

DIVIDEND PAYOUT PATTERN: NIGERIA DEPOSIT MONEY BANKS IN PERSPECTIVE

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ABSTRACT: *Investors invest their money with the hope to have returns that could improve their welfare in future. Dividend is one of those expectations that investors hope to get as a result of their investment. A Company pays dividend in order to encourage further investment for growth. However, the degree and extent by which dividend is made depend on the organization management decision. There has been contradicting arguments on firms dividend payout ratio such as rightist, leftist and the middle of the road hypothesis on whether firms should pay dividend or not. Hence there has not been any conclusive study on the factors that determine the dividend growth pattern of Deposit Money Banks in Nigeria. It is this perceived gap that informs the empirical analysis of growth pattern of dividend payout of quoted banks in Nigeria. The study relies majorly on secondary data sourced from the financial report of seven (7) quoted banks in the Nigeria Stock Exchange. It was found that all the explanatory variables (inflation, share price and earnings per share) have significant impact on dividend payout. The study recommends that deposit money banks in Nigeria should improve on their performance so as to increase earnings which will go a long way in determining the Dividend Payout Pattern of their banks while government should makes both investment and production environment suitable for banks to produce locally and avoid much importation to control inflation.*

KEYWORDS: Dividend Payout Pattern, Banks, Investment, Inflation, Nigeria,

INTRODUCTION

A fundamental financial management decision which deposit money banks often have to make is the Dividend decision. This involves the determination of the percentage of earnings to retain and the proportion to distribute to shareholders which prompted many studies on dividend policy to focus on such areas as the relevance or irrelevance of dividend theory to the value of a firm and the determinants of dividend yield and dividend payout rate. Despite extensive debate and research, the actual motivation for paying dividends remains a puzzle.

Three opposing theoretical views have emerged all attempting to explain the variability in dividend policy of an organization. The first is the view of the rightists advocated by Gordon (1962) and Walter (1963). The rightists posit that a policy of paying out more cash dividends, all things being equal, will tend to increase the share price and value of a firm since rational investors are risk-averse and will prefer near dividends to future dividends. The second view is that of the leftists supported by Litzenberger and Ramaswamy, (1979 and 1982). The Leftists position is that a high dividend payout is bad since it tends to reduce the share price of a firm where dividends are taxed more heavily than capital gains. In-between the two extremes lies the middle-of-the-road party represented by Miller and Modigliani (1961). They maintain that the share price of a firm is not affected by its dividend payout policy. This is because as long as investment and borrowing policy are held constant, a firm's overall cash flows are the same regardless of payment policy. This is particularly true in a world without taxes, transaction costs and other market imperfections. These three schools of thought offer contradictory advice to banks. The rightists urge firms to pay high dividend because it increases the wealth of the shareholders. The leftist advice firms to pay low dividend since dividend is often taxed more heavily than capital gains. The middle of the road encourages firms to vary dividend payment since it does not matter whether dividend is paid or not.

Retained earnings are usually considered in practice, as the most significant source of long-term fund required to finance a firm's long-term growth. However, a firm is made up of a coalition of members with somewhat conflicting interests. Three members of the coalition are considered as the most prominent in a firm's dividend decision. These are the firm (itself), the owners (shareholders) and creditors (bondholders and others). This implies that a firm's decision to retain a large proportion of its earnings will adversely affect the two other coalition members. A high retention ratio will result in low payout ratio, which implies less current dividends. A high retention ratio will also imply lower net cash flow because of the relationship between dividend payment and cash flow. A lower net cash flow reduces a firm's solvency, that is, its ability to pay its debts as and when due. Thus a firm must strike a proper balance between these conflicting interests.

In Nigeria, early studies on dividend policy attempted to highlight the dividend policy pursued by Nigerian firms during the period of indigenization, Uzoaga and Alozienwa (1974); Eriki, (1976) and Jang, (1974). These studies fall short of utilizing the conventional dividend models in their investigation. Subsequent studies such as Oyejide (1976), Izedonmi and Eriki, (1996) and Adelegan, (2000 and 2001) have tested the application of Lintner's model and the modified Lintner-Britain model as adopted by Charitou and Vafeas (1998), in an attempt to explain the dividend policy of Nigerian firms at different periods. Most of these studies however, recognized the dynamic nature of the Nigerian economy and the need for further research in order to validate the conclusion that emanated from the studies.

The main objective of the study examined the determinants of dividend payout pattern of the deposit money banks in Nigeria. To achieve this objective, the following hypotheses has been formulated in null form and tested

- H₀: Earnings Per Share has no significant impact on dividend payout pattern of Deposit Money Banks in Nigeria.
- H₀: Share Price has no significant impact on dividend payout pattern of Deposit Money Banks in Nigeria.

H₀: Inflation has no significant impact on dividend payout pattern of Deposit Money Banks in Nigeria.

REVIEW OF RELATED LITERATURE AND THEORETICAL FRAMEWORK

Dividend policy is one of the most controversial subjects in the finance literature. The debate over the importance of dividend policy first appeared in the study of Miller and Modigliani (MM) (1961) who concluded that given perfect capital markets, dividend decision does not affect firm value and is therefore irrelevant. Most financial practitioners and many academics greeted this conclusion with surprise because the conventional wisdom at the time suggested that a properly managed dividend policy had a significantly positive impact on share prices and shareholders' wealth.

The term dividend in a general sense refers to cash paid out of current or accumulated profit. The term "distribution" is used for payment made by a firm to its owners from sources other than current or accumulated earnings (Ross *et al*, 1996). Dividend payment therefore involves cash outflow. Profits and cash flows vary overtime as is the case with investment opportunities. This could probably suggest that firms often vary their dividends overtime, increasing them when cash flows are large and the need for funds is low, and vice-versa. However, Lintner (1956) and later Fama and Babiak (1968) find that firms in practice focus on dividend changes than on absolute levels. Thus managers "Smooth" dividends and are reluctant to make dividend changes that might have to be reversed. Consequently, the level of dividends is more stable than the level of earnings. What this tends to suggest is that managers consider dividend stability as a desirable policy in practice. According to Pandey (1999) shareholders seem generally to favour this policy and value stable dividends higher than fluctuating dividends. Dividend stability generally refers to the payment of dividend for a long unbroken period, that is, regularity in dividend payment. Thus Pandey (1999) identified three forms of dividend stability viz: Constant dividend per share, constant payout, constant dividend per share plus extra dividend.

Constant dividend per share refers to the policy of paying a fixed amount per share on paid-up capital as dividend every year, irrespective of fluctuation in earnings. The dividend per share can be increased when a firm reaches new levels of sustainable earnings. This suggests that the policy can best be adopted by companies with stable profits. Firms with wide fluctuations in earnings may find this policy most unsuitable. According to Mainoma (2001) a stable per share dividend policy contains substantial information content for common shareholders, especially when a firm with fluctuating earnings maintains its payments during periods of reduced total earnings using dividend equalization reserve. This is because shareholders interpret the policy as an indication of a firm's ability to maintain high level of profitability and liquidity.

Constant Pay-out Policy involves payment of a certain constant percentage of earnings to the shareholders in each dividend period. Earnings fluctuate from period to period and, thus, this policy imply that dividend per share will also fluctuate. The problem with the policy is that if the firm's earnings drop or if a loss occurs in a given period, the dividends may be low or even nonexistent and would cause uncertainty to the investors.

Constant dividend per share plus extra dividend policy involves the setting of a high amount of dividend by companies with stable earnings and a minimum dividend per share with a step-

up feature by firms with fluctuating earnings. The high level or minimum dividend per share is fixed to reduce the incidence of dividend omission. This is usually followed by a payment of an extra dividend (such as an interim dividend) in periods of prosperity. The wisdom here is to prevent investors from expecting that the dividend represents an increase in the established amount (Pandey, 1999). A possible advantage of this policy according to Mainoma (2001) is that it enables a firm to pay regular dividend without default, and allows a great deal of flexibility for supplementing the income of shareholders only when there is an increase in the firm's earnings. Thus the extra dividend can be omitted without decreasing the regular dividend. A major drawback of this policy is that the shareholders may become used to the extras and always expect it. If the expectation is not met, some shareholders may choose to sell the shares which may result in a fall in market price per share.

The seminal study on dividend policy carried out by Lintner (1956) revealed that every firm, in practice, follows a particular dividend policy. The study further shows that firms consider the proportion of earnings to be paid out without recourse to their investment requirements. In other words, investment requirement is not a factor for modelling the dividend policy of firms. Hence firms generally have a long-run dividend payout ratio, which are usually smoothened in the process of determining dividend changes that follow shifts in long-run sustainable earnings.

Oyejide (1976) used a modified Lintner – Brittain model adopted by Charitou and Vafeas (1998) to demonstrate the applicability of Lintner's model to commercial banks in Nigeria. The study revealed that the Lintner type conventional models perform remarkable well in explaining the dividend policy of quoted firms in Nigeria.

A survey carried out by Ramesh and Pandey (1994) showed that the typical policy of most firms in practice is to retain between one-third and half of the earnings and distribute the remaining amount to shareholders. The Board of Directors (BODs) in this regard has a large degree of flexibility to decide on the proportion of earnings to pay as dividend.

The decision is by no means an easy one largely because of the alternative approaches to the establishment of dividend policy in practice. One of the important approaches used in establishing a dividend policy is the residual dividend approach. Under this approach, firms generally avoid new equity sales and rely heavily on internally generated cash flow to finance profitable projects. Dividend is paid only from the left over of cash after satisfying investment requirements. With this policy, the firm's objective as Ross *et al* (1996) indicate is to maintain its investment needs and its desired debt/equity ratio before paying dividend. Given this objective, the expectation is that firms will pay a high percentage of their earnings as dividend when investment opportunities are few and vice-versa. This approach is employed by both growing and matured firms.

Dividend decision can be considered as a passive decision variable based on the various dividend theories. Passive decision variable implies that, dividend is only to be paid out if a firm cannot make better use of its fund for the benefit of its shareholders. This implies that earnings are retained to the extent that they are required to finance a firm's optimal capital budget. Dividends are paid only if more earnings are available than are needed to support the capital budget. This is referred to as the "Residual theory of dividend" (Brealey and Myers, 1996). The problem with this theory as Block and Hirt (2000) and Mainoma (2001) indicate is that no consideration is given to shareholders feeling about dividend. The treatment of dividend policy as a passive residual determined by the availability of acceptable investment opportunities suggests that shareholders are indifferent to a firm's decision to pay dividend or retain earnings.

The residual theory also confuses a firm's dividend policy with its investment and financing policy. Miller and Modigliani (1961) criticized the theory that dividend policy affects the share price of a firm on the grounds that the proponents of the theory mixed up a firm's dividend decision with its financing and investment decisions. Where this occurs, it will be difficult to separate the impact of dividend policy from the impact of investment and financing policy. Brealey and Myers (1996) thus argue that a firm's dividend policy must always be isolated from other problems of financial management.

The pecking order theory posits that firms prefer internal finance. They adapt their dividend payout ratios to their investment opportunities, while trying to avoid sudden changes in dividends. Where there is fluctuation in profitability and investment opportunities, the internally generated cash flows, could be greater than or less than capital expenditure. If it is more, the firm will pay off its debt or invest in short-term marketable securities. If it is less, the firm drawdown its cash balance or sell off its short-term marketable securities. However, if the firm must resort to external financing it starts with debt, then possibly hybrid securities such as convertible bonds, and then equity as a last resort. The pecking order theory assumes that debt ratios change when there is an imbalance of internal cash flow, net of dividends and real investment opportunities. Thus highly profitable firms with limited investment opportunities try to maintain a low debt ratio while firms whose investment opportunities outrun internally generated funds are driven to maintain a high debt ratio. The pecking order theory can be considered in terms of the constant growth stock valuation model.

METHODOLOGY AND MODEL SPECIFICATION

The study utilized both quantitative and descriptive research approach for the purpose of addressing the problem of the research. Quantitative research approach was used because the variables investigated are amenable to empirical measurement and verification. In addition, the study places emphasis on statistical data. Twenty (20) licensed deposit money banks operating in Nigeria as at 31st December, 2013 formed the population for the study of which seven (7) banks were selected based on Yamane (1967) sampling model as adjusted by Smith (1983) to justify the sufficiency of the sample size of seven (7) banks from the population of 20 banks. The formula applied is given as:-

$$n = \frac{N}{3 + N(e)^2}$$

Where 3 = adjusted constant value smith (1983)

N = Population size

e = level of precision (significant level)

n = sample size

The seven (7) banks selected through simple random sampling techniques are: Access Bank Plc., First Bank Nig Plc., Gtbank Plc., Union Bank Nigeria Plc., United Bank for Africa Plc., Wema Bank Plc. and Zenith Bank Plc. The study employed Statistical Packages for Social Science (SPSS) version 20 for its data analysis. Multiple regressions have been used to estimate the effect of independent variables (Earnings Per Share, Share Price and Inflation) on

the dependent variable (Dividend Payout Pattern). The technique of least Squares has been used to estimate the regression coefficient in the model of the study. Thus:

$$DPP = \beta_0 + \beta_1 EPS + \beta_2 SP + \beta_3 IF + e$$

Where: DPP = Dividend Payout Pattern

β_0 = intercept

EPS = Earnings Per Share

SP = Share Price

IF = Inflation

E = error term

RESULT AND DISCUSSION

The results of multiple regression in relation to the effect of Earnings per Share, Share Price and Inflation on dividend payout pattern of deposit money banks in Nigeria are presented in table below.

Dividend Payout Pattern of money deposit banks in Nigeria.

Variables	Dividend Payout Pattern
Intercept	0.000 (-5.23)
EPS	0.016** (2.693)
SP	0.038** (2.267)
IF	0.014* (2.772)
R	0.93
R ²	0.87
Adj. R ²	0.84
F. Sig.	0.000
Durbin Watson	2.4

Source: Regression Result Using SPSS

The estimated relationship for the model is

$$DPP = -5.23 (\beta) + 2.693 (EPS) + 2.267 (SP) + 2.772 (IF)$$

The model indicates that all the independent variables are significant in determining dividend payout pattern of Nigerian money deposit bank. First, the regression result in table above reveals that earnings per share as an explanatory variable has explained the variations in the dividend payout pattern of Nigerian deposit money banks. The t-value of 2.693 signifies that for every ₦ 2.70k increase in earnings per share, dividend increases with ₦1. However, the result shows that earnings per share is significant on the dividend payout pattern of Nigerian deposit money banks at 5% level of significance. This provides evidence of rejecting the hypothesis one (H₀₁) of the study.

Secondly, the regression result also reveals that the share price as one of the independent variables influences the changes in the Dividend Payout Pattern of Nigerian deposit money banks in Nigeria. The implication is by the time the price of Nigerian deposit money banks shares fluctuates the dividend to shareholders also changes. It is also discovered that the Share Price is significant at 5% level of significance which produces another evidence of rejecting hypothesis two (H_{02}) of the study.

Thirdly, the result produces evidence that inflation is significant at 5% level of significance on the Dividend Payout Pattern of Nigerian deposit money banks. The implication of this result is that the higher the inflation the more banks declare dividend for its shareholders.

Finally, the combined effect of the determinants of Dividend Payout Pattern of Nigerian deposit Money banks is indicated in the model summary of the regression result. The combined relationship between the dependent and independent variables of the study is 93% which implies strong positive and significant relationship. While the coefficient of determination R^2 0.87 shows that Earnings Per Share, Share price and Inflation determines Dividend Payout Pattern in Nigerian deposit money banks of up to 87% and the remaining 13% is covered by other factors. The R^2 indicates the variance of dependent variable which is explained by the available independent variables in the regression model. The Durbin-Watson value of 2.4 implies a complete absent of serial correlation within the period of the study.

The study suggests that, the higher the current earning the higher the dividend that may be paid. As earnings increases, it improves cash flow and enables a firm to pay more dividends. This supports the findings of Bhattacharya & Pandey (1999). This study has also confirmed that not only does dividend payout determine market value or price of the shares of Deposit Money Banks in Nigeria, but determines their dividend growth. The implication of this finding is that shareholders have an expected rate of return on their investment. These investments are represented by the market price of their investment at any point in time. They therefore expect dividend to increase as the market price of their shares increase in order to meet the expected rate of return on investment.

Consequently, this study has also identified inflation as a major determinant of dividend payout pattern in Deposit Money Banks in Nigeria. Finally, Nigerian shareholders would expect higher dividend as the value of currency diminishes as a result of inflation. This explains why Banks in Nigeria continue to increase dividend payments as the value of the naira diminishes.

CONCLUSION AND RECOMMENDATIONS

The findings of the research are based on the time series data collected for the period 1993 to 2012 from the seven DMBs in Nigeria. The result of the study reveals that the three predictor variables- Earnings Per Share, Share Price and Inflation have an aggregate significant effect at 1% level of significance on the Dividend Payout Pattern of Deposit Money Banks in Nigeria. This produces evidence of rejecting all the hypotheses of the study stated in null form. The study also reveals that Inflation has the highest determining ability of the Dividend Payout Pattern of Nigeria deposit money banks followed by Earnings Per Share and then the Share Price.

The study concludes that there is a complete absence of multi co-linearity between Earnings Per Share, Share Price, and Inflation as determinants of Dividend Growth Pattern of DMBs in

Nigeria. Also, the correlation matrix reveals that, Inflation has the highest relationship with the Dividend Growth Pattern then followed by Earnings Per Share before Share Price.

The study therefore recommended that deposit money banks in Nigeria should improve on their performance so as to increase earnings which will go a long way in determining the Dividend Payout Pattern of their banks. The management of the banks should also modernize their services towards customers' satisfaction to increase turn over and profitability as this will go a long way in attracting investors in which the shares prices of the banks are expected to rise and favourably determine the Dividend Payout Pattern of the banks. Government should make both investment and production environment suitable for companies to produce locally and avoid much importation to control inflation as this will make Dividend Payout Pattern of Nigerian banks to be favourable.

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APPENDIX

Aggregate Values of Dependent and Independent Variables

YEARS	DEP/VARIABLE DGP(M) ₹	INDEPENDENT VARIABLES		
		EPS(M) ₹	SP(M) ₹	IF (%)
1993	1.20	2.73	18.50	5.40
1994	1.63	4.23	18.50	7.50
1995	2.31	6.01	14.50	5.08
1996	3.00	5.82	17.50	6.84
1997	4.75	4.87	26.00	5.71
1998	6.63	6.09	13.50	8.01
1999	1.80	4.76	13.50	7.28
2000	2.85	5.00	13.50	6.87
2001	2.80	7.11	13.50	5.99
2002	2.63	5.31	14.31	7.86
2003	3.10	5.00	18.00	6.62
2004	4.72	6.04	13.50	6.94
2005	6.62	7.43	14.31	7.88
2006	4.50	6.08	19.00	6.33
2007	1.72	5.41	15.75	5.91
2008	2.8	4.88	15.0	6.02
2009	2.0	6.02	13.0	5.98
2010	5.0	10.61	17.31	8.24
2011	13.0	11.61	21.66	10.22
2012	14.61	12.88	23.98	12.14

Source: NSE fact Book 2013 and CBN Bulletin 2013