \frac{N(D_1 + P_1)}{(1+k)}$$

If the firm sells m number of new shares at time 1 at a price of  $P^1$ , the value of the firm at time 0 will be

$$nP_0 = \frac{ND_1 + (n+m)p_1 - mp_1}{(1+k)}$$

The above equation of M – M valuation allows for the issuance of new shares, unlike Walter's and Gordon's models. Consequently, a firm can pay dividends and raise funds to undertake the optimum investment policy. Thus, dividend and investment policies are not confounded in M – M model, like Walter's and Gordon's models.

1. The assumption that taxes do not exist is far from reality.
2. M-M argue that the internal and external financing are equivalent. This cannot be true if the costs of floating new issues exist.
3. According to M-M's hypothesis the wealth of a shareholder will be same whether the firm pays dividends or not. But, because of the transactions costs and inconvenience

associated with the sale of shares to realise capital gains, shareholders prefer dividends to capital gains.

4. Even under the condition of certainty it is not correct to assume that the discount rate (k) should be same whether firm uses the external or internal financing.

If investors have desire to diversify their port folios, the discount rate for external and internal financing will be different.

5. M-M argues that, even if the assumption of perfect certainty is dropped and uncertainty is considered, dividend policy continues to be irrelevant. But according to number of writers, dividends are relevant under conditions of uncertainty.

### **2.3.4 Signaling (Asymmetric Information)**

Theory of Dividend Payment The signaling hypothesis of dividend payment or the information content of a dividend is one of the theories that support dividend relevance theory by suggesting that managers have a better knowledge of current and future prospects of the business than outsiders. In order to reduce information asymmetry, changes in the dividend may be used by them to signal future earnings and growth to the market. Therefore, an announcement about changes in the dividend could be interpreted by investors differently, depending on the type of news it carries. Lintner (1956) suggests that managers are interested in dividend signaling and only increase the dividend when they are convinced that earnings have increased. This suggests that a rise in dividend payouts indicates long-run sustainable earnings; which is consistent with the 'dividend-smoothing hypothesis'. The signalling hypothesis was documented

earlier but it was modelled in the late 1970s and mid-1980s by Bhattacharya (1979), John and Williams (1985) and Miller and Rock (1985). In particular, Bhattacharya (1979) suggested that the cost of signalling is the transaction cost incidental to the external borrowing, whereas Miller and Rock (1985) argued that the dissipative cost was the distortion arising from the optimal investment decision, and finally, John and Williams (1985) suggested that the signalling costs to a firm were the tax liability on dividends in relation to capital gains. In summary, Bhattacharya (2015) Miller and Rock (1985) and John and Williams (1985) suggested that dividend paying firms (value-firm) will command a higher market price than non-dividend paying firms (growth) because of the signalling effect of announcements.

#### **2.4.6 Clientele Effects of Dividends**

Another justification for dividend relevance is on the basis of taxes on dividends and capital gains. Clientele effects or the preferred habitat hypothesis was formulated on the premise that firms are made up of different clienteles ranging from dividend clientele, capital gain clientele, risk-based and transaction-based clientele, each having different reasons for investing in a particular firm (Miller and Modigliani, 1961). According to Miller and Modigliani (1961), investors might be influenced by certain market imperfections, for example, differential tax rates and transaction costs. They further argued that in the absence of taxes and transaction costs, dividends paid would not affect the firms' value. On the contrary, they argued that the variation between taxes on dividends and capital might induce an investor to buy stocks of a firm that pays dividends in order to avoid the transaction costs associated with selling shares. However, in reality, there are different taxes on dividends, capital gains and transaction



costs, and these differences may influence their clienteles. Earlier dividend theories tend to focus on two types of clientele effect, namely, transaction cost minimisation and tax minimisation.

- **Tax-Induced Clientele Effects** One of the arguments behind the dividend clientele hypothesis centred on the different tax treatment of dividends and capital gains. Prior studies argued that because dividends are often taxed at a higher effective rate than capital gains in most countries, investors already facing high marginal tax rates, or who cannot avoid paying taxes on dividends, may prefer not to receive cash dividends so as to minimise their tax liabilities (Brennan, 1970; Elton and Gruber, 1970; Litzenberger & Ramaswamy, 1979). Similarly, investors who can avoid paying taxes on dividends or face low margin tax rates do not mind receiving cash dividends (Han, Lee & Suk, 1999; Dhaliwal, Erickson & Trezevant, 1999).

- **Transaction Cost-Induced Clientele** Bishop et al. (2010) posit that investors such as retirees, income-oriented investors and others who depend on dividend income for their consumption needs might prefer high and stable dividend-paying shares to selling part of their shares, which could result in a significant transaction cost. On the contrary, some investors, particularly the wealthy, may not need dividend income to meet their consumption needs, and may therefore favour low or no dividend payouts, to avoid the transaction costs associated with reinvesting the dividends. Furthermore, transaction costs are involved when both groups of investors decide to move from one company's shares to other types of security. However, Miller & Modigliani's (1961) view that homemade dividends are free, does not hold true because in a real world transaction costs are involved when securities are traded (Scholz, 2017).

Similarly, another effect of transaction costs on dividend policy is based on fact that dividend payments are an outflow of cash which may be used for investment purposes. In other words, when a firm pays a cash dividend, they may have to rely on external financing in order to execute their investment, which may in turn involve costs. For instance, if a firm issues equity to raise cash for its investment programme, or resorts to debt financing, there are costs. If the costs of external financing are significant, it is likely that firms would prefer to use retained earnings rather than external financing, which supports the pecking order theory (Myers, 2010). Prior studies have identified transaction costs associated with dividends: Bhattacharya's (1979) signalling model and Rozeff's (1982) trade-off model are amongst the justifications for clientele effects of dividends. Thus Rozeff (1982) argued that companies with high levels of debt should adopt a lower dividend payout ratio as higher payouts are associated with higher transaction costs arising from the use of external financing. Therefore, on the basis of evidence from the literature, the dividend payout ratio and transaction costs are expected to be negatively correlated.

### **2.3.5 Agency Problems and Dividend Theories Agency**

Theory concerns the relationship between a principal and his agents (Arnold, 2015). The agency relationship often creates conflict which leads to agency problems (Jensen and Meckling, 1976) related, for example, to the cost of administration, restructuring and enforcing of contracts (Brealey, Allen & Myers, 2016). Ross (2018) suggest that

agency costs arise when managers try to enrich themselves at the expense of the owners or their creditors. Agency costs arising from conflicts between stakeholders in an organisation have been studied extensively. Prior studies have all investigated the impact of agency costs on the organisation and how the dividend payout ratio could be used as a tool for reducing agency costs (Jensen & Meckling, 2012; Rozeff, 2013; Easterbrook, 2016).

Firstly, Jensen and Meckling (2012) suggest that managers tend to invest free cash flows, which should have been distributed to shareholders as dividends in unprofitable (negative NPV) projects, thereby creating an agency problem which may lead to high costs. He further argued that in order to reduce the high costs associated with agency, firms pay cash dividends to shareholders instead of investing it in negative NPV projects. Secondly, Easterbrook (1984) asserted that higher dividend payouts reduced retained earnings available, which could force managers to borrow from the capital market in order to raise funds for its investments. Furthermore, he suggested that cash dividend payments limited the possibility of investment in sub-optimal projects, increased monitoring as managers sought external financing in the capital market, and finally, ensured that they acted in the best interests of the shareholders (Easterbrook, 1984).

Lastly, Rozeff (1982), Crutchley & Hansen (1989), and Chen & Dhiensiri (2019) argue that corporate ownership, leverage, size, and agency problems affect firm dividend policies. In other words, firms with lower (higher) levels of insider ownership may have higher (lower) dividend payout ratios. For example, an increase in insider ownership

reduces agency costs, because whatever affects shareholders will also affect their equity ownership in the firm. Therefore, most agency theories found consistent evidence that ‘dividend policy controls agency cost by reducing funds available for unnecessary and unprofitable investments, requiring managers to look for financing in capital markets which increases the monitoring’ (Kilincarslan, 2015).

### **2.2.6 Dividends and the Industry Effect**

Literature suggests that the industry effect is one of the major reasons behind variations in dividend payouts (Ozo, 2012). For example, Lintner (2014) observes that mature firms are more likely to pay dividends than growth firms, due to their maturity. He maintains that most mature firms are stable, and can afford to pay higher dividends than the growth (newly established) firms. In addition, some studies have examined the correlation between the dividend payout ratio and industry dummies, but their findings have been inconclusive. For example, Baker, 2011; Baker, 2018; Baker & Powell, 1999) found a positive correlation between the dividend payout ratio and industry effect. In particular, Baker (2012) surveyed NYSE listed companies to ascertain the managers’ views on the determinants of dividend policy. They found that high payouts were associated with the utilities, whereas manufacturing and retail sectors have moderate to low dividend payouts because of the highly liquid nature of their business, suggesting a variation in payouts among industries. Furthermore, they conclude that, investors’ desire for current income over future income influences firms’ dividend payout decisions. Similarly, Baker (2015) examined the perception of managers of financial and non-financial institutions in Canada on the dividend payout ratio and industry

effect, and also found a positive correlation. However, he claimed that the industry effect has diminished compared to previous findings, as earnings are the main determinant of dividend payouts over time. Therefore, empirical evidence from the literature in corporate finance supports the industry effect, showing that dividend payout is positively correlated. Therefore, we expect industry dummies to influence the dividend payouts of Nigerian listed firms, due to the uniqueness of each industry and its shareholders.

### **2.3.7 Dividend Payments in Nigeria**

This section discusses dividend payments in Nigeria. Usually, dividends can either be paid by cash, shares or share buybacks (Arnold, 2018). Nigeria's financial system did not allow for share buyback until a recent amendment within the Companies and Allied Matters Act 2014, which empowers firms to buy back its shares under stringent conditions and specifies the categories of people whom they can buy from, in order to protect the debt holders and avoid dilution of the company's capital. Accordingly, Section 187 of this Act provides for the payment of the share buyback from the distributable profits of the firm. Also, Section 380 of the Act stipulates that firms can pay dividends from their revenue reserves, profits arising from the sale of its fixed assets or profits arising from the use of its properties. It also states that directors of the company may pay dividends either in the form of cash or bonus issues as they deem fit. The Act did not mandate companies to pay dividends, as seen in most developed countries; instead, they are allowed to decide when to pay and only if they would not wound-up after payment of cash dividends (see Companies & Allied Matters Act, as amended 2014).

The researcher seeks to examine the determinants of dividend payouts on Nigeria listed companies and to consider the implications when compared with prior empirical evidence documented in developed markets.

### **2.3.8 Institutional Environment in Nigeria**

Nigeria has witnessed many reforms, from Structural Adjustment Programme (SAP) introduced in 1986 during military regime to the National Economic Empowerment and Development Strategy introduced by the civilian government in 2013. One of the major economic reforms (Banks Consolidation) by Olusegun Obasanjo in 2014 was geared towards strengthening the financial sector, as a result of the interest rate ceiling imposed by the Structural Adjustment Programme, in order to improve the availability of credit. These economic reforms liberated the financial sector from the real negative interest rates imposed by the SAP in the past by ensuring that a minimum capital base of  $\text{N}25\text{billion}$  was maintained by banks in Nigeria, thereby enhancing the liquidity of the financial sector. Also, the economic reforms brought about the deregulation of markets, an increase in GDP growth to 1.94% in 2019, lowering of taxes and a rise in foreign direct investment.

Following the enactment of the Investment and Securities Act in 2017 by the Securities and Exchange Commission (SEC), there has been a massive improvement in the market as a result of scrutiny and supervision of the Nigerian Stock Market by the SEC. As a consequence, firms can now raise funds through the capital markets rather than depending on the retention of profits for investment purposes which may influence their dividend payout. Another peculiar feature of the stock market concerns the issue of

shareholding. In Nigeria, most of the company's shares are placed in the hands of institutional investors who are mostly financial institutions, which reduces the stock float and increases the propensity of firms to pay cash dividends.

Corruption affects most countries globally (Ojeka, 2019). The effect of corrupt practices on the business environment has generated considerable debate among scholars. Some have argued that a weak legal system, which is seen in most corrupt countries, fails to protect the interests of shareholders and thereby discourages cash dividend payments (La Porta, 2010). Others view it as a more of a corporate governance problem (Xia and Fang, 2015). Recent studies have shown that the institutional environment determines corporate behaviour and dividend payouts. For instance, Faccio (2011) and Brockman & Unlu (2019) share the view that high dividend payouts by listed firms in the common-law countries, signify strong investor protection. However, this cannot be said of Nigeria, despite her being one of the common-law countries.

Since independence in 1960, Nigeria's economic environment has been marred by corruption, not only among public officers, but also across policy makers in various institutions (Ojeka, 2019). According to Transparency International in 2019, Nigeria ranked 146 out of 180 most corrupt countries in the world, as evidenced by a corruption perceptions index score of 26/100, which shows the prevalence of corrupt practices in the Nigerian environment. However, there are few empirical studies that examine the influence of corruption on firms' dividend payouts in the Nigerian context, despite substantial evidence from other countries (Kalcheva & Lins, 2017). Yaroson (2013)

studied the effect of corruption in financial sectors, which led to bank failures in Nigeria after the merger of banks in 2014, using World Bank institutional quality indices such as political instability, rule of law, regulatory quality, control of corruption index, government effectiveness, voice and accountability, and found that bank failures could be linked to corruption in the institutional environment. Similarly, Ojeka (2019) studied the impact of perceived corruption, institutional quality and performance on Nigerian listed firms. They found that corruption was more common in the non- financial sector than the financial sector in Nigeria, due to less strict regulation. They also found that the financial sector was more leveraged compared to the non-financial sector, increasing the risk appetite of the board to maximise owners' economic wealth through high dividend payouts. In other words, the excessive risk appetite of financial institutions in Nigeria, may have led to stricter regulation within the environment (Haan & Vlahu, 2012). In conclusion, the institutional environment may be vital in examining the determinants of dividend payouts of firms in Nigeria, as suggested by prior studies (Ojeka, 2019; Yaroson, 2013). Also, it is expected that dividend payouts of firms listed on the Nigerian Stock Exchange may be different to other developing countries, as a result of a weak regulatory environment, widespread corruption, a weak legal system, weak corporate governance and a low retention ratio.

### **2.3.9 Prior Dividend Studies in Nigeria**

This section reviews the empirical studies on determinants of dividend policy conducted in Nigeria in order to identify the gaps in the existing literature. It is important to note that prior Nigerian studies on the determinants of dividend policy



have used small samples, only covering a few industries such as oil and gas, and consumer goods, and their findings were either contradictory or inconclusive.

A number of studies have examined the determinants of payout ratios of Nigerian listed firms using methods similar to those of research conducted in developed countries (Lintner, 1956; Friend & Puckett, 1964; Miller and Scholes, 1974; and Baskin, 1989). For instance, Uzoaga & Alozieuwa (1974) studied the pattern of dividend policy employed by Nigerian firms during the period of indigenisation and the participation programme in 1973. The study used a sample comprising 13 firms listed on the Nigerian Stock Exchange (NSE) over a period of four years. There was insufficient evidence to validate the 'classical influences' that determine dividend policies in Nigeria during that period. However, they concluded that 'fear and resentment' seem to have taken over from the classic forces. In addition, Soyode (1975) challenged the findings of Uzoaga and Alozieuwa (1974) on the grounds that they excluded certain relevant factors that determine the optimal dividend policy of a firm, such as earnings, size, and free cash flows.

Oyejide (1976) extended the previous work by Uzoaga & Alozieuwa (1974) and Soyode (1975) by testing dividend policy in Nigeria using Lintner's model as modified in Brittain (1964). The findings of the study showed that dividend payouts of Nigerian firms can be explained by conventional factors such as the target payout ratio, leverage, growth, and profitability. Odife (1977), in attempt to discover the rationale behind the dividend policy pattern of Nigerian firms, studied dividend policy in the era of indigenisation in Nigeria, and found a strong evidence to disagree with Oyejide (1976),

for failing to adjust for stock dividends. Izedonmi & Eriki (1996) carried out a study on the dividend policy of Nigerian firms using Lintner's model and found consistent evidence that target and future payout ratios influence firms' dividend policy, thus supporting Oyejide (1976). In a similar manner, Adelegan (2013) examined the incremental information content of cash flows in explaining dividend changes and earnings in Nigeria. The study focused on 63 firms quoted on the Nigerian Stock Exchange from 1984-1997, and found results consistent with Oyejide (1976). Furthermore, Fodio (2019), Adelegan (2019), Adefila, Oladapo, & Adeola (2013), Oyinlola & Ajeigbe (2014), Duke, Ikenna & Nkamare (2015), and Egbeonu, Paul- Ekwere & Ubani (2016) carried out similar studies on the determinants of dividend policy of financial firms in Nigeria and found a positive correlation between dividend payout and firm-level factors (e.g., earnings, liquidity and size). Recent studies by Uwuigbe (2013) and Dada & Malomo (2015) found dividend payouts of Nigerian banks to be correlated with size, leverage, and board independence, while Edet (2014) found a negative correlation between dividend payout and liquidity. The rest of the studies can be found in Appendix 3. In conclusion, the review shows that prior studies

in Nigeria were mostly on the financial sector due to its strict regulatory framework and the availability of data (Edet, Ataire & Anoka, 2014). In other words, it may be due to the different techniques, time-variation and small sample size. Some studies have found profitability, liquidity, and size to be negatively correlated the dividend payout ratios of financial institutions (Saeed, 2013; Edet, Ataire & Anoka, 2014). However, there is also evidence from literature that suggests that profitability, liquidity and size are positively correlated to dividend payout ratios (Fama & French, 2011; Manos 2012).

This current study attempts to fill a gap in the literature by examining the determinants of dividend payout ratios in the non-financial sector in Nigeria which has been neglected despite the fact that it represented 70% of Nigeria's GDP in 2019.

### **2.3.10 Other Theories of Dividend Payment**

The catering theory of dividend payments, which was developed by Baker & Wurgler (2014a) as an alternative to Miller and Modigliani's (1961) dividend irrelevance theory, suggests that firm pays dividends as a result of investors' preference for current cash in order to meet their consumption needs rather than future cash. The maturity hypothesis developed by Grullon (2012) argued that a firm's dividend payout ratios are based on their life-cycle rather than free cash flows as suggested by Jensen and Meckling (1986), and finally, residual dividend theory argued that firms should only pay dividends when the demand for cash for projects with a positive net present values had been met. 2.2.8 Empirical studies on Dividend Policy Conducted in Developed Countries The determinants of dividend policy have been widely investigated in the developed economies (see for example, Bradley, 1998; Aivazian 2013; Mayers & Frank, 2014). Most of the previous studies conducted in this context have been based on testing the

theoretical predictions of dividend policy by relaxing either one or more of its assumptions. Some of these studies have focused on the ownership structure (e.g. Jensen et al., 1992; Aivazian 2013; Gugler, 2013; Elston 2014; Bradford 2013); other on agency costs (Rozeff, 1982; Crutchley and Hansen, 1989; and Chen & Dhiensiri, 2019); institutional environment (Booth & Zhou, 2017; Baker & Wurgler, 2014a; Grutten, Kanatas, & Weston, 2010); local culture (Pantzali and Ucar, 2014; Zheng,

Ashraf, & Badar, 2014; Ucer, 2016); corporate governance (La Porta 2010; Chan and Cheung, 2011; Chen 2015; Oliveira & Jorge, 2016), and investors dividend clienteles (Becker 2011; Graham & Kumar, 2016).

This review focused only on firm-level determinants relevant to this study, as there is a vast literature on dividend policies. One of the main determinants of dividend payouts, according to the literature is profitability. Empirical studies in developed countries have found a positive correlation between the dividend payout ratio and profitability (DeAngelo 1992; Fama & French, 2011; Aivazian 2011). It is argued that the more profitable a firm is, the more likely they are to pay a dividend (Aivazian 2011). Fama & French (2011) argued that firms with higher profitability and low-growth opportunities tend to have a higher dividend payout ratio because of free cash flow. Similarly, Denis and Osobov (2018) found that a higher dividend payout ratio is associated with higher profitability, as a result of a higher retention ratio. Also, both Amarjit (2010) and Gill (2010) share the view of Denis and Osobov (2018) that profitability and dividend payout ratios are positively correlated, in their study of the determinants of dividend policy of American service and manufacturing companies.

Another determinant of firm dividend payouts is size. Empirical evidence from the literature argues that large firms have access to external funds in the capital markets with fewer restrictions compared to small firms, and as a consequence, may pay high dividends (Jensen , 1992; Redding, 1997; Holder, 1998; Fama & French, 2010; Manos, 2012; Travlos, 2012). For instance, Holder, (1998) found a positive correlation between dividend payout ratio and firm size. They argued that larger firms have access to the

capital markets, follow stricter mandatory disclosure requirements, are followed by financial analysts, and have a higher dividend payout ratio. Forace (2013) examined the dividend policy of Australian and Japanese listed firms, and also found size to be positively correlated with dividend payouts. However, Smith and Watts (1992) found no correlation between the dividend payout ratio and firm size. Current earnings and past earnings have been documented as another factor influencing dividend payouts. Benarti (1997) examined the determinants of dividend payouts using a sample of 1025 firms listed on the New York Stock Exchange (NYSE) for a period of 13 years from 1979-1991. They found a positive correlation between the dividend payout ratio and current earnings. According to Fama and Babiak (1968) the level of expected earnings influences dividend payouts, as firms are reluctant to increase dividends only when earnings is certain. Other studies have also found a positive correlation between earnings and the dividend payout ratio (Bradley, 1998; Mayers & Frank, 2014; Pappadopoulos & Dimitrio, 2017). However, Fama and Gaver (1993) examined the determinants of payouts using a sample of US firms; and found a negative correlation

between the dividend payout ratio and growth opportunities. Similarly, Fama and French (2010) and Grullon (2012) found consistent results that the dividend payout ratio and growth are negatively correlated. They argued that mature firms have less investment, larger free cash flows, and are more likely to pay dividends compared to growing firms with larger growth opportunities. In contrast, Abreu (2016) found a positive correlation between the target dividend payout ratio and growth opportunities as measured by growth in sales.

Another determinant of payouts as evidenced in the literature is debt. Prior studies (e.g., Rozeff, 1982; Aivazian, 2013; DeAngelo & DeAngelo, 2017), have all investigated the determinants of dividend policy using debt as one of the proxies in their models. Some scholars have argued that agency costs associated with free cash flow problems may be mitigated through issuing debt or paying cash dividends to shareholders (Jensen and Meckling, 1979; Jensen, 1986; Crutchley & Hansen, 1989). They argued further that debt and dividends may serve as alternative measures in controlling agency problems; therefore, the two are inversely correlated. In addition, Rozeff (1982) suggests that the dividend payout ratio and debt are inversely correlated. He argued that high fixed interest obligations arising from the use of debt financing will reduce profit after tax, and consequently, reduce the dividend payout ratio. Aivazian (2013) examined the determinants of dividend policy with a comparative analysis of developed and developing markets. They used the debt ratio as one of the proxies of dividend determinants and found a negative correlation between debt and the dividend payout ratio, consistent with results found in the developed markets. In addition, prior studies (e.g. Darling, 1957; Jensen, 1986; Manos, 2012; Kisman, 2013) have suggested that liquidity helps in maintaining sound financial manoeuvring and also influences dividend policy decisions of firms because the shorter the conversion of its stock to cash, the more likely that cash dividends will be paid to shareholders. Similarly, Manos (2012) and Ho (2013) agreed that higher dividend payouts are positively correlated with higher liquidity because firms that are liquid are better placed to pay cash dividends as no external borrowing is required which might otherwise increase interest payments, compared to illiquid firms. In support of Ho (2013), Gupta & Parua (2012) argued that

higher liquidity shows that the firm is sound and capable of meeting its financial obligations. However, a few studies have documented a negative relationship between liquidity and the dividend payout ratio by suggesting that liquidity has no informational effect on the dividend payout ratio (Mehta, 2012; Al-Najjar, 2017).

Asset tangibility has also been investigated as another determinant of dividend payouts (e.g., Jensen & Meckling, 1986; Rajan & Zingales, 1995; Booth, 2011). For instance, Jensen and Meckling (1986) argued that managers can use non-current assets (fixed assets) to raise additional debt in order to increase monitoring by the debt holders. In support of agency theory, Aivazian, Booth, and Clearly (2013) suggest that firms with more tangible assets in relation to total assets have lower dividend payouts compared to firms with less tangible assets, in a market where short-term debt is the major source of funding. They went on to argue that, more tangible assets allow firms to borrow more to control agency costs rather than relying on dividends to mitigate agency problems.

## **2.4 Empirical Review**

Smits (2015) analysed the impact of the recent financial crisis on US firms' dividend pay-out policy, using variables like size, liquidity, investor composition and spread of bid/ask. Overall his findings showed that the financial crisis did not affect dividend pay-out ratios, despite the evidence that dividend pay-out increases during crisis for larger firms with higher percentage of institutional owners. However, there is evidence that both firm size and clientele influence the impact of a crisis on dividend policy: dividends increase during the crisis for larger firms and those with a higher percentage of institutional owners. This might be so, may be due to the fact that the firms might

want to communicate to their shareholders that the crisis does not affect the firm (as much) as it does others.

Hauser (2015) investigated whether corporate pay-out policy changed during the financial crisis in the US between 2016 to 2019. The study used a life-cycle model to predict the probability that a firm pays a dividend. The data sample for this research followed that of Fama & French, (2016) and that of DeAngelo, DeAngelo, & Stulz, (2016) for the time period of 2016-2019. The panel logistic regression analysis considers the firm cluster effects and the autoregressive correlation of the firm clusters. The study found that the probability that a firm paid a dividend declined in 2018 and 2019, even after taking the firm's financial condition into account. Furthermore, the analysis also shows that dividend policy did shift during the financial crisis.

Soondur, Maunick& Sewak, (2016) explored the determinants of dividend policy of companies listed on the Stock Exchange of Mauritius. The study used a sample size of 30 companies selected from the Stock Exchange of Mauritius using the regression analysis. The fixed and the random effect model were conducted to determine the effects of earnings per share, net income, retained earnings, cash and debt to equity on the dividend policy of the listed companies operating in the Mauritian Stock Exchange and for this purpose, companies' annual reports for the period 2019-2013 were used. Moreover, two measures of the dividend policy were considered namely the dividend per share and the dividend pay-out ratio.

The study attempted to provide a comparison between the dividends policies of companies listed on the official market with that listed on the DEM. The findings show



there is a significant negative relationship between companies' dividend policy and their retained earnings. Furthermore, the results indicated that there was no meaningful connection between the dividend policy and a company's cash and debt to equity ratio.

Yusof & Ismail, (2016) investigated the determinants of the dividend policy of public listed companies in Malaysia. The factors examined in this study include earnings, cash flows, free cash flows, debt level, growth, investment, size, largest shareholders, risk and lagged dividend. Data were obtained from the relevant databases and annual reports of the sampled companies. The study examined a total of 147 listed companies. In analyzing the data, the study used fixed and random effects, pooled least squares model, robust standard errors on fixed effects and random-effects models. The results revealed the five factors (earnings, debt, size, investment and largest shareholder) have a significant influence on dividend policy, with earnings, firm size and investment revealed to have a positive significant effect, while debt and large shareholders have a negative significant effect.

Mui, & Mustapha (2016) examined the determinants of dividend policy among public-listed firms in Malaysia. Secondary data was hand-collected from the annual reports of the listed firms for a period of five years. This study employed multiple regressions to estimate the relationship between the determinants and dividend pay-out decisions. The results indicated that investment opportunity, liquidity and firm size significantly influence the dividend pay-out of Malaysian listed firms.

Echchabi and Azouzi (2016) investigated the determinants of dividend pay-out among the Tunisian listed companies and particularly to inspect the influence of the Jasmine revolution on firms' dividend policies. The study employed panel data models using pooled data from the companies listed on the Tunisian Stock Exchange from 2013 through 2012. This specific study period has been selected because it includes the Arab uprisings events which started in Tunisia at the end of 2010. The findings indicated that net cash flow and market to book value have significant influence on the dividend pay-out, while the Jasmine revolution had no significant impact on the dividend pay-out among the Tunisian listed companies. Hence, the study provided insight on the possible influence of similar events on the dividend policy and the other factors that may influence its dynamics.

Kuzucu (2016) examined determinants of dividend Policy Turkish Listed Firms using Panel Data Analysis for eight-year (from 2016 to 2013) from the Turkish stock market (Borsa Istanbul). The results show that financial leverage, size, growth rate, age, profitability, ownership structure and P/E ratio are statistically significant. The relationship of leverage, growth rate, profitability and family control with dividends is negative, whereas the relationship of size, age and P/E ratio is positive. Therefore, firms with higher debt ratios / growth rates / higher earnings are likely to retain more of their earnings. The study found that, as a firm matures, the availability of profitable projects reduces and earnings decrease. As the investment opportunities reduce, the need for resources decreases and the firm increases dividend pay-outs to shareholders.

Banerjee (2016), examined determinants of dividend distribution on Information Technology (IT) companies in India. Four top Information Technology (IT) companies in India were analysed over a span of 5 financial years. Three factors namely Leverage, PE Ratio, and Return on Equity are found to be statistically significant, as far as Dividend Distribution Decisions were concerned.

M'rabet (2016) examined the relationship between dividend policies and financial performance of selected listed firms in Morocco. Data were sourced through secondary means from the annual reports of the sampled quoted firms and was analyzed using panel data regression model. Two models were developed in an attempt to provide a theoretical explanation on the birds-in-hand dividend relevance theory and the Modigliani and Miller's (MM) dividend irrelevance theory. The findings indicated that Dividend policy is an important factor affecting firm performance. Their relationship was also strong and positive. The study concluded based on the findings of this research that dividend policy is relevant and that managers should devote adequate time in designing a dividend policy that will enhance firm performance and therefore shareholder value. The recommendation was that management of companies should also invest in projects that give positive Net Present Values, thereby generating huge earnings, which can be partly used to pay dividends to their equity shareholders.

Akani, and Sweneme (2016) examined the impact of dividend policy on the profitability of selected quoted manufacturing firms in Nigeria from 1981 to 2014.

Time series data were computed from financial statement of the selected quoted manufacturing firms and stock exchange fact book. Return on Investment (ROI) and Net Profit Margin (NPM) were modelled as the dependent variables while Dividend Pay-out Ratio (DPR), Retention Ratio (RR), Dividend Yield (DY) and Earnings per Share (EPS) were proxied as the independent variables. Multiple regressions with the aid of statistical package software known as STATA were used as data analyses techniques. Multi co-linearity, co-linearity, Durbin Watson, F-statistics and regression coefficient were used to determine the dynamic relationship between the variables. Findings revealed that all the independent variables have positive relationship with the dependent variables except dividend yield. The recommendation was that operational efficiency of Nigerian financial market should be deepened and management should strengthen its effort for effective dividend policy that will increase the profitability of the quoted manufacturing firms Nigeria.

Elmi and Muturi, (2016) investigated four theories which are dividend relevance theory, dividend irrelevance theory, free cash flows hypothesis and signalling theory. Descriptive research design was applied in this research study. The population for this study was ten commercial and services firms listed in the Nigerian Stock Exchange as at 31st December 2015. Data for these companies for ten years from 2015 to 2014 was used in the study. Both primary and secondary data were applied in the study. Data was collected from the audited financial statements of the commercial and services firms, Nigerian Stock Exchange and also made use of questionnaire design to extract information from the firms and also using secondary information from Capital Markets

Authority. The study applied descriptive statistics and panel data analysis model. The study used panel data analysis and applied the fixed effects model. The study found that profitability was an insignificant factor in determining dividend pay-out. The study recommended that though profitability may not hurt the ability of the firm to pay dividends in the short term, continued poor performance will definitely affect pay-out negatively.

Khan, Naeem, Rizwan, and Salman, (2016), investigated the factors that determine the dividend pay-out ratio and to examine the relationship between these factors and dividend pay-out ratio. The results indicated that there is a negative relationship between profitability and dividend pay-out ratio. There is a negative relationship between leverage and dividend pay-out ratio. Firm Size and P/E ratio does not have any impact on the dividend pay-out ratio. Thomas (2013) examined the effect of board characteristic on dividend policy for Standard & Poor (S&P) 500 firms between the period of 2018 and 2011. The board characteristic comprises of board size, percentage of insider directors, percentage of women directors, ownership structure and directors tenure are measure against dividend policy. The study used ordinary least square (OLS) and fixed effect test to analyse the cross sectional data and test the robustness of the model. Findings showed that board size has positive significant relationship with dividend policy while board independence show negative significant relationship with dividend policy. Board independence was revealed to reduce monitoring cost of the agents. The study also revealed that the percentage of share held by the directors is

inconclusive. However the result of the fixed effect test shows that all the independent variables except the board size were not significant.

Pandey and Ashvini (2016) analysed the determinants of dividend policy (DP) of Fast Moving Consumer Goods sector in India. FMCG companies included in CNX FMCG the sectorial index for National Stock Exchange of India are fifteen and twelve companies have been taken for the study. The period of study considered was ten years from 2013 to 2012. Various factors affecting DP such as dividend pay-out ratio (DPR), debt equity ratio (DER), earnings (ERN), corporate tax (CT), earnings per share (EPS) and firm size (FS) were considered for analysis. The study revealed that DPR, DER, ERN, CT had significant impact on EPS and were also good predictors of dividend pay- out in FMCG sector. Ordinary Least Square models were used to estimate the impact of DER, DPR, ERN, FS, and EPS and on the DP. The DP of overall FMCG sector is strongly influenced by DPR, DER, EPS, and CT, which reveals that the DP of FMCG sector is significantly influenced by the selected financial variables during the period of the study. The overall regression analysis shows that the determinants of DP are significantly and positively influenced by the DPR, DER and EPS.

Mahdzan, Zainudin and Shahri (2019) examined the determinants of the dividend policies of public listed firms in Malaysia for the period 2015 to 2019. A panel regression estimation model was used to identify the determinants of dividend policy within Malaysian firms. These determinants were then examined across eight different industries – Technology, Industrial, Consumer Noncyclical, Basic Material, Communication, Consumer Cyclical, Diversified and Energy – to investigate possible

divergences in the determinants of dividend pay-outs in the context of an emerging market. The study found that firm size, leverage position, and profitability are significantly and inversely related to the dividend policy of firms in Malaysia. However, the industry-specific determinants of dividend policy displayed a number of variances that could plausibly be used as an indication of the selection of stocks in specific industries by potential investors. The results indicate that agency cost is positively related to dividend policy for the Basic Material industry. In addition, size and leverage play an important role in determining dividend pay-out for firms in the Technology and Consumer Noncyclical industries. For the Industrial sector, the size and profitability significantly affect the dividend policy of firms. However, the results failed to display any significant results for the Energy and Consumer Cyclical industries.

Based on the above reviewed literatures, only the study of Thomas, (2018) examined the effect of board characteristic on dividend policy, some studies examined the factors that determine the dividend pay-out ratio, some examined the impact of dividend policy on the profitability while some examined the relationship between dividend policies and financial performance and some studies examined the impact of the recent financial crisis on firm's dividend pay-out. However, some of the studies [for instance Yusof and Ismail (2016) Pandey and Ashvini (2016) Khan, (2016) Kuzucu (2016) Echchabi and Azouzi (2016) Mui, (2016), Mahdzan (2016)] were carried out in foreign countries. In view of this, the study tends to fill this gap by examining the Determinants of dividend policy of Listed Companies in the Nigerian Stock Exchange.

## **CHAPTER THREE METHODOLOGY**

### **3.1 Introduction**

In this chapter, the study presents the operationalization of the variables explaining how the research work is conducted. It presents the research design, data source, method of data analysis and the model used for the study.

### **3.2 Research Design**

The research design for this study is longitudinal and cross-sectional research design examining data over some period of time (time series) and across different firms (cross sectional). The research design also follows the pattern of causal effect research design. This is because the study attempts to find the cause effect of one variable on another variable. This it does by establishing the relationship between the dependent and the independent variables and finding out which of the variable statistically affect the other variable using statistical method.

### **3.3 Sources of Data**

The type of data used for this study is secondary in nature and were sourced from the annual report of the firms investigated in the study. The financial statements of the firms are gotten from the Securities and Exchange Commission website. The financial statements that are of major focus are: the income statement, statement of financial position, consolidated statement of changes in equity and statement of cash flows. For ease of data collection, five year financial summary were also utilized.



### 3.4 Population and Sample

The population for the study is the Nigerian financial sector. The sample for the study consists of 15 banks listed on the Nigerian Stock Exchange as at 18<sup>th</sup> June 2018(see appendix A for the banks).

### 3.5. Variable Measurement

The dependent variable in this research is return on equity. Return on Equity (ROE) shows the relationship between net profit available to equity shareholders and the amount of capital invested by them. Mathematically,

$$\text{ROE} = \frac{\text{Profit After Tax}}{\text{Shareholders Equity}}$$

The independent variables are;

- a. **Dividend Payout Ratio:** This is the proportion of earnings available, which shareholders actually receive as dividend. This is expressed as:  $\text{DPR} =$

$$\frac{\text{Dividend Per Share}}{\text{Earnings Per Share}}$$

- b. **Dividend Yield:** It shows the percentage of dividend paid per share to market price

per share.  $\text{DY} = \frac{\text{Annual Dividends Per Share}}{\text{Market Price Per Share}}$

### 3.6 Estimation Technique

The statistical methods used for the analysis are descriptive statistics, correlation results, and panel least square. The Hausman test was used to check which of the regression results best suit for interpretation. EViews 8.0 software was used for estimating the specified model in the study. The panel least square is used because it takes care of the cross sectional and period specific effect in estimation processes. The probability value of the regression parameters are used for examining the impact of one variable on another, while the other variables are also used for general description of the data and explanation used of the model in the study.

### 3.7 Model Specification

The model for the study which is pool regression model where used to establish a relationship between firm financial performance using profit after tax and dividend policy variable. The focus is to examine the effect of dividend policy on the firm financial performance of financial firms in Nigeria. This follows the argument of the relevance theory of Modigliani and Miller argue against the relevance of dividend policy.

The functional relation establishing this relationship is stated thus:

$$ROE_{it} = f(DPO, DVY) \quad (1)$$

Where

ROE = return on equity (Profit after tax / total equity)

DPO = dividend pay out ratio (Dividend per Share / Earnings Per Share)

DVY = Dividend Yield (dividend per share/market price per share)

The models are thus stated econometrically as:

$$ROE_{it} = \alpha_0 + \beta_1 DPO_{it} + \beta_2 DVY_{it} + \varepsilon_{it} \quad (2)$$

Where

$\alpha_0$  = Intercept

$\varepsilon$  = Error term

$i$  = cross – sectional identifier where  $i = 15$

$t$  = time series identifier where  $t = 8$

Therefore  $it = 120$  (that is,  $15 \times 8$ )

Which is the double subscript represents cross section and time series

*A priori* expectations are as follows:

$$\alpha_0 > 0, \beta_1 > 0, \beta_2 > 0.$$

The pooled regression model

$$ROE_{it} = \alpha_0 + X_{it}\beta + \Sigma_{it} (V_t = 0) \quad (3)$$

$$ROE_{it} = \beta_1 + \beta_2 + DPO_{it} + \beta_3 + DVY_{it} + U_{it} \quad (4)$$

Where  $i$  = cross section identifier, that is, 15 banks

$t$  = time identifier, that is, 8 years (2012-2019)

Notice that the subscripts,  $i$  is not part of the intercept suggesting that the cross-sectional units are the same.

Fixed effect model

$$ROE_{it} = (\alpha_0 + U_i) + X_{it}\beta + V_{it} \quad (5)$$

$$ROE_{it} = \beta_1 + \beta_2 + DPO_{it} + \beta_3 + DVY_{it} + U_{it} \quad (6)$$

Notice that we have put the subscript,  $i$  on the intercept to suggest that the intercept of the cross sectional units may be different.  $\beta_1$  is treated as fixed.

Random effect model

$$ROE_{it} = \alpha_0 + X_{it}\beta + (U_i + V_{it}) \quad (7)$$

$$ROE_{it} = \beta_1 + \beta_2 + DPO_{it} + \beta_3 + DVY_{it} + \Sigma_i + V_{it} \quad (8)$$

Notice that the random effects equation was denied when  $\beta_{it}$  under the fixed effects treated as  $\beta_{it} = \beta_i + \Sigma_i$

The hypothesis for the appropriateness of a model as:

Null hypothesis: Random effects is appropriate

Alternative hypothesis: Fixed effect model is appropriate

The Hausman Test is applicable here.

$X_{it}\beta$  rep the independent variables and the parameters for all  $i$  and  $t$ .

## CHAPTER FOUR

### DATA PRESENTATION, ANALYSIS AND INTERPRETATION

#### 4.1 Introduction

This chapter presents the data and interpretation to the estimation results for the study.

The estimation results for the study are interpreted in the order of data description to inferences. The Hausman test was used to determine which of the regression results is appropriate for interpretation. The regression parameters of the panel least square are used for the hypotheses testing.

#### 4.2 Data Presentation

The data used in the analyses are enclosed as Appendix A to this study. Also the full results of the various analytical tools used are enclosed as Appendix B.

#### 4.3 Descriptive Statistics

The result of the descriptive statistic which is used for describing the data in the context of normality is presented in this section.

**Table 1: Descriptive Statistic on Firm Profitability and Dividend Policy**

	ROE	DPO	DVY
Mean	0.043913	4.124050	6.280189
Median	0.046609	0.067460	0.015434
Maximum	1.094442	73.52941	350.0000
Minimum	-3.943182	-0.074893	-0.005962
Std. Dev.	0.410524	13.92994	45.34702
Skewness	-7.899439	3.738422	7.473393
Kurtosis	77.68334	15.71743	56.90704
Jarque-Bera	28650.43	1070.044	15386.10
Probability	0.000000	0.000000	0.000000
Sum	5.181759	486.6379	741.0623
Sum Sq. Dev.	19.71797	22703.05	240593.2

Source: Researcher's Computations from E-View Version 9.0 (2019)

Observations	118	118	118
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Source: Researcher's Computations from E-View Version 9.0 (2019)

The results of the descriptive statistics shows that the data oscillate around the mean region as the values of the standard deviation are not too high and not far apart from the mean. DVY has the highest mean value while ROE has the lowest mean value. The highest ROE value for the firms examined is 1.094442 while the lowest ROE value is – 3.943182 implying that some of the firms examined made loss in the period under consideration. The results of the Jarque – Bera statistic revealed that the data were not normally distributed since the probability value of the Jarque-Bera statistic is not significant at 5% level of significance. However, we proceed with the analysis by relying on the method of analysis which is the panel least square to take care of the data error that may emanate from non-normality of the data.

**Table 2: Correlation Results on Firm performance and Dividend Policy**

Covariance Analysis: Ordinary

Date: 08/02/18 Time: 22:38

Sample: 2012 2019

Included observations: 118

Balanced sample (listwise missing value deletion)

Correlation Probability	ROE	DPO	DVY
ROE	1.000000 -----		
DPO	0.120261 0.1946	1.000000 -----	
DVY	0.071708 0.4403	0.450505 0.0000	1.000000 -----

Source: Researcher's Computations from E-View Version 9.0 (2019)

On the relationship between firm financial performance and dividend policy, DPO was found not to be significantly related with the firm financial performance using return on equity as a proxy for financial performance. However, this relationship was a positive one implying that the higher the dividend payout of firms the more the firm is likely to have higher financial performance. Also, on the relationship between financial performance and dividend yield in the banking sector in Nigeria, dividend yield was found not to significantly affect the firm financial performance. Also, their relationship is a positive relationship implying that the higher a firm's dividend yields the more the firm's financial performance.

**Table 3; Baseline Regression Results on Firm Financial Performance and Dividend Policy**

Dependent Variable: ROE

Method: Panel Least Squares

Variable	Coefficient t	Std. Error	t-Statistic	Prob.
C	0.029251	0.039472	0.741041	0.4602
DPO	0.003252	0.003055	1.064449	0.2894
DVY	0.000199	0.000939	0.212139	0.8324
R-squared	0.014848	Mean dependent var		0.043913
Adjusted R-squared	-0.002285	S.D. dependent var		0.410524
S.E. of regression	0.410992	Akaike info criterion		1.084611
Sum squared resid	19.42519	Schwarz criterion		1.155052
Log likelihood	-60.99204	Hannan-Quinn criter.		1.113212
F-statistic	0.866647	Durbin-Watson stat		1.618889
Prob(F-statistic)	0.423086			

Source: Researcher's Computations from E-View Version 9.0 (2019)

The baseline regression results revealed that the neither dividend payout ratio nor dividend yield significantly affect the firm financial performance of Nigerian banks. However, the signs of the coefficient for the two independent variables are positive



implying that an increase in the independent variable will cause a proportionate increase in the dependent variable.

#### 4.3.1 Statistical Criteria

To determine the statistical relevance of the regression result, diagnostic tests like the t-statistic, f-statistic, t-prob,  $R^2$  (coefficient of determination) and  $R^2$  adjusted shall be used.

**T-Statistic:** The t-statistic measures the individual significance of the independent variables on the dependent variable. It shows how the independent variables explain the dependent variable individually. The rule here is that when the value of the t-statistic is equal to or greater than 2, it is significant, otherwise, it is not significant.

**F-Statistic:** The f-statistic measures the joint significance of the independent variables on the dependent variable. The significance of the f-statistic can be obtained from the value of the f-probability.

**Coefficient of Determination:** The coefficient of determination ( $R^2$ ) measures the overall goodness of fit of the model. It measures the extent to which the variation in the dependent variable is accounted for by the variations in the independent variables. It is usually interpreted in percentages.

**$R^2$  Adjusted:** The  $R^2$  adjusted is similar to the coefficient of determination but in this case, it takes into consideration the degrees of freedom.

**T-Probability:** The t-probability, also known as t-prob, always agrees with the t- statistic. If the value of the t-prob is less than 0.05 at 5% level of significance, then it is significant, otherwise, it is not significant.

**Table 5: Random – Effect Regression Results on Firm Financial Performance and Dividend Policy**

Dependent Variable: ROE

Method: Panel EGLS (Cross-section random effects)

Variable	Coefficient t	Std. Error	t-Statistic	Prob.
C	0.029870	0.043498	0.686695	0.4937
DPO	0.003088	0.003234	0.954833	0.3417
DVY	0.000196	0.000933	0.209794	0.8342

#### Effects Specification

	S.D.	Rho
Cross-section random	0.070444	0.0289
Idiosyncratic random	0.408172	0.9711

#### Weighted Statistics

R-squared	0.011620	Mean dependent var	0.039463
Adjusted R-squared	-0.005569	S.D. dependent var	0.404706
S.E. of regression	0.405836	Sum squared resid	18.94086
F-statistic	0.676012	Durbin-Watson stat	1.665040
Prob(F-statistic)	0.510651		

#### Unweighted Statistics

R-squared	0.014815	Mean dependent var	0.043913
Sum squared resid	19.42584	Durbin-Watson stat	1.618548

#### Correlated Random Effects - Hausman Test

Equation: Untitled

Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.731528	2	0.6937

Source: Researcher's Computations from E-View Version 9.0 (2019)

The probability value and the Chi-Square value of the Hausman test revealed that the random-effect regression result is appropriate for interpretation. The regression results of the random effect revealed that none of the independent variables is statistically significant in determining the dependent variable. These variables however show positive relationship with the dependent variable. The values of the coefficient are not significant enough to cause major changes in the dependent variable. The value of the Durbin-Watson statistic of 1.618548 shows no evidence of serial correlation in the model used for the estimation.

#### **4.4 Test of Hypotheses**

##### **Hypothesis One**

For better understanding, the hypothesis is restated again as

Ho1: There is no significant relationship between financial performance (Return on Equity) and dividend payout ratio.

To test this hypothesis, we employed the coefficients of the t-statistics obtained in the regression result. From the regression results obtained, the value of the t-statistic corresponding to financial performance of firms using return on equity and dividend payout ratio with statistical value of 0.954833 (see table 5) which is highly statistically insignificant since it is less than 2. We therefore accept the null hypothesis and conclude that firm financial performance does not significantly affect the firm's dividend payout ratio in the Nigerian banking sector.

## **Hypothesis Two**

Ho2: There is no significant relationship between financial performance (Return on Equity) and dividend yield.

To test this hypothesis, we employ the coefficients of the t-statistics obtained in the regression result. From the regression results obtained, the value of the t-statistic corresponding to financial performance of firms using return on equity and dividend yield with statistical value of 0.209794 (see table 5) which is highly statistically insignificant since it is far lesser than 2. We therefore accept the null hypothesis and conclude that firm financial performance does not significantly affect the firm's return on equity and dividend yield in the Nigerian banking sector.

## **SECTION FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary of Findings**

From the empirical analysis of the data, we found that:

- i. Firm financial performance does not significantly affect the firm's dividend payout ratio in the Nigerian banking sector.
- ii. Firm financial performance does not significantly affect the firm's return on equity and dividend yield in the Nigerian banking sector.

#### **5.2 Conclusion**

Based on the findings from the analysis, we conclude that financial performance of firms in the Nigerian banking sector does not necessarily depend on the firm's dividend policy. Their financial performance therefore depends on factors other than dividend policy. This agree with theories of dividend policy that support what matters in the firm is not whether the firm pays dividend or not but that what matters most is the firms earning power at a particular point in time which may also be a function of its size in the context of their target market. Consequently, the firms positive net present value project, which will produce earnings for the firm will determine whether the firm will have enough resources for dividend payment or decide on dividend payout.

### **5.3 Recommendations**

We therefore recommend that:

- a. Since financial performance is not affected by dividend yield and dividend payout, investigations should be made to ascertain other factors that affect financial performance in the Banking sector.
- b. That firm should strive to maintain constant and healthy dividend policies. This could be attained by investing in projects that give positive Net Present Values, thereby generating huge earnings, which can be partly used to pay dividends to their equity shareholders.

### **5.4 Areas of Suggestion for Further Studies**

We suggest that future research may choose to focus their research on the effects of firm financial performance on dividend policy of other sectors of the Nigerian economy. And also, investigate the effect of variables other than dividend on firm's financial performance.

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