Dividend Policy and Share Price Valuation in Nigerian Banks

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Abstract: This study examined dividend policy and share price valuation in the Nigerian banks. The study which covered a ten-year period made use of secondary data sourced from published financial statements of four major banks in Nigeria, namely; Access Bank, First Bank, United Bank for Africa and Guarantee Trust Bank. The study employed the Ordinary Least Square (OLS) regression model in the analyzing the data obtained. Findings from the study show that a significant positive relationship exist between earnings per share and market price. The study concluded that banks should put in place efficient and robust dividend policy and leverage on the new e-dividend payment initiative for a better performance. An amendment should be carried out on Company and Allied Matter Act (CAMA) 2004 as amended to compel any company with a total asset value in excess of ₦10billion to be listed on the Nigerian capital market with a view to attracting more investors.

Keywords: Dividend Policy; Share Price Valuation; Earnings; Payout Ratio; Market Price

JEL Classification:

1.   Introduction

One of the fundamental objectives of any business organisation is the maximisation of the shareholders' wealth. One of the important variables that affect the maximisation of shareholder's wealth is the earnings potentials of a business enterprise. The ability of a firm to make reasonable earnings is a function of the quality of its products or services in the market, its market share, the quality of the board and management team to make sound decisions, its financial strength and the quality of its assets. If a business organisation makes adequate earnings, it would be possible for it to embark on profitable investment opportunities that will further enhance or maximise the share value of the firm (Pushpa & Sumangala. 2012; Uwuigbe, Olubukunola and Okorie, 2015).

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Traditionally, there are three fundamental decisions the managers of companies make with a view to impacting positively on their market value. These decisions include an investment, financing and dividend decisions. Investment decision deals with apportionment of an enterprise financial resources among various investment opportunities that will yield future benefits to the company with a view to maximising shareholders wealth. In investment decision, managers evaluate investment opportunities in relation to the expected returns and risk with the objective of maximising the shareholders' wealth (Uwuigbe, Jimoh and Ajayi, 2012). Financing decision involves the determination of the best financing mix or capital structure. The financial manager, therefore, decides where to get additional funds either internally (retained earnings) or externally (debt) having given due consideration to its associated cost and its implication on the shares value. Dividend decision, on the other hand, involves the determination of the appropriate percentage of the company's earning to earmark for the dividend payment to investors and amount to retain within the company for future expansion (Uwuigbe, Olowe & Agu, 2012). These decisions were basically conceptualised and worked out with an intent to maximise the wealth of the shareholders. It is expected that the decision to pay a certain percentage of earnings as dividend must be favourably compared with the opportunity cost of retained earnings (Pandey, 2005).

The dividend policy of an organisation becomes fundamental as the survival of any business enterprise like a bank depends on its ability to continuously have access to investible funds in order to continue in business in foreseeable future. Thus, financial managers must, therefore, decide on the proportion of earnings that must go into dividend payment depending on the shareholder's preference for immediate cash or capital gains. If a high payout ratio is adopted, the company will likely resort to external borrowing through capital market and likewise, a low payout ratio will cause the company to utilise its retained earnings to take advantage of available investment opportunities for expansion and growth (Pandey 2005). Adefila, Oladapo, & Adeoti (2004), avowed that financing and investment decisions of a company are significantly influenced by the magnanimity of its retained earnings which is determined by its dividend policy.

- Although the concept of dividend policy has been discussed and debated by financial scholars and academics in the past two decades; as it relates to issues relating to the theories of dividend and dividend patterns which had invariably shaped the thinking and direction of the corporate organisation. This has led to a paradigms shift in the theory of dividend policy as propounded by Modigliani-Miller (1961) and its effect on firm's market values.

- More so, there have been considerable prior studies such as (Porta, Lopez-de-Silane, Shleifer, & Vishny, 1998; Yilmaz, & Gulay, 2006; Masum, 2014; Al-Hasan *et al.*, 2013; Hashemijoo *et al.*, 2012) on whether a high dividend payout ratio or a high retention ratio or a striking balance between the two alternatives should be considered as optimal dividend decision that would guarantee the maximisation of shareholders' wealth – market value. However, the same cannot be said for developing economies (e.g. Nigeria); hence, this study basically examined the effect of earnings, dividend yield, retention ratio on the market value of Nigerian banks.

- In the light of the aforementioned objectives, the remaining part of this study has been structured as follows. Following the introductory section is the review of relevant literature and hypotheses development. Section 3 describes the methodology adopted for the study. While section 4 and 5 presents the empirical findings and conclusions for the study.

MACROECONOMICS AND MONETARY ECONOMICS

2.   Literature Review and Development of Hypotheses

Dividend Policy and Share price Valuation

Every year, public liability companies, banks inclusive, take a decision on whether to return cash to its owners and in what proportion. This is, in a nutshell, is referred to as dividend decision which is central to the dividend policy. It involves the decision on whether to pay dividends to investors out of earnings or to retain earnings for reinvestment in profitable ventures with a view to shoring up the value of shareholders. Dividend policy decisions forms a very vital part of any company's long-term financing strategies (Yusuf, 2015).

There has been an extensive debate on dividend policy and its effects on the value of a firm. Some researchers have argued that regular payment of dividends to investors significantly increase the market value of shares (Gordon, 1963). On the other hand, while some others have debated on the irrelevance of dividends (Miller and Scholes, 1978), others opined that payment of dividends leads to the reduction in shareholder wealth. Uwuigbe, Jafaru & Ajayi (2012) in their study on dividend policy and performances of companies listed on the Nigerian Stock Exchange established a strong link between the performance of firms and dividend payout. Also, Jones (2005) averred that dividends represent the cash payment an investor receives directly from the firm and it forms the foundation upon which stocks prices of firms are valued. Similarly, Denis & Osobov, (2008) avowed that the fact that market price of stock instantaneously responds to an unexpected announcement in a change in the dividend. Indicating marginal investors preferences for dividends where other things remaining constant. However, instability in share prices of firms is inevitable where there are frequent changes in firm's dividend policies (Yilmaz & Gulay, 2006). Similarly, Higgins (1995) maintained the fact that if a company has inadequate funds to invest, or intends to raise additional funds from external sources for profitable investments, the claim on the future cash flows by the shareholders will ultimately reduce share price of the company. Hampton (1996) emphasised that value of the stock would be enhanced with an increase in payout ratio and share price would remain undervalued if dividend payout ratio is lowered.

Empirical studies on dividend policy and its attendant effects on the value of firms have equally been carried out in related studies. Benaruzi (1997); Ofer & Siegel (1987) and Bae (1996) in their study established the influence of dividends on share prices. Similarly, Campbell & Shiller (1988) observed a strong influence of earnings and expected dividends on stock prices. They were of the opinion that dividends and earnings are, over times, predominant factors in determining returns on stocks. In the same vein, Jensen & Johnson (1995) avowed that reduction in dividend resulted in the fall in share price. Similarly, Miller and Modgliani (1961) argued that imperfection in the market is the only condition that may cause dividend to influence stock price. However, Baskin (1989) in their study observed a negative association between stock prices instability and dividend yield when he carried out a study on 2,344 firms operating in the United States of America covering period 1967 to 1986. Also, the study observed that dividend policy can only be used as a control mechanism to checkmate volatility in share prices.

Chen, Huang & Cheng (2009) conducted a research in China on the effect of a cash dividend on share price covering the period 2000-2004. The result showed a positive impact of a cash dividend on the market value of firms. It shows that whenever there is an increase in cash dividend, stock prices also

increase proportionately and vice-versa. Akbar & Baig, (2010) examined the effect of dividend announcement on stock market prices. The study observed that mere announcement of cash or stock dividends or a combination of stock and cash dividends significantly affected the market value of firms. Khan, Aamir, Qayyum, Nasir, & Khan (2011) took a sample of fifty-five (55) companies listed on Karachi Stock Exchange (KSE) to investigate the impact of dividend payment on the market value of stocks. They concluded that such variables as dividend yield, earnings per share, return on equity and profit after tax impacted positively on stock prices. They equally submitted that retention ratio impacted negatively on stock prices. Hussainey, Mgbame, & Chijoke-Mgbame (2011) in a related study observed that size of firms, earnings potential, growth rate, and level of debt are potent factors responsible for changes in stock prices in the United Kingdom.

On the other hand, Nazir, Nawaz, Anwar, & Ahmed (2010) in their study observed that the size of the firms and financial leverage had a negative effect on share values of firms. Ali and Chowdhury (2010) in a related study observed an insignificant relationship between stock prices and dividends. Khan (2012) examined the implication of dividend announcements on the value of stock in Pakistan with a special focus on the chemical and pharmaceutical sector. The study observed that Earnings per Share and stock dividend did not have any impact on market value. Habib et al, (2012) in a related study on dividend policy and share price volatility evidence from Pakistan observed that dividend yield and share price were positively related but dividend payout ratio was negatively related. Also, Hashemijoo et al (2012) in their study observed that dividend yield and dividend payout both had a negative effect on share price volatility. Other extant literature such as (Black & Scholes, 1974; Adefila, Oladipo & Adeoti, 2004; Uddin & Chowdhury, 2005; Denis & Osobov, 2008; Adesola & Okwong 2009; Al-Hares, AbuGhazaleh & Haddad, 2012) Who are vanguard proponents of dividend policy irrelevance on stock prices, supports dividend irrelevance theory based on the notion that earnings potential of a firm is germane in the valuation model of the market value of shares and not dividends. More interestingly, their observation corroborates earlier findings from Miller & Modgliani (1961) where they averred that dividends would not have an impact on share prices if the condition of perfect market exists. Nevertheless, the nexus in the literature provides a basis for this research.

Theoretical Framework

Though there are a sizable number of theories developed on dividend policy like Modigliani and Miller theory, Walters's model of dividend policy and Gordon's dividend policy theory but for the purpose of this study, Gordon's dividend policy theory is adopted. This is premised on the uniqueness of its share price valuation method which is based on future streams of dividends.

Gordon Theory

This theory promulgated the concept of dividend relevance in the valuation of the market value of shares. The Gordon's model is known for its mathematical models in calculating the market value of a company's share. The model equates the market value of a company to present value of future streams of dividends. The variables taken into cognizance when determining the market value of a company include dividends, the cost of fund and expected growth rate. The theory maintained that dividend payout ratio, the interplay of the rate of returns and cost of capital, to a greater extent, influences the market value per share of a company.

It further emphasised the relevance of dividend yield as a good measure of return on equity rather than the future growth rate in dividends. This was based on the fact that future growth rate and capital gains cannot be determined with precision.

The theory, like other earlier identified theories, is based on the following assumptions:

-   Absence of debt in capital structure of the firm;

-   Investments are financed through retained earnings, no external financing.

-   There is no tax.

-   The absence of business risk.

According to this theory, dividend policy impacts the company in the following circumstances.

i.   If the rate of return is higher than the cost of fund, profits are reinvested for future growth rather than distributing it as a dividend.

ii. If the internal rate of return is same as the cost of the fund, reinvestment of earnings or payment of dividends out of earnings makes no difference.

iii. If the rate of return is lower than the cost of fund, the firm distributes profits in the form of a dividend.

Though this theory has been duly criticised on the strength of the stated assumptions but it has been found out to be the most reliable model for the valuation of the market value of a company. It concurs with the submission of some researchers that dividends play an important role in share price valuation (Baker, Veit, & Powell, 2001). It is therefore on this premise that this study investigated the interplay of earnings per share, dividend yield, and retention ratio in determining the market value of a bank's shares.

Research Hypotheses

The hypotheses to be tested to give direction for this study are stated in null forms as shown below:

H₁: *There is no significant relationship between the earnings per Share (EPS) and market Price per share (MPS).*

H₂: *There is no significant relationship between the dividend per Share (DPS) and market Price per share (MPS).*

H₃: *There is no significant relationship between the dividend Yield (DY) and market Price per share (MPS).*

H₄: *There is no significant relationship between the retention Ratio (RR) and market Price per share (MPS).*

3. Methodology

The annual reports of four banks (FBN, Access, GT Bank and UBA) and other variables from stock market most especially MPS for the period 2006-2016 were obtained and analysed in order to realise the objective of the study. The use of the judgmental sampling technique was adopted where only four (4) Deposit Money Banks (DBMs) were selected representing approximately 29% of the total number of fourteen (14) DMBs on the Nigerian Stock Exchange (NSE). The preference for these banks was borne out of the size of their statements of financial positions, availability of the annual financial reports, International commercial banking license status and good corporate governance practice among others. The study employed ordinary least square (OLS) statistical tool in the analysis of results.

Model Specification

The study adapted the model in the research carried out by Stephen, Nneji and Nkamare (2015) on dividend policy and its impact on share price valuation. The model was adapted because it establishes a relationship between dependent and independent variables. In this study, while Market Price per Share (MPS) represents a dependent variable, Earnings per Share (EPS), Dividend Yield (DY) and Retention Ratio (RR) are independent variables. The model specification is as stated under:

$$MPS_{it} = f\ (EPS_{it},\ DPS_{it},\ DY_{it},\ RR_{it},) \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\ (1)$$

The model is further express as

$$MPS_{it} = b_0 + \beta_1 EPS_{it} + \beta_2\ DPS_{it} + \beta_3 RR_{it} + \beta_4\ DY_{it} + \acute{e} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\ (2)$$

Where:

MPS = Market Price per Share represents the end of the year values for each of the banks for the period covered

     (2006 to 2015)

DY = Dividend Yield Dividend Yield (DY). DY is viewed as interest rate earned on an investment. It is calculated

     by dividing dividend by the market price of shares.

RR = Retention Ratio It is calculated by dividing total earnings by the total number of outstanding shares of

     a firm's stock at the end of the financial year.

EPS = Earnings per Share It is calculated by dividing total earnings by the total number of outstanding shares

     of a firm's stock at the end of the financial year.

é = Stochastic Error Term

4. Discussion of Findings

Table 1. **Descriptive Statistics of Variable**

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis
EPS	40	-.05	3.47	1.6727	.90668	.057	.733
DPS	40	.05	170.00	14.2857	36.01679	3.065	.759
DY	40	.50	25.00	6.9340	5.12609	1.552	.778
RR	40	13.30	95.70	55.2943	20.91798	.161	.778
MPS	40	3.38	41.53	12.7222	8.63766	1.448	.768

Source: SPSS Result (2017)

Findings from our descriptive statistics as presented in table (1) present a mean market price per share of about 12.7222 for the selected banks under consideration. This represents an averaged percentage distribution of about 12.7% for the period. On the other hand; earning per share, dividend per share, dividend yield and retention ratio maintained an averaged mean distribution value of about 1.6727, 14.2857, 6.934 and 55.2943 respectively for the sampled listed banks. Correspondingly, the review of empirical findings from the Pearson correlation analysis as depicted in table (2) on the correlation between dividend policy and share price valuation show a significant positive correlation between market price per share (MPS) and earning per share (EPS). This is evident in the correlation coefficient (r) value of .398. In the same vein, as presented in table (2), a negative correlation was observed between the dividend per share (DPS) and market price per share (MPS). The outcome here is however, not significant. Similarly, a negative correlation was also observed between dividend yield (DY) and market price per share (MPS) with a correlation coefficient (r) of about .341 and it is significant at 5%. Likewise, a significant negative correlation was observed between retention ratio (RR) and market price per share of the sampled listed banks. This was also evident with a correlation coefficient of about (r) .227 and it is significant at 5% level.

Table 2. Correlations

	MPS	EPS	DPS	DY	RR
MPS	1.000				
EPS	.398 .009	1.000			
DPS	.129 .230	.276 .054	1.000		
DY	-.341 .023	.029 .435	.035 .420	1.000	
RR	-.227 .095	.274 .056	.003 .493	-.418 .006	1.000

Source: Authors' Computation (2016) using SPSS Version 20

Table 3. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.775 [a]	.600	.547	5.80489

a. Predictors: (Constant), RR, DPS, EPS, DY

Table 4. ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1516.504	4	379.126	11.251	.000[a]
	Residual	1010.902	30	33.697		
	Total	2527.406	34			

Table 5. Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
(Constant)	24.924	3.995		6.238	.000	.398	.652	.544	.828	1.208
1 EPS	5.976	1.268	.598	4.713	.000	.129	-.018	-.011	.918	1.090
DPS	-.003	.031	-.012	-.098	.923	-.341	-.667	-.565	.803	1.245
DY	-1.061	.217	-.631	-4.897	.000	-.227	-.665	-.563	.739	1.353
RR	-.270	.055	-.655	-4.877	.000					

Dependent Variable: MPS

Firstly, the test for multicollinearity was carried out before the analysis of regression model. The test is necessary because multicollinearity can affect the parameters of a regression model (Field, 2000; Uwuigbe, Uwuigbe & Daramola, 2014). Menard (1995) and Adeyemi & Fagbemi (2010) suggested that a tolerance value less than 0.1 indicates a serious multicolinearity problem between the independent variables. However, since all values are more than 0.10, there is no issue of multicolinearity between the independent variables. Similarly, Myers (1990) suggested that a variance inflation factor (VIF) value greater than 10 calls for concern, however, for this study, the VIF values are less than 10.

Moreover, the findings from the regression analysis for the selected banks as presented in table (3) shows R^2 which otherwise known as the coefficient of determination of the variables as .600. The R-Squared which equally measures the overall fitness of the model indicates that the model is capable of explaining about 60% of the variability in the market price per share of the banks. This indicates that the model explains about 60% of the systematic variation in market price per share, dependent variable. This invariably suggests that about 40% of the variations in dividend policy of the sampled banks accounted for by other factors not captured by the model. This result is supported by the adjusted R^2 (adjusted R-squared) of about 54.7%, which is the proportion of total variance that is described by the model. Similarly, findings from the Fishers ratio (i.e. the F-Statistics which is a prove of the validity of the estimated model) as reflected in table (4), presents a pvalue that is less than 0.05 (p-value < 0.05); this

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invariably suggests clearly that simultaneously the explanatory variable (i.e. EPS, DPS, DY and RR) are significantly associated with the dependent variable, market price per share (MPS).

In line with our apriori expectation ($\beta_1 > 0$), the result in table (5) presents a significant positive relationship between earnings per share and market price per share. This is evident in the t-statistics value of (4.713 and a p-value = .000). This outcome implies that the more a bank makes or generates more earnings from operations, the more the market value will be enhanced. To this end, the study hypothesis (1) which states that there is no significance relationship between EPS and MPS is rejected and the alternate hypothesis is accepted. This result is in tandem with the submission of Pushpa & Sumangala (2012). Similarly, empirical findings from the regression analysis on the second hypothesis indicates that there is no significance relationship between Dividend per share and (DPS) and market price per share (MPS). This is evident in the t-statistics value of -.0098 and a p-value of .923. This outcome is in line with the submission of Adefila, Oladipo & Adeoti (2004), (Uddin & Chowdhury, 2005), Denis & Osobov (2008) and Adesola & Okwong (2009). Results on the third hypothesis as depicted in table (5) shows that there is no significance relationship between dividend yield and Market price per share (MPS). This outcome is evident in the t-statistics value of -4.897 and a p-vale of > 000. That is a bank with a potential for high growth will pay lesser dividends from earnings to their shareholders so as to have opportunity for more investment. Thus, indicating that an inverse relationship between DPS and MPS. This outcome is in consonance with the findings of Heaney & Pavlov (2004) where a significant negative relationship was observed between dividend yield and the stock prices of firms. Finally, results on the fourth hypothesis as depicted in table (5) also shows that there is no significant relationship between retention ratio (RR) and market prices per share (MPS). This outcome is also evident in the t-statistics value of -4.877 with p-value of 000. This outcome corroborates the findings of Taimer, Harsh and Rekha (2015), Mohammad (2013) and Khan, Aamir, Qayyum, Nasir and Khan (2011) where they observed a significant negative relationship was observed between retention ratio and stock price performance of firms.

5. Conclusion

The study basically looked dividend policy in Nigerian banks and how it impacts on share valuation. Findings from the study shows that while a significant positive relationship was observed between earnings per share and market price per share, on the other hand, dividend yield and retention ratios had a significant negative impact on the market price per share for the sampled firms. This outcome therefore, suggests that the dividend policy of banks operating in Nigeria should favour high payout ratio for their share value to be enhanced. This will invariably shore up the fundamental and technical performance of their shares which will position them for improved performance with resultant higher profit. The management and boards of banks should hence, ensure that robust dividend policy is put in place. Also, the efficient record keeping and update of shareholders register must be ensured. The initiative of the security and exchange commission in collaboration with Central Securities Clearing System (CSCS) as it affects e-dividend must be pursued vigorously to ameliorate the incidence of unclaimed dividend.

6. Limitation and Suggestion for Further Study

The study considered variables such as EPS, DPS, Dividend Yield (DY) and Retention Ratio (RR) to measure their impact on share prices. However, there are other countless variables that affect dividend policy of a firm with their attendant consequences on the share prices. The influence of other factors such as the ownership structure of a company, the different expectations of shareholders, liquidity, inflation and age of the firm, on the dividend policy could be explored in the subsequent research with the attendant effects on the share price.

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