



DIVIDEND POLICY AND VALUE OF THE FIRM: IS DIVIDEND RELEVANT OR NOT?

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Abstract

This study examines the possible effects of dividend policy on firm value. The study covers 10 quoted companies studied for the period of 1995 - 2015. In so doing, the methodology adopted is the ordinary least square regression analysis for primary data analyses and multiple regression analysis for the secondary data analyses with models MPS (Market Price per Share) as dependent variable, EPS (Earnings per Share) and DPS (Dividend Per Share) as independent variables. The study shows the relevance of dividend as a signaling model and proves that firm value is greatly influenced by dividend policy as far as public limited companies are concerned.

1.1 Introduction

Dividend decisions are important because they determine what funds flow to investors and what funds are retained by the firm for investment. Also, they provide information to stakeholders concerning the company's performance. Firm investments determine future earnings and future potential dividends, and influence the cost of capital (Olowe, 1998).

The dividend policy of the firm has remained one of the most contentious, but interesting issues in corporate finance. The relative merits of dividend policy on the performance of firms are important both from the firm and stakeholders' perspectives. In examining this issue, the question is whether the dividend policy of a firm actually impacts on its economic value and performance.

Dividends are sticky because firms are typically reluctant to change dividends, in particular, firms avoid cutting dividends even when earnings drop. Dividend decisions are recognized as centrally important because of the increasingly significant role of the finances in the firm's overall growth strategy. The objective of the finance manager should be to find out the optimal dividend policy that will enhance the value of the firm (Frankfurter and Wood, 2002) argued that the share prices of a firm tend to be reduced whenever there is a reduction in the dividend payments. Announcements of dividends generate abnormal negative security returns. A drop in share prices occurs because dividends have a signaling effect. According to the signaling effect, managers have private and superior information about future prospects and choose a dividend level to signal that private information. This may lead to a stable dividend payout ratio.

The theoretical literature focuses on opinion from researchers' ranges from the position that dividend policy has no real impact on the value and performance of the firm to the position that the dividend policy of a firm does

impact on the value and performance of that firm. Modigliani-Miller (1958) opined that in a world of efficient market condition, absence of taxes, transaction costs and asymmetric information, the value of the firm is not a function of the dividend policy and the debt structure of the firm. In other words, the value of a firm is unaffected by how that firm is financed. To them, the dividend policy of a firm is seen as not influencing the performance of the firm and the maximization of shareholders' wealth. On the other hand, Allen and Gale (2003) posited that the value and the performance of a firm is a function of the dividend policy and other variables like the way the firm is being finance. In a related study, Cebenoyan and Strahan (2002) conducted a research in the United States of America and reported that an upward or downward movement in dividend payout of a firm generally has positive or negative influence on the stock market price of that firm. Supporting the impact of dividend policy on the value of a firm further, Abor and Bokpin (2010) reported that, firm's dividend policy have a significant positive impact on its shareholders' wealth.

In this study, we assume that the dividend policy of an organization would have an impact on its performance and, in turn, the wealth of shareholders. Dividend policy is especially critical in imposing discipline and providing fresh leadership when the corporation is performing sub-optimally and thus unable to guarantee the basic objective of maximizing shareholders' wealth (Al-Malkawi, 2007).

In the finance literature, the dynamics of dividend policy has been analyzed for years. But, scholars in this field have presented different views to explain the dynamics of dividend policy over time and across cultural settings.

1.2 Research Hypotheses

H₁: There is a significant relationship between the financial performance and dividend payout of the 10 listed firms in Nigeria used in the study.

H₂: There is a significant relationship between ownership structure and the dividend payout of the 10 listed firms in Nigeria used in the study

H₃: There is a significant relationship between firm size and the dividend payout of the 10 listed firms in Nigeria used in the study

2.1 Literature Review

Technically, the dividend policy of the firm relates to various decisions on payment of dividend, which remain a major aspect of the strategic decision of the firm. Essentially, it involves the determination of how earnings generated would be shared between payments to stockholders and reinvestments in projects that would yield positive net present value for the firm. In dividend policy decision, management needs to decide the amount ratio and pattern of distributions to shareholders over time. As documented in the literature, the debate on dividend policy has basically focused on the irrelevance and relevance of dividend policy to the value of the firm (Modigliani and Miller, 1958; 1961). The basic theory as put forward by Modigliani-Miller (MM) (1958) states that "in the absence of taxes, transaction costs, and asymmetric information, and under the condition of an efficient market, the value of a firm is unaffected by how that firm is financed". To Modigliani and Miller, it does not matter what the structure of a firm's dividend policy might be. Neither does it matter if the firm raised its capital by the issuance of stock or sale of debt. In the present economic rearrangement and reforms both at the public and private sectors as occasioned by the dynamics in the environment, the significant influence of dividend polices on performance has continued to gain attention with divergent views.

A number of studies on dividend policy of the firms have produced both theoretical and empirical works, especially since Modigliani and Miller (1961) documented the dividend irrelevance theory in their seminar paper. Prior to Modigliani-Miller's theory on dividend policy, Lintner (1996) developed and empirically tested the partial-adjustment model to investigate the factors that may influence firm's dividend policy decisions. In that study, Lintner documented the influence of possible changes in earnings and dividend rates as significant to

dividend policy decisions. He therefore concluded that managers tended to follow a smooth pattern of dividend policy on the short run since this would be appealing to investors who look forward to derive returns for their investment.

Supporting the Lintner's view on dividend policy, Fama and French (2001) examined other models of dividend policy and concluded that managers prefer stable and sustainable dividend policy decisions. Other empirical studies such as Oyediji (1996) and Adelegan (2003) tested the modified version of Lintner's model and affirmed support for managers' preference for stable and sustainable dividend policy decisions, at least on the short run.

The investigation on the determinants of dividend policy has equally been carried out using the behavioural approach, which tends to rely on the survey of corporate managers in order to determine factors that influence firm's dividend policy. As reported in Baker and Farrelly (1988), factors such as the level of past and present earnings and the previous pattern of dividend policy may play significant roles in deciding firm's dividend policy decisions. These factors may be given different levels of importance by different managers at different times in order to enhance the value of the firm.

Investigating the dividend policy further, Ahmed and Javid (2009) evolved an alternative model to analyze the determinants of dividend policy. In this model, they identified other variables that might also influence the dividend policy of the firm, such as average revenue growth rate, percentage of shares held by insiders and the number of ordinary shareholders were related to the level of dividend payout ratio and found to influence the dividend policy decisions. However, Al-Najjar and Belghitar(2011) tested the model on another seven-year period and confirmed the robustness of the model on dividend policy.

In the decision around dividend policy, management usually contends with several factors in order to optimize the potentials of such policy to maximize shareholders' return on investment. For instance, investigating the elements that shape dividend policies of firms quoted in Argentina Stock Exchange for the period 1996 to 2002, Black (2004) reported that while larger and profitable firms without any viable investment opportunities pay something more to shareholders in return for their investment, firms with higher degree of risk and less chances to borrow tend to pay something less as dividend to investors. In a related study, Grullon and Michaely (2002) posited that a firm's pattern of dividend policy tend to follow a stable future cash flows. Apart from factors such as liquidity position, inflation, interest rate, investment, future growth consideration and legal requirements, dividend policy of a firm may be influenced too by the nature of ownership structure and the overall level of corporate governance enshrined in that firm. This is evident in a study by Ehsan, Khalid, Akhter(2011) who found managerial ownership to have a significant level of influence on dividend payout.

2.1 Dividend irrelevance theory

The dividend irrelevance theory by Miller and Modigliani (1961) is based on the premise that a firm's dividend policy is independent of the value of the share price and that the dividend decision is a passive residual. They are of the view that the value of the firm is determined by its investment and financing decision within an optimal capital structure, and not by its dividend decision. A common dividend policy should be able to serve all firms because the dividend policy is irrelevant in determining firm value. The residual concept of dividends is based on the decision of dividing surplus earnings between future investments and the payment of dividends. Thus, a firm can either retain all of its surplus earnings for investment in future positive NPV projects or distribute dividends from the residue of the surplus earnings after providing for positive NPV investments, the firm is not obliged to pay dividends. In this manner, dividends are seen as a passive residual and are irrelevant in affecting firm's value. Alternatively, shareholders are indifferent as to whether they receive the expected return on their investment in the form of dividends or in the form of an appreciation of share value.

The basic premise of their argument is that firm value is determined by choosing optimal investments. The net payout is the difference between earnings and investments, and simply a residual. Because the net payout

comprises dividends and share repurchases, a firm can adjust its dividends to any level with an offsetting change in share outstanding. From the perspective of investors, dividend policy is irrelevant, because any desired stream of payments can be replicated by appropriate purchases and sales of equity. Thus, investors will not pay a premium for any particular dividend policy.

Miller and Modigliani (1961) concluded that given firms optimal investment policy, the firm's choice of dividend policy has no impact on shareholders wealth. In other words, all dividend policies are equivalent. The most important insight of Miller and Modigliani's analysis is that it identifies the situation in which dividend policy can affect the firm value. It could matter not because dividends are "safer" than capital gains, as was traditionally argued, but because one of the assumptions underlying the result is violated. The propositions rest on the following four assumptions;

1. Information is costless and available to everyone equally.
2. No distorting taxes exist.
3. Flotation and transportation costs are non-existent.
4. None contracting or agency cost exists.

In summary, the dividend irrelevance theory according to Uddin and Chowdury (2005) states that the logic of the irrelevance theory is not disputed given the assumptions underlying the model. However, it is now generally accepted that the value of a model lies in the predictive or explanatory power and that the model cannot be judged by reference to the realism of its underlying assumptions.

2.2 Empirical study of dividend in Nigeria

Adelegan(2003) attempted to highlight the pattern of dividend policy pursued by Nigerian firms, particularly during the period of indigenization and participation programme defined in the first indigenization Decree of 1973 their study covered 52 company- years of dividend action (13 companies for four years). He found very minimum evidences to support the classical influences that determine dividend policies in Nigeria during this period, and concluded that fear and resentment seem to have taken over from the classical forces.

Soyode (2005) concluded that the problem arising from dividend policy can be attributed to the share pricing policy of the capital issue commission (CIC), which seem to have ignored the classical factors that should have govern the pricing of equity share issues. This in turn made companies to abandon all the classical determinants of dividend policy.

Furthermore, Oyejide (1996) empirically tested for company dividend policy in Nigeria using Lintner's model. He disagreed with previous studies and reported that the variable evidence strongly support the fact that conventional devices explain the dividend policy of Nigerian public companies. However, Adeyemi and Fagbemi (2010) using data from 1989-2008 found supporting evidence in Nigeria for Lintner's model.

Hauser (2013) evaluated the asymmetric information of dividend, given earnings by shareholders in Nigeria. He carried out a study on 882 firms by analyzing the dividend policy and its effect on wealth maximization on a sample of 62 quoted firms in Nigeria over a wider testing period of 1887-2000. He found a significant result and concluded that dividend policy does affect wealth maximization.

3.1 Methodology

The structural framework of this study is based on Survey design and ex-post facto research design. Questionnaires were administered to the respondents from First bank Nigeria plc, Nigerian Breweries plc, Prescoplc, Julius Berger plc, Cadbury Nigeria plc, Oandopl, Guinness Nigeria plc, Dangote Cement Nigeria plc, May & Baker Nigeria Plc, Royal exchange Assurance. To ensure that all industries quoted in the Nigerian stock exchange are covered, these companies were selected. The ex-post factor design type will also be used in this research work to analyze secondary data because there is no experiment involved, but rather is designed to test

an event that has already taken place. Therefore, it deals with historical facts about dividend policy and its effect on firm value.

Primary and Secondary data will be used in this work. The research instrument used to obtain primary data is the structured questionnaire. The data machinery adopted for secondary data will be the published annual reports of selected firms for the relevant years sampled for analysis. The Central Bank of Nigeria (CBN) bulletin and the closing price of share for each company, for the relevant years sampled for analysis.

The population of this research will be the 180 public limited companies in Nigeria as at 2015, with a selection of 10 companies using the Quota random sampling technique. This is applied where the population is made up of some natural grouping or parts. Each natural grouping is given a fair representation in the sample (Asika 2006). The basis is to ensure that all industries are covered. The respondents of these firms are their finance managers, chief accountants, chartered accountants who act as agents, stock brokers, directors and shareholders. A total number of 120 questionnaires were distributed. The research instrument contains 13 questions on dividend policies against which the respondents were asked to indicate their level of agreement upon a five point Likert scale (where 5 = strongly agree, 4 = agree, 3 = undecided, 2 = disagree and 1 = strongly disagree). Each question number is subsequently referred to as S1-S13. The sample size is denoted by (n) and is derived using the Yaro-Yamen's formular

$$n = \frac{N}{1 + N(e)^2}$$

Where n = sample size

N= Population

e =margin for error terms (5%)

$$n = \frac{216}{1 + (216)(0.05)^2}$$

$$n = \frac{216}{1 + (216)(0.0025)}$$

$$n = 140$$

3.2 Reliability Statistics

Table 1

Cronbach's alpha	No of items
.839	12

Source: Author's Computation 2017

3.3 Model Specification

$$MPS = (EPS, DPS) \text{-----} 1$$

$$MPS!t = a_0!t + b_1 + EPS!t, b_2 + DPS!t, + \epsilon r!t \text{-----} 2$$

$$MPS!t = a_0!t + b_1 EPS!t * DPS!t + \epsilon r!t \text{-----} 3$$

$$MPS = (EPS, DPS) \text{-----} 1$$

$$MPS!t = a_0!t + b_1 + EPS!t, b_2 + DPS!t, + \epsilon r!t \text{-----} 2$$

$$MPS!t = a_0!t + b_1 EPS!t * DPS!t + \epsilon r!t \text{-----} 3$$

Where; MPS!t: Market price per share \hat{i} in year t .

EPS!t: Earnings per share \hat{i} in year t ; DPS!t: Dividend per share \hat{i} in year t .

$\beta_0, \beta_1, \beta_2,$ = coefficients ϵ_i = error terms.

The model is expected to be $\beta_0 > 0; \beta_1 > 0, \beta_2 > 0$. Simple regression technique, ordinary least square (OLS) was

used for data estimation and analysis. In the course of analysis, correlation coefficient analysis, pooled regression analysis and other diagnostic test were conducted. These were done with the aid of E-View 7 software.

4.1 Data Analysis And Interpretation

4.1.1 Test of Primary Data

Table 2

YEAR	FRV	AGC	DVP	IFA
50	65	26	35	28
100	48	20	25	20
150	72	33	40	32
200	84	38	50	40
250	90	40	50	40
300	91	42	50	40
350	234	160	201	159

Table 3

Included observations: 7				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
AGC	0.977640	0.677224	1.443599	0.2446
DVP	32.61981	7.383513	4.417925	0.0215
IFA	39.77522	9.446195	4.210714	0.0245
C	9.257143	4.502554	2.055976	0.1320

R-squared	0.999809	Mean dependent var	121.1429
Adjusted R-squared	0.999619	S.D. dependent var	123.0345
S.E. of regression	2.401820	Akaike info criterion	4.885890
Sum squared resid	17.30621	Schwarz criterion	4.854981
Log likelihood	-13.10061	Hannan-Quinn criter.	4.503866
F-statistic	5247.108	Durbin-Watson stat	1.669173
Prob(F-statistic)	0.000004		

Source: Author's computation using Eviews 9 (2017)

R² equals 0.999809 showing that 99% of the total variations in FRV are explained by the independent variables AGC, DVP and IFA. The Durbin Watson is 2 and shows a perfect correlation and a positive effect of information content of dividend and firm value, agency cost and firm value, dividend policies and firm value. We accept H₁, H₂, & H₃ which states that there is information content of dividends determines dividend payout by firms, agency cost between shareholders and management affects the dividend payment pattern of firms and there is an effect of various dividend policies on shareholders wealth.

YEAR	MPS	DPS	EPS
1995	72.0032	4.9843	29.0344
1996	73.3422	5.3297	43.211
1997	89.2018	6.7456	123.221
1998	95.9873	7.3201	23.674
1999	95.4321	7.1002	45218
2000	97.0011	7.5783	156002
2001	98.7321	7.8235	13.8344
2002	9867321	78456	78.364
2003	100.2011	8.2118	46.732
2004	98.2036	8.0021	3745110
2005	110.041	8.3901	1249.4
2006	123.674	9.2364	104.456
2007	125.5054	9.9018	113.8202
2008	13.27525	3.671203	9.598825
2009	20577412	2952466	23464697
2010	73.56	78.74548	-5.29797
2011	117.3005	-77.7132	194.1557
2012	21344198	21087125	254716
2013	72.57277	15.3941	56.7845
2014	214.2989	73.99791	139.7844
2015	28.0125	19.9034	7.8508

Table 5

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DPS	-2.03E-07	6.37E-07	-0.318284	0.7541
EPS	5.60E-07	7.04E-07	0.796398	0.4368
SER01	2.88E-07	5.34E-07	0.538466	0.5972
C	2004.477	1.499712	1336.575	0.0000
R-squared	0.096565	Mean dependent var	2005.000	
Adjusted R-squared	-0.062865	S.D. dependent var	6.204837	
S.E. of regression	6.396898	Akaike info criterion	6.719147	
Sum squared resid	695.6453	Schwarz criterion	6.918104	
Log likelihood	-66.55104	Hannan-Quinn criter.	6.762326	
F-statistic	0.605687	Durbin-Watson stat	2.259003	
Prob(F-statistic)	0.620281			

4.1.2 Test of Secondary Data

Table 4

Source: Author's Computation using Eviews 9 (2017)

$R^2 = 0.096565$. This shows that 100% of the total variations in MPS are explained by the independent variables DPS and EPS. The Durbin Watson is 2.259 and shows a no correlation between MPS, DPS and EPS. We accept H_1 , H_2 , & H_3 which states that there is information content of dividends determines dividend payout by firms, agency cost between shareholders and management affects the dividend payment pattern of firms and there is an effect of various dividend policies on shareholders wealth.

4.2 Summary of Findings

This chapter dealt with analyzing responses based on respondent's views on dividend payments and the effect on firm value. The majority of respondents agreed with the following dividend policy statements:

1. A dividend policy that maintains steady or modestly growing dividend payments
2. A dividend policy that adjusts dividend payments towards a target payout ratio
3. The above policy statements are a consequence of the majority of respondents agreeing to the following statements on dividend relevant theory:
4. Importance of dividend policy on firm value
5. The bird-in-the-hand theory of dividend payments
6. Dividend payments prevent surplus cash flows from being used in unprofitable investments
7. Dividend payments are better signals of confidential information
8. A formal dividend policy gives the assurance of predictable dividend payments
9. A common policy can be used by all firms to determine firm value
10. Shareholders are indifferent to receiving dividends as compared to share increase

There is a very high correlation between dividend policies and firm value at 0.99 which is an almost perfect correlation (close to 1), and 0.1 which shows a perfect correlation. This shows that dividend policies have an overwhelming significant effect on firm value of public limited companies in Nigeria. The results further corroborate the works of Oyejide (1996) and Adelegan (2003). This study adds to the body of literature on corporate dividend policy in Nigeria. The results of the study underscore the need for Board of Directors (BODs) to maintain a steady increase in earnings, cash flow and dividend payment

5.1 Recommendation and Conclusion

This study basically looked at dividend policy and firm performance in Nigeria. The study came up with findings that are of salient importance to scholars investigating dividend issues in the Nigerian context. Based on the first hypotheses, the study observed that that firm performance has a significant impact on the dividend payout of listed firms in Nigeria. That is, an increase in the financial wellbeing of a firm tends to positively affect the dividend payout level of firms. Also, findings from the second hypothesis assert that there is a significant positive relationship between ownership structure and the financial performance of firms.

Finally, the findings from the third hypothesis validate the propositions provided in Barclay, Holderness, and Sheehan (2003), Fama and French (2001), Grullon and Michaely (2002), and Al-Malkawi (2007) where they suggested the fact that larger companies tends to pay more dividend due to larger firms have easier access to external financing and rely less on internal capital. More so, they are politically more sensitive and therefore prefer to decrease political costs by distributing dividend. Consequently, the paper concludes that while the ownership structure of firms terms of equity interest appear to have a visible and significant effect on dividend payout of firms, on the other hand, firm size tend to have a significant positive impact on firms dividend payout ratio since larger firms have better access to the capital markets and also can easily to raise funds at lower a costs.

In addition, large firms tend to pay more dividend to reduce agency costs since they tend to face high agency costs as a result of ownership dispersion, increased complexity and the inability of shareholders to monitor firm activity closely. More so, due to the weak control in monitoring management in large firms, a large dividend payout increases the need for external financing, which, in turn, leads to the increased monitoring of large firms by creditors. This may be a quality that is attractive to the shareholders.

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