CRITICAL EVALUATION OF THE DETERMINANTS
OF DIVIDEND POLICY OF BANKING SECTOR IN NIGERIA

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Abstract

This study is aimed at critical evaluation of the determinants of the Dividend Policy of Nigerian Banks. We have based this study on panel data of selected Banks that are listed on the Nigerian Stock Exchange (NSE) having financial data for the 2008 to 2013 that was covered in the study. The appropriate diagnostic test on the data was conducted using the data Skewness and Kurtosis test of the data distribution normality while the relationship between the variables was tested using the panel least square regression analysis , however robustness of the result was confirmed with the correlation analysis. Dividend payment is positively related with leverage, performance, corporate governance and last year dividend while it is negatively related with firm's liquidity. This study confirm the relevance of the Agency theory to the Banks Dividend Policy while the future dividend can be predicted based on the current dividend.

Keywords: Dividend Policy, Leverage, Performance, Corporate Governance and Liquidity

INTRODUCTION

This study is aimed at a critical evaluation of the Dividend Policy of the banking sector of the Nigerian economy taking cognisance of the application of relevant theories to Nigerian Banks. The vitality of the Banking Sector of the Nigerian Economy derives from its been the second largest after the Oil Sector. Its Corporate and Investor characteristic therefore deserves all the attention this subject matter is getting from this research efforts. However this study will unveil the basic features of dividend policy of Nigerian Banks.

The primary objective of a business organisation is to provide goods and services that will meet the needs of its consumers. The attainment of consumer satisfaction in addition to an efficient production process will result into profit that could either be re-invested into the business or distributed to the share holders. Zameer et al (2013) described dividend policy as the process relating to the amount and how profit is distributed amongst the owners of a company.

Dividend Policy has attracted the attention of researcher in corporate finance due to the sensitive nature of the subject because of the importance of the share holders expectation and the need to meet these expectations so as to reducing the conflicts between the firms stakeholders, this could be inform of a conflicts of interest between the business owners and the Managers . Despite the amount of academic discus on Dividend Policy, it still remain a puzzle because it was observed that there are significant differences between the Dividend Policy of different countries, this is based on the fact that countries were are faced with different tax systems, rules, regulations, capital market and different regulatory institutions. These basic differences makes it important for the Dividend Policy of Nigerian banks to be investigated and help to contribute to the current knowledge on the subject.

The study is aimed at investigating the basic determinants of dividend policy of Nigerian banks based on the established theoretical framework and the relevance of the various dividend policies such as the Residual Policy, Dividend irrelevance theory, Bird in hand theory, Dividend signalling and information asymmetry theory, Tax preference theory, Agency theory and Pecking Order theory.

This researchers has observed that the study on the Dividend Policy of Banks has been very scanty, this is probably because of the nature of the financial structure of banks. We are however of the opinion that this sector must not be ignore, particularly in emerging economies like Nigeria because its significance and contribution to it.

This study is divided into six sections, this section is the introductory part of the study , section two will deal with the statement of the objectives of the study, section three will aim at the review of relevant literature, section four will be the methodology and the research design,

section five is the analysis and discussion of findings while section six is the conclusion of the study.

Objectives of the Study

1. To evaluate the determinants of Dividend Policy of Nigerian Banks
2. To critically appraise the application of existing theories to Nigerian Banks.
3. To develop a dividend policy framework for Nigerian Banks

LITERATURE REVIEW

Dividend policy has attracted tremendous attention recently. This attention was triggered by the work of Modigliani and Millers (1961) when they concluded that the value of the firm depends on the firms cash flow and that the value of the firm is independent of the dividend payment. The dividend irrelevance theory was based on the assumption of the existence of a perfect financial market with no transaction cost, no bankruptcy cost, no tax effect and with the existence of investors that act rationally. They observed that if all investors have same information and opportunity, the effect of information asymmetry is eliminated. They concluded based on the perfect financial market assumptions that dividend policy has no impact on the value of the firm nor the firms cost of capital.

Contrary to the postulation of the dividend irrelevance theory, Gordon (1959) stated that investors are risk averse, that they will rather prefer dividend payment now than future capital gain. He concluded that capital policy affect the value of the firm. This led to the formulation of the Bird in hand theory. Bird in hand theory state that the investors prefer cash payment instead of future growth. He observed further that dividend paying firms are considered profitable firms which will affect their valuation and access to fund in the capital market.

Residual policy is a theory that states that firms will only pay dividend from the balance of the firm's earning after all project with positive net present value (NPV) have been financed. This theory assumes that the manager will continue to invest; therefore, divided policy is not relevant. This policy is adopted by firms that rely on internal fund and believe that the firm will save the floatation cost and other cost associated with issue of stock or debt. Zameer et al (2013) observed that managers believed that this policy with associated high retention will facilitate high growth to the firm.

Modigliani and Miller (1961) in a follow up study to the dividend irrelevance theory observed that divident could have a signalling effect, and that change in the dividend payout transmit information to the investors and the market. It was argued that a reduction in dividend

payout will send a negative signal to the market leading to a decrease in the value of the firm's shares. This was supported by Jacklin and Bhattacharya (1988).

Berman (1977) observed that tax is an important factor that is considered by investors in the consideration of dividend policy. He stated that cash dividend is taxed at higher rate than capital gain. Therefore he concluded that capital gain is preferred by many investors instead of cash divident to avoid high tax rate.

Jensen (1986) suggested that dividend payment could be used to reduce the agency problem when he argued that dividend payment would reduce the amount of cash that is available to be managed by the management of the firm. This was supported by Easterbrook (1984) when he observed that dividend payment will reduce the cash flow of the firm, the firm will then be forced to approach the capital market with associated restrictions for the finance of the project.

Zameer et al (2013) observed that the existence of excess cash flow will lead to agency problem because they believed that the excess cash flow could make managers to invest on project with zero net present value (NPV) or even on project with negative net present value and they could get involve in empire building while the cash could be used for their comfort and leisure. This was supported by Dang (2013) when he argued that a firm could pay dividend as a deliberate act to reduce the cash flow of the firm and to reduce the agency problem of the firm.

Pecking order theory was the product of the studies by Myer (1984) and Myer and Majluf (1984) when it was observed that a firm prefer internal finance instead of external finance. They stated that the firm will exploit the use of internal financing before the consideration of the external sources. External financing is considered only when the company did not have enough fund from the internal sources.

The implication of the pecking order theory is that the firm will finance its project using retained earning rather than payment of dividend to the shareholders since internal financing of project will increase the value of the share and the share holders wealth.

Dang (2013) observed that zero leverage firms can be classified based on their dividend payment. He classifies them as dividend payer and non-dividend payer. He concluded that each of these classifications have different motives to have eschewed debt, the non dividend payer could be as a result of financial constraint and lack of cash flow to support such payment while the payer could deliberately have zero leverage to avoid investment distortion and to reduce the agency problem faced by the firm.

Pruitt and Gitman (1991) observed that profitability , both current and previous years profit have significant impacts on the dividend policy of firms , as it was measured in term of dividend payment. This observation supported the findings of Linter (1956) and Baker et al

(1985) when they argued that profitability have positive effect on dividend payment and the firm's dividend policy.

Rodriguez-pose and Gill (2005) observed a positive relationship between dividend payout and firm's profitability. This was supported by the study of Kohli et al (2011) when he used the return on asset as a measure of firm's profitability. Sheikh and Wang (2011) in the study of Greek banking industry observed that current year dividend is not determined by last year's dividend and they concluded that due to high volatile nature of banking industry, the dividend payout is not affected by the firm's performance.

Obenbe et al (2014) in a study of non-financial firms in Nigeria, observed that profitability is an important determinant of the firm's dividend policy. They however concluded that profitability have a positive and significant impact on the dividend policy of Nigerian firms.

Mirza (2014) observed that liquidity plays a significant role on the dividend policy of a firm, he however suggested that the extent of the impact of cash flow on the dividend payout vary from one country to another. This result was consistent with the finding of Pappadopoulos and Dimitrios (2007) when they concluded that the cash flow is the most important determinant of a firm's dividend policy. Zang and Fu (2014) observed that ownership structure and profitability are the most important determinant of dividend yield and that the size of the firm has negative effect on the dividend policy.

This study is aimed at bridging the observed gap that is due to the exclusion of banks in most of the recent studies in corporate finance because of the special nature of bank finance, as a result of the observed gap, we have isolated the Nigerian Banks in this study.

METHODOLOGY

Sampling and Data Collection

This study is based on the data of Banking Institutions listed on the Nigerian Stock Exchange for the period of ten years between 2003 and 2012. The primary source of data is Orbis database while the Annual Reports of the banks provide good alternative where some data are missing.

We have ensured that only Banks with continuous data for the period covered in the study are included while Banks with incomplete data and non dividend payment banks are removed from the study to avoid the distortion their inclusion could bring into the study

Research Design and Model Development

A research model was formulated to illustrate the relationship between the dependent and the independent variables. This relationship is determined using OLS regression with the

application of Eviews econometrics software. The goodness of fit of the data and distribution normality is tested with the measure of Skewness and the Kurtosis while the robustness of the analysis is tested with the conduct of Hausman test.

The regression model is formulated as follows using the fixed effect model.

$$Div_{it} = \alpha i + RXit_{-1} + Et \quad ....(i)$$

Div_{it} is the dividend payout for the current period.

$RXit_{-1}$ is the vector of the firm's features that affect its dividend policy , these are the independent variables.

The dividend per share will be regressed against the independent variables, these is illustrated in the equation below.

$$Div_{it} = \alpha i + \beta_1 Prof_{t-1} + \beta_2 Size_{t-1} + \beta_3 Div_{t-1} + \beta_4 Liq_{t-1} + \beta_5 Bcomp_{t-1} + \beta_6 Lev_{t-1} + Et \quad ....(ii)$$

Where ,

Div is dividend payout

αi is the constant coefficient

β_1 is the regression coefficient of the independent variable that explain the relationship between dependent and the independent variables.

The table below illustrate the variables specification, their proxy and how they are measured in this study.

Table 1: Variable specification and measurements

Variables	Proxy	Measurement
Dividend payout	Div	Dividend pay-out ratio
Profitability	Prof	EBIT / Total Assets (ROA)
Size	Size	Natural log of total assets
Last year Dividend	Div_{t-1}	Last year Dividend pay-out ratio
Liquidity	Liq	Ratio of Current Assets to Current liabilities
Ownership Structure	Bcomp	Ratio of independent directors to total board of directors
Leverage	Lev	Debt to assets ratio (Total debt/Total Assets)

The hypothesis was generated based on the review of the empirical studies and the popular findings were adopted for this study.

H1 : There is positive relationship between profitability and dividend payout

H2 : There is positive relationship between last year dividend and dividend payout

H3 : There is positive relationship between liquidity and dividend payout

H4 : There is positive relationship between ownership structure and dividend payout

H5 : There is negative relationship between leverage and dividend payout

ANALYSIS AND DISCUSSION OF FINDINGS

This study applied different estimation techniques to evaluate the determinants of dividend policy of Nigerian Banks, particular attention was on the use of both the correlation and the regression analysis based on the derived fixed effect model for the establishment of the relationship between firm's dividend policy and the observed independent variable . This will lead to the formulation of functional model of the dividend policy of Nigerian Banks.

Table 2: Descriptive Statistics

	DIV	LEV	LIQ	EPS	BCOMP	AGE	DIV_1
Mean	0.441484	0.852533	0.137192	58.15012	0.255014	30.79518	0.447047
Median	0.353900	0.861766	0.131050	57.00000	0.166667	24.00000	0.369400
Maximum	5.445900	1.402119	0.318700	830.0000	0.411765	69.00000	5.445900
Minimum	-1.897800	0.086695	-0.197300	-2018.000	0.125000	3.000000	-1.897800
Std. Dev.	0.886161	0.150815	0.076874	302.6321	0.113830	18.28818	0.881397
Skewness	3.679428	-1.479467	-1.029104	-4.725370	0.179571	0.831616	3.723282
Kurtosis	20.19804	15.48979	7.444969	32.44353	1.271451	2.526601	20.54136
Jarque-Bera	1210.158	569.7605	81.97940	3306.990	10.77916	10.34197	1255.897
Probability	0.000000	0.000000	0.000000	0.000000	0.004564	0.005679	0.000000
Sum	36.64319	70.76024	11.24972	4826.460	21.16618	2556.000	37.10490
Sum Sq. Dev.	64.39308	1.865094	0.478677	7510066.	1.062492	27425.52	63.70251

Table 2 above show the descriptive statistics that illustrate the basic features of the data representing the variable both the dependent and the independent variables to determine the appropriateness of the data and the relationships to be measured. The mean dividend was 0.441484 with a median of 0.353900 which indicate that the average dividend payout ratio is 0.35 or 35% of profit is paid as dividend . The mean leverage was 0.852533 that mean that leverage constitute 85% of the Banks capital structure. Average liquidity was 0.137192 that can be considered to be very low, the low liquidity was due to the special financial structure of banks and the impact of deposit liability. Average EPS was 58.15012 which seem to be very high show the profitability of the Banks during the study period. Bcom a measure of corporate governance was 0.255014 that mean the proportion of independent Directors is 26%, while the average age of Bank considered was 31years.

The test of normality that illustrated the appropriateness of the data distribution for the study is done using the values of the skewness and the Kurtosis, using the data above it was observed that the value of the skewness indicate that the data distribution is appropriate for the study .

Table 3: Regression table showing the Dividend payment
and other independent variables

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.017342	0.692648	0.025037	0.9801
LIQ	-0.112620	1.381532	-0.081518	0.0352
LEV	0.152846	0.716842	0.213222	0.0317
EPS	0.248541	0.206329	1.204588	0.0321
BCOMP	0.062501	0.929737	1.142797	0.2568
AGE	-0.002664	0.006427	-0.414437	0.6797
DIV_1	0.257451	0.112025	2.298155	0.0243
R-squared	0.393727	Mean dependent var		0.442363
Adjusted R-squared	0.321225	S.D. dependent var		0.891578
S.E. of regression	0.882065	Akaike info criterion		2.668399
Sum squared resid	58.35293	Schwarz criterion		2.873851
Log likelihood	-102.4044	Hannan-Quinn criter.		2.750885
F-statistic	1.292757	Durbin-Watson stat		2.226441
Prob(F-statistic)	0.070952			

Table 3 above show the relationships between the dividend payment and the observed determinants using the panel least squares regression method. The value of R-squared is 0.393727 which indicate that 39% of any change in the independent variable can only be explained by the independent variable, this can be considered good for the study especially when the values of the F-statistic and Probabilities were considered.

There is a positive and significant relationship between Dividend payment and earnings per share as a measure of the firm's profitability therefore hypothesis 1 should be accepted. This result is consistent with the studies by Rodriguez-pose and Gill (2005), Kohli et al (2011), Zang and Fu (2014) and Obenbe et al (2014). However it is contrary to the finding of Sheikh and Wang (2011).

Last year Dividend also have positive impact on dividend payment which is compatible with the findings of Pruitt and Gitman (1991), Linter (1956) and Baker et al (1985) . Based on the above observation hypothesis two is therefore accepted.

It is observed that Dividend payment and Liquidity were negatively related and statistically significant, this is consistent with the finding of Pappadopoulos and Domitrios (2007) and that of Mirza (2014). This result confirmed the relevance of the concept of Agency theory to the determination of dividend policy therefore hypothesis three is rejected.

The ownership structure and Dividend payment is positively related though not statistically significant indicating a weak relationship, this result supported the finding of Zang and Fu (2014) therefore the hypothesis on ownership structure is accepted.

There is a positive and significant relationship between the firm's leverage and the Dividend payment support the fact that leverage stimulate the firm profitability due to the tax effect ,this is based on the revised study of Modigliani and Miller (1961) though this finding is contrary to the postulation of Pecking order theory of Myer and Majluf (1984).

CONCLUSION

Dividend policy has become a topical issue that have attracted the interest of numerous researcher. However this study of on the determinants of dividend policy of on banking industry is considered unique because of the limited research on this sector due to the special nature of the capital structure of the Banks, therefore we realised the need to isolate the sector for this particular study more so when we considered the importance of this sector to the economy in term of its contribution to the GDP.

We observed that the firm's profitability and the last year Dividend were the most important determinants of Dividend policy of Banking industry in Nigeria. This could result from fact that profitable firms payout dividend based on the Agency theory and for avoidance of agency problem and the consideration of the signalling effects. This payment also confirm the fact that the investors prefer dividend payment rather than future growth that is in support the Bird in hand theory.

In a related development, positive relationship between Dividend payment and the last year dividend show that Banks are conscious of the signalling effect of any change in dividend payment therefore the firms tend to avoid the negative signal a reduction in Dividend payment could have on the value of the firm. This confirms that current Dividend could be relevant for the prediction of the Dividend policy of Banks and the future dividend of the firm. This will help the investor to take more appropriate investment decision.

The main limitation of this study is the reduced sample size as a result of the 2011 Banking reform in Nigeria. This reform lead to merger and acquisition of some Banks which accounted for the exclusion of these banks because the affected Banks lack complete data for the research period.

The relationship between the age of the firm and Dividend payment could not be established in this research, this could be a subject for further studies that could also include other variables not included in this study.

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