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Dividend Payout Ratio and the Financial Performance of Deposit Money Banks in Nigeria

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ABSTRACT

This study examined the effect of dividend payout on the financial performance of selected listed deposit money banks in Nigeria from 2007 to 2016. The study randomly selected ten (10) banks listed on the Nigeria Stock Exchange and obtained data from the annual reports of the banks from 2007 to 2016. The data extracted were analyzed using the pooled ordinary least square method of regression, descriptive analysis and correlation analysis. 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. For the first model, the dependent variable (EPS) shows that $R^2 = 0.57$ (57%) and the adjusted $R^2 = 0.50$ (50%) this shows that 57% and 50% of the total variation in the dependent variable is explained by the independent variables (leverage, growth, bank size, board size). The p-value of dividend payout ratio is 0.000000; the model therefore shows that there is a significant relationship between firm performance and dividend payout variables. The result found that there was a positive and insignificant relationship between bank size and earnings per share. While the second model, the dependent variable (Tobin Q) shows that $R^2 = 0.394463$ (39%) and the adjusted $R^2 = 0.294728$ (29%) that the independent variables are not sufficient enough to explain the dependent variable. The study finds that the p-value is 0.000034; the model therefore shows that there is a significant relationship between firm performance and dividend payout variables. The study found that there was a positive and insignificant relationship between Tobin Q and the independent variables; dividend payout and board size. The study therefore recommends that banks with riskier and higher profits should adopt a low dividend payout ratio. They should plough back a major proportion of the profit into the bank in order to retain capital for future investment.

Keywords: Dividend, Financial performance, Leverage, Board size, Earning per share

INTRODUCTION

The decisions of banks regarding its dividend payout focuses on deciding if the bank should distribute its entire profit to its shareholders or hold back some portion of it as retained earnings for the purpose of reinvesting it into the operations of the bank. Mizuno (2007) argues that a firm ought to pay dividends to shareholders if it cannot identify suitable investments which would bring higher returns than those expected by the shareholder. Firms that are seen to be performing well generate high profits. There are tendencies for banks to reinvest such profit into the business based on the residual dividend theory.

Dividend can be seen as the amount a firm is expected to pay its shareholders as a return on their investments. According to Brigham and Houston (2009), dividends are company's gains which are to be distributed to shareholders over a fixed period of time. Dividend payout ratio is the fraction or portion of the firm's profit paid to its shareholders as dividends. The dividend payout policy and the bank's decision to either pay or not to pay dividend during a financial year is one of the major component of corporate policy. Dividend payout policy issues have been of a great concern in both developing and the developed countries around the world. Enekwe, Nweze, and Agu (2015) opined that although the dividend payout of firms is not only the source of cash flow to the shareholders, it gives information to potential investors and shareholders regarding the current and future performance of the firm. According to Wanjiru (2014), dividends are relevant because they have informational value. The financial signaling theory asserts that dividends maybe used to convey information. Information, rather than dividend itself, affects share prices. Brealey and Myers (2008) viewed dividend policy controversy as one of the major unsolved problems of corporate finance which deserves more research in order to increase understanding of the subject. On the other hand, when a firm announces cash dividend it means that the company have less investment plan. And as such there will be need for dividend to be paid (Arumba, 2012).

Many scholars have attempted to solve the many issues relating to dividends. Marfo-Yiadom and Agyei (2011) find the determinants of dividend policy of banks in Ghana to include profitability, leverage, growth, collateral capacity, age and changes in dividend. Murekefu and Ouma (2013) studied on a survey of the relationship between dividend payout and firm performance in listed companies in Kenya and concluded that dividend payout affects firm performance and that this relationship is strong and positive. Zaman (2013) examined the determinants of dividend policy of a private commercial bank in Bangladesh. In Nigeria; few empirical studies have been done to establish the effect of dividend payout ratio on firm's performance. Masdiah and Hamid (2015) examined the impact of performance on dividend payout ratio of some selected deposit money banks in Nigeria. The findings revealed that dividend payout ratio is negatively related to banks' leverage and profitability. Uwuigbe (2013) investigated the determinants of dividends policy in the Nigeria stock exchange market. The study in its findings observed that there is a significant positive relationship between firms' financial performance, size of firms and board independence on the dividend payouts decisions of listed firms in Nigeria.This study fills the gap by establishing the effect of dividend payout ratio on the financial performance of selected listed Deposit Money Banks.

Research Objectives

The major objective of this study is to investigate the possible impact of dividend Payout Ratio on the financial performance of deposit money banks in Nigeria. Other objectives include:

1. To determine the effect of dividend payout ratio on market performance of listed Deposit Money Banks in Nigeria.
2. To determine the effect of dividend payout ratio on financial performance of listed Deposit Money Banks in Nigeria.

Research Questions

This study sought to answer the following research questions:

1. What is the effect of dividend payout ratio on the market performance of deposit money banks in Nigeria?

What is the effect of dividend payout ratio on the financial performance of deposit money banks in Nigeria?

LITERATURE REVIEW AND CONCEPTUAL FRAMEWORK

According to Brigham and Houston (2009), the dividend policy of a firm depends on the willingness of investors to forgo the amount of dividend they are to be paid now for future returns and their perception of the risk which is associated with the dividends postponed. Management should only retain income when they can reinvest those retained earnings at higher rates of return than the shareholders can earn themselves.

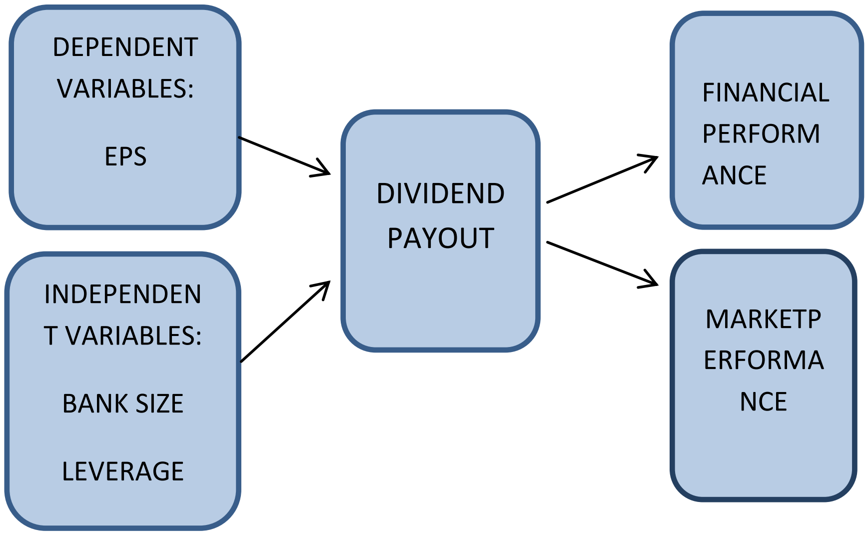

Figure 1: Conceptual framework of Dividend payout and Bank's performance
Source: (By the Author, 2017)

Theoretical Review

On the relationship between dividend and the performance of banks, different theories have been advanced. Some of the major different theories of dividend in financial performance are as follows; signaling theory, Bird in hand theory, Tax Effect theory, Clientele theory and Modigliani and Miller's irrelevance theory.

Signaling Theory

The signaling theory suggests that dividend policy can be used as an information communication device to communicate about a firm's future prospects to investors. According to Rachid and Wiame (2016), the intuition which underlies this argument is based on the information asymmetry between managers (insiders) and outside investors, where managers have private information about the current and future fortunes of the firm that is not available to outsiders. Aruma, (2014), observed that dividend announcements by a firm communicate valuable information, and also shows that when the announcement of dividend increases, the market reacts positively (significant increase in stock prices), and the market reacts negatively when the announcement of dividend decreases (significant drop in stock prices). An increase in dividend reduction produces a decrease in share price which is mostly contrary to M&M model that shareholders do indeed prefer dividend to future capital gains. The change in dividend payment is to be interpreted as a signal to shareholders and investors about the future earnings prospects of the firm (Hamid, 2015). Rachid and Wiame (2016) opined that it is only the good-quality firms can send signals to the market through dividends and poor quality firms cannot mimic these because of the dissipative signaling cost.

According to Amidu (2007), dividends have less risk than capital gains because of the uncertainty of capital gains. Therefore, investors would prefer dividends to capital gains. Dividend policy has a positive impact on a firm's value since dividends paid tend to increase the firm's value. Where there is uncertainty and imperfect information, issue arises and we find dividends and retained earnings not being valued the same which leads to investors preferring the "bird in the hand" of cash dividends rather than the "two in the bush" of future capital gains (Al-Malkawi, Rafferty and Pillai, 2010).

Yinka,(2017) suggested that every investor's portfolio choices might by influenced by certain market imperfections such as different tax rates and transaction costs According to Rachid and Wiame (2016), investors will invest only in companies which have dividend policy consistent with their special desires, requirements and conditions. Thus, a firm that pays no or low dividends should not be penalized for doing so, because its investors do not want dividends. Ongeri, (2014) stated that different shareholders have different income levels. Most retired individuals or those who do not have a regular source of income or low income earners prefer firms that have a high dividend payout. Such investors are usually in zero or low tax bracket hence taxes are of no concern to them. They also view such regular dividend payout as a source of regular income to take care of their immediate consumption or needs.

According to Rachid and Wiame (2016), Litzenberger and Ramaswamy presented three major reasons why investors might prefer lower payout companies. Firstly, long-term capital gains allow the investor to defer tax payment until they decide to sell the stock unlike dividend. Secondly, up until 1986 all dividend and only 40 percent of capital gains were taxed. The tax-effect theory hypothesizes that low dividend payout ratios lower the cost of capital and increase the stock price of a firm since the low dividend payout ratios lead to maximizing the firm's value (Al-Malkawi, Rafferty and Pillai, 2010). This argument is based on the assumption that dividends and capital gains are taxed differently (dividends higher than capital gains).

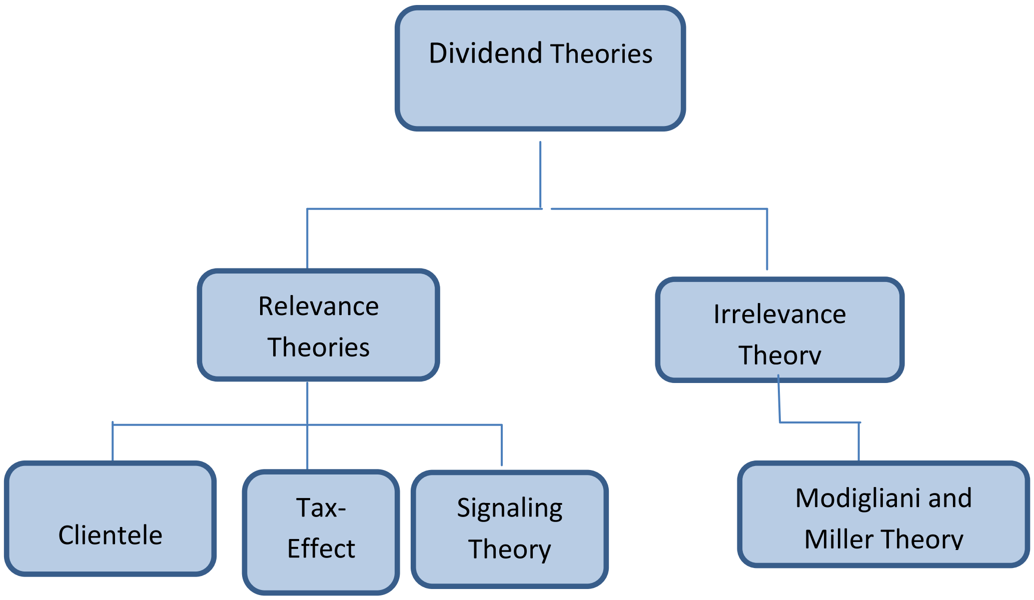

Figure 2: Dividend Theories
Source: (By the author, 2017).

Empirical Review

Dividend policy has been analyzed for many decades, but no universally accepted explanation for companies' observed dividend behavior has been established (Agyei and Marfo-Yiadom, 2011). Agyei and Marfo-Yiadom (2011) examined the relationship between dividend policy and performance of banks in Ghana. The study used panel data constructed from the financial statements of 16 commercial banks in Ghana for a period of 5 years, from 1999-2003. These financial statements were obtained from the Banking Supervision department of Bank of Ghana. STATA was used for the data analysis. The result of the study indicates that banks pay dividend to increase their performance. Generally, the result is shown that dividend policy has an effect on firm value.

Hashim, Shahid, Sajid and Umair (2013) carried out a study on the topic Determinants of dividend policy: A case of banking sector in Pakistan. The study made us of stepwise regression analysis, and also used 27 domestic and foreign banks operating in Islamic and conventional banking. The results shows positive impact on Profitability, last year dividend and ownership structure on the dividend payout, liquidity show negative impact while Size, leverage, agency cost, growth and risk show insignificant relationship and have no impact on the dividend payout.

Hasan (2015) examined the relationship between dividend payout ratio and profitability of a firm in Pakistan. For this, two main sectors of Pakistan are selected, energy and textile. The study covers a time span of 12 years from 1996-2008. Firm performance is measured by earning per share (EPS) and return on assets (ROA). The results of result show that there is a negative impact of dividend payout ratio on next year earnings of a firm no matter what industry it is. These results are very surprising and giving new dimensions to the finance researchers to further study in this area and find out the insights.

Mehta (2012) investigated the effect of profitability, risk, leverage, size and liquidity of firms on dividend payout. The following industries were used for the study; health care, construction, real estate, communication and energy sectors of the industries in Abu Dhabi Stock Exchange for a period of five years from 2005 to 2009. The study revealed that size and profitability are the key factors in significantly changing dividend payout decision. Priya and Nimalathasan (2013) examined the dividend Policy Ratios and Firm Performance. The study was based on a case study of selected hotels and restaurants in Sri Lanka for the period 2008-2012. The results revealed that dividend policy ratios has a great impact on all firm performance ratios except return on investment (ROI) and return on equity (ROE).

Badu (2013) investigated the determinants of Dividend Payout Policy of listed financial Institutions using fixed and random effects. The results of the study show that a significant and positive relationship exists between liquidity and age but also the result showed that there is an insignificant relationship between profitability, collateral and dividend payment. He concluded that the major determinants of dividend policy in financial institution are liquidity, age of the firm and collateral. Uwalomwa, Jimoh and Anijesushola (2012) investigated the relationship that exists between the financial performance and dividend payout among listed firms' in Nigeria. The Variables used in the study include ownership structure, dividend payouts and firm size. The period used for the data was 2006-2010. The study found that there is a significant positive relationship between the performances of firms and the dividend payout of the sampled firms in Nigeria. Additionally revealed that ownership structure and firm's size has a significant impact of the dividend payout of firms too.

METHODOLOGY

Descriptive research design was used to establish the relationship between dividend payout and firm performance. Regression analysis was used to establish the relationship between dividend payout and firm performance with the aid of e-view software. As at May 2017, there are 15 banks quoted on the floor of the Nigerian Stock Exchange (2017, May 16). Retrieved from http://www.nse.com.ng. The population of this study covered all the banks quoted on the floor of the Nigeria Stock Exchange. Stratified random sampling was used as the basis of selection as all the listed banks could not be used. A sample size of 10 banks quoted on NSE was selected. The companies were selected based on the availability of annual reports, size of the banks and their ability to pay dividend during the period under consideration. The annual reports (particularly the ten years financial summary) of these banks were analyzed to obtain information on the performance of the banks as it relates to their dividend payout ratio.

Table 3: Working population

The following banks were selected for the purpose of the study:

S/N	Bank Name
1	Access Bank Plc.
2	Diamond Bank Plc.
3	Guaranty Trust Bank plc.
4	Stanbic IBTC holding
5	Sterling Bank plc.
6	Zenith Bank plc.
7	FCMB plc.
8	First Bank of Nigeria holding plc.
9	United Bank of Africa
10	Union bank plc.

A-Priori Expectation

The study used multiple regression methods to evaluate dividend policy on the financial performance of the selected banks quoted on the Nigerian Stock Exchange.

This can further be expressed as follows; β_1>0, β_2>0, β_3 >0, β_4>0, β_5>0, while on the other handβ_6<0

Model Specification

The following model is used to examine the association between independent and the dependent variables of the listed banks in Nigeria.

EPS = f (DP, BSIZE, FSIZE, GRTH, LEV)

TOBIN Qit= f (DP, BSIZE, FSIZE, GRTH, LEV)

This can be expressed using linear equation as;

EPSit= $\beta_0 + \beta_1 DP_{i,t} + \beta_2 BSIZE_{i,t} + \beta_3 FSIZE_{i,t} + \beta_4 GRTH_{i,t} + \beta_5 LEV_{i,t} + \mu\text{i, t}$

TOBIN Qit = $\beta_0 + \beta_1 DP_{i,t} + \beta_2 BSIZE_{i,t} + \beta_3 FSIZE_{i,t} + \beta_4 GRTH_{i,t} + \beta_5 LEV_{i,t} + \mu\text{i, t}$

DATA ANALYSIS AND RESULTS INTERPRETATION

Data Presentation

Table 1: Descriptive statistics of dependent and independent variables

	DP	EPS	FS	G	LEV	TQ	BS
Mean	0.520	2.279	7.752	-0.291	5.269	0.244	14.110
Median	0.480	0.850	8.505	-0.205	5.440	0.190	14.00
Maximum	2.400	60.920	9.490	1.00	12.040	1.260	21.000
Minimum	-0.510	-1.580	4.860	-6.310	0.000	0.030	6.000
Std. Dev.	0.475	8.484	1.469	0.726	2.636	0.222	2.70
Skewness	1.651	6.694	-0.473	-5.644	0.0170	2.158	-0.036
Kurtosis	7.214	46.557	1.643	48.464	3.163	9.099	3.591
Jarque-Bera	119.488	8652.385	11.39	9143.770	0.116	232.660	1.476
Probability	0.000	0.000	0.003	0.000	0.943	0.000	0.477
Sum	52.07000	227.9700	775.2700	-29.11900	526.966	24.440	1411.000
Sum Sq. Dev.	22.426	7127.23	213.657	52.300	688.191	4.883	721.790
Observations	100	100	100	100	100	100	100

Source: Author's Computation (2017)

The table above presents the descriptive statistics of the data series used in this study. The mean value is the highest at 14.110 while -0.291 is the lowest value representing mean value for board size and assets growth respectively. Standard Deviation shows the variation in the data with the highest value Standard Deviation 8.484 implying that the great variation in the performance of listed deposit money banks in Nigeria is due to earnings per share. Tobin q has the least value of Standard Deviation at 0.222 implying that Tobin q causes minimum variation on the performance of listed deposit money banks in

Nigeria. The Skew measure symmetry of distribution and Kurtosis refers to the peak and flatness of the distribution.

From the table above, the dependent variables (performances of listed deposit money banks) are measured by earnings per share and Tobin q. It can be observed that the average of earnings per share for deposit money banks in Nigeria is 2.27 which range from -1.58 to 60.9 with standard deviation of 8.48. Also, it was positively skewed at 6.69 and peak at 46.55. Tobin q on average has 0.244 which also range from 0.03 and 1.26. It was skewed at 2.15 and pick at 9.09.

The dividend payout was used as independent variable. On average, it has 0.52 which range 0.52 as minimum and 2.4 as maximum. It was skewed at 1.65 and peak at 7.2. Firm size, sales growth, leverage and board size were used as control variables respectively. On average, they have 7.75, -0.281, 5.26 and 14.11 respectively.

The table2 below shows the degree of association between the financial performance and the dividend payout ratio. The result indicates that the financial performance has weak negative relationship with dividend payout ratio at -10% meaning that a kobo decrease on in dividend payout ratio will lead to 10% increase in financial performance or a kobo increase in dividend payout ratio will lead to 10% decrease in financial performance of listed Deposit Money Banks in Nigeria.

Table2: Correlation test between financial performance and dividend payout ratio

	EPS	G	FS	BS	DP
EPS	1.00				
G	0.12	1.00			
FS	-0.05	0.041	1.00		
BS	0.00	0.09	0.11	1.000	
DP	-0.10	0.01	-0.28	-0.27	1.00

Source: Author's Computation (2017)

To determine the degree of association between the market performance and the dividend payout ratio, the correlation test was performed as showed in table 2 below. The result shows that there is a positive relationship between the dividend payout ratio and the Tobin q though weak at 19%. It means that an increase in dividend payout ratio by 19% will also lead to 19% increase in the market performance of selected listed Deposit Money Banks. Leverage, sales growth, firm size and board size have weak negative relationship with the market performance of listed Deposit Money Banks in Nigeria.

Table3: Correlation test between market performance and dividend payout ratio

	TQ	LEV	G	FS	DP	BS
TQ	1.00					
LEV	-0.23	1.00				
G	-0.15	0.03	1.00			
FS	-0.16	0.20	0.04	1.00		
DP	0.19	-0.30	0.01	-0.28	1.00	
BS	-0.12	0.11	0.09	0.11	-0.27	1.00

Source: Author's Computation (2017)

Table 4: Regression Analysis on the effect of dividend payout ratio on bank's performance.

Dependent variable: EPS

Linear estimation after one-step weighting matrix				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	-14.82631	3.881074	-3.820157	0.0003
DP	-0.995090	0.479341	-2.075954	0.0409
BS	-0.104392	0.075328	-1.385840	0.1694
FS	2.484578	0.488619	5.084900	0.0000
G	-0.374201	0.368116	-1.016531	0.3123
LEV	-0.052000	0.072667	-0.715596	0.4762
	Effects Specification			
Cross-section fixed (dummy variables)				
	Weighted Statistics			
R-squared	0.573974	Mean dependent var		7.852404
Adjusted R-squared	0.503806	S.D. dependent var		11.90382
S.E. of regression	6.183258	Sum squared resid		3249.778
F-statistic	8.179898	Durbin-Watson stat		1.255676
Prob(F-statistic)	0.000000			
	Unweighted Statistics			
R-squared	0.082888	Mean dependent var		2.279700

Sum squared resid	6536.467	Durbin-Watson stat		1.195458

Source: Author's computation, (2017)

The fixed effect is chosen over the random effects because of unique attributes of the variables which vary cross-sectionally but are quite constant over time.

SUMMARY OF FINDINGS

The study investigated the effect of dividend pay-out ratio and the performance of deposit money banks in Nigeria. The population of the study is the 15 listed deposit money banks in Nigeria. The study used ten (10) banks listed on the Nigeria Stock Exchange from the period of ten year (2007-2016). The data used were extracted from the financial statement of the sampled quoted banks. Panel data regression model (pooled ordinary least square) was used to analyse the data within the framework of the fixed effects model. The study tested two models using dividend payout ratio as a proxy for dividend policy, and Tobin Q and Earnings per Share (EPS) for market performance and financial performance respectively. Leverage, sales growth, bank size and board size was introduced and used as a control variable. Correlation was used to determine the degree of association among the variables used.

CONCLUSIONS

The following conclusions can be drawn from the study:
That R2 of all the dependent variables (Earnings per Share and Tobin Q) used for this study were affected by other variables outside our model.

The study observed that the dividend payout ratio has a positive though an insignificant relationship with the dependent variable (Tobin q). This means that the dividend payout ratio does not significantly contribute to the market performance of the sampled listed firms in Nigeria. This is in line with the bird in the hand theory which viewed dividend payout as relevant.

Dividend policy has a positive impact on a firm's value since dividends paid tend to increase the firm's value. Where there is uncertainty and imperfect information, issue arises and we find dividends and retained earnings not being valued the same which leads to investors preferring the "bird in the hand" of cash dividends rather than the "two in the bush" of future capital gains (Al-Malkawi, Rafferty and Pillai, 2010).

Similarly, the second dependent variable (EPS) shows a negative though a significant relationship between dividend payout ratio and financial performance of selected banks. It means that the financial performance of the sampled firms will reduce by a certain percentage with a 1% increase in dividend payout ratio.

The bank's financial performance falls as more dividends are paid out of its retained earnings. The findings also reviewed that there is a negative and insignificant relationship between leverage and the dividend Payout in both dependent variable .The result of which is consistent with the a priori expectation (β_6<0). Most banks that have low dividend payout ratio plough back a major proportion of their profits in order back to support expansion or growth. This is because majority of the banks that are highly levered are not willing to distribute profits to their shareholders with a view of accumulating high retained earnings in order to strengthen positive net present value projects which will help the bank to reduce their dependence on debt finance with high interest and also fuel sales growth in the banking firm.

The result also shows that the dependent variable (Tobin q), has a significant and negative relationship between the control variables (growth and firm size) and dividend payout ratio of the selected listed bank. The board size shows a positive but significant relationship between dividend payout and market performance.

Similarly, the result on the dependent variable (EPS) shows that there is a negative and significant relationship between board size and growth and dividend payout ratio.

RECOMMENDATION

Based on the aforementioned findings and conclusions, the following recommends are put through:

The management of banks should carry out adequate feasibility study in order to identify projects that would generate huge earnings for the banks which can be used to pay dividends to shareholders. This will also prevent managers from wasting the banks money on investments with negative net present value.

Banks with riskier and high profits should adopt a low dividend payout ratio. They should plough back a major proportion of the profit into the bank in order to retain capital for future investment. Managers should adopt a good dividend policy which will help banks to avoid mistakes about payout policy and also increase the value of the banks. The management should ensure proper accountability and prudency by exercising adequate supervision and monitoring of the banks operations.

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