MEASURING AND ANALYZING THE EFFECTS OF DIVIDEND POLICY IN BANKING PROFITS AND GROWTH

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Abstract
The paper examined the effects of dividend policy on profits and growth of banking firms in Nigeria. Survey research design was adopted and structured questionnaire was administrated to elicit data from employees of Eco Bank Plc. Three hypotheses were formulated and tested using chi-square statistical tool. The findings revealed that dividend policy is a strategic tool for growth in the banking industry and dividend payout has an impact in the wealth maximization in the banking industry. It also revealed that there is significant relationship between the dividend policy and profitability in the banking industry. The paper therefore recommended that the board of directors should review the dividend payout policy of the banking industry to ensure maximum operation. The banking sector should also ensure compliance with relevant and required policies of dividend payment in order to reduce the adverse effects of dividend payment on the profitability of the banking industry.

Keywords: Dividends, dividend payout; wealth maximization; profits; growth

Introduction
The importance of dividend policies in public stock companies, particularly the banking industry cannot be over-emphasized. A firm must decide each period whether to retain all its earnings or distribute part of them to shareholders. This also depends on whether the firm is optimistic of having acceptable investment opportunities in the future. If the firm pays a low dividend, there will be high retained earnings for future investment opportunities. If the investment opportunities did not materialize, then dividends would be increased and share price falls (i.e shareholders’ value falls) and the shareholders will be disappointed (Pandey 1983). With the last consolidation exercise initiated by the CBN on July 06 2004 to meet the banking industry cannot be overemphasized 25 billion naira recapitalization requirement, it saw banks raising money by issuing shares to the general public. This has made imperatives that good dividend policies should be made so that shareholders wealth is maximized in the long run. The problem is isolating the dividend increase from investors’ disappointment. This raises the
question on the role of dividend policy in achieving profitability and growth in the banking industry. Dividend policy has presented different issues to academicians and practitioners such as what should the bank’s dividend policy be? Once the bank decides on whether to pay dividend they may establish a somewhat permanent dividend policy, which may in turn impact on investors and perceptions of the bank in the financial markets. What they decide depends on the situation of the bank at present and in the future. It also depends on the preferences of investors and potential investors. There is a need to also ask, what should the investors do about dividend policy? Some evidence suggests that investors are not concerned with a bank's dividend policy since they can sell a portion of their portfolio of equities if they want cash. This evidence is called the “dividend irrelevance theory,” and it essentially indicates that an issuance of dividends should have little or no impact on stock price.

Furthermore, the choice of the appropriate dividend policy depends on the references of investors and potentials investors as well on the company’s capital structure and its future plan. The board of directors holds a fiduciary (trustable) position both with regard to the company as well as shareholders. The board of directors must combine three decisions pertaining to investment, financing and dividends simultaneously as these three decisions are interrelated. Dividend policy decision influences the financing decision of the firm through retained earnings.

The primary aim of this research was to consider the effect of dividend policies in profit and growth in the banking industry and make policy recommendation on effective and efficient dividend policies in the banking industry

Review of Literatures
Black (1976) in his study concluded with the following question: “What should the corporation do about dividend policy?. A number of factors have been identified in previous empirical studies to influence the dividend policy decisions of the firm. Profits have long been regarded as the primary indicator of the firm’s capacity to pay dividends. DeAngelo and DeAngelo (1990) in an empirical study find that firms in financial distress are reluctant to reduce dividends. Dividend can also provide important information to the stockholders regarding the firm’s performance. Asquith and Mullins (1983), Healy and Palepu (1988), Michaely, Thaler, and Womack (1995) among others referred to this as a signaling effect. Pettit (1977), Nissim and Ziv (2001) and Bali (2003) have also provided evidences in support of signaling effect.

Grullon et al. (2002), and DeAngelo and DeAngelo (2006) advance life-cycle explanations for dividends that rely, implicitly or explicitly, on the trade-off between the advantages (e.g., flotation cost savings) and the costs of retention (e.g., agency costs of free cash flow). The trade-off between retention and distribution evolves over time as profits accumulate and investment opportunities decline, so that paying dividends becomes increasingly desirable as firms mature (DeAngelo, DeAngelo & Stultz, 2006).

Fama and French (2001) find that firms with current high-profitability and low-growth rates tend to pay dividends, while low profit/high-growth firms tend to retain profits. Murhadi (2010) find that corporate life cycle stages influence dividend policy when a company in its growth stage tends not to distribute dividends.

168
Following the work of Miller and Modigliani (1961), researchers, relaxing the assumption of perfect capital market, have investigated various factors influencing dividend decision. Extensive studies have been done over time to find out the factors affecting dividend payout ratio of a firm. Some of the factors identified in previous empirical studies to influence the dividend policy decisions of the firm include profitability, risk, cash flows, growth, taxes, price etc.

Lintner (1956) conducted a classic study on how U.S. managers make dividend decisions. He developed a compact mathematical model based on survey of 28 well-established industrial U.S. firms which is considered to be a finance classic. According to him the current year earnings and previous year dividends influence the dividend payment pattern of a firm.

Fama and Babiak (1968) studied the determinants of dividend payments by individual firms during 1946-64. The study concluded that net income seems to provide a better measure of dividend than either cash flows or net income and depreciation included as separate variables in the model. Baker, Farrelly and Edelman (1986) surveyed 318 New York stock exchange firms and concluded that the major determinants of dividend payments are anticipated level of future earnings and pattern of past dividends.

Pruitt and Gitman (1991) asked financial managers of the 1000 largest U.S. and reported that, current and past year’s profits are important factors influencing dividend payments and found that risk (year to year variability of earnings) also determine the firms’ dividend policy. Baker and Powell (2000) concluded from their survey of NYSE-listed firms that dividend determinants are industry specific and anticipated level of future earnings is the major determinant. In other studies, Rozeff (1982), Lloyd et. al. (1985), and Collins et. al. (1996) used beta value of a firm as an indicator of its market risk. They found statistically significant and negative relationship between beta and dividend payout. D’Souza (1999) also found statistically significant and negative relationship between beta and dividend payout. However showed a positive but insignificant relationship in the case of growth and negative but insignificant relationship in case of market to book value.

Alli et.al (1993) reveal that dividend payments depend more on cash flows, which reflect the company’s ability to pay dividends, than on current earnings, which are less heavily influenced by accounting practices.

Green et al. (1993) questioned the irrelevance argument and investigated the relationship between the dividends and investment and financing decisions. Their study showed that Dividend decision is taken along with investment and financing decisions, the results however do not support the views of Miller and Modigliani (1961).

Dhrymes and Kurz (1967) and McCabe (1979) found that the firm’s investment decision is linked to its financing decision. Higgins (1972), Fama (1974), and Smirlock and Marshall (1983) documented no interdependence between investments and dividends. Higgins (1981) indicated a direct link between growth and financing needs: rapidly growing firms have external financing needs because working capital needs normally exceed the incremental cash flows from new sales. Arnott and Asness (2003) based their study on American stock markets (S&P500) and found that higher aggregate dividend payout ratios were associated with higher future earnings growth. Both Zhou and Ruland (2006) and Gwilym et al. (2006) supported the findings of Arnott and Asness. Zhou and Ruland examined the possible impact of dividend payouts on future earnings growth. Their study used a sample of active and inactive stocks listed on NYSE and NASDAQ with positive, non-zero payout ratio companies covering the period from 1950-
2003. Their regression results showed a strong positive relation between payout ratio and future earnings growth.

Mancinelli and Ozkan (2006) undertook an empirical investigation of the relationship between the ownership structure of companies and dividend policy using 139 firms listed in Italian exchange. Their results suggested that the dividend payout ratio is negatively associated with the voting rights of the largest shareholders. Mohammed Amidu and Joshua Abor (2006) examined the factors affecting dividend payout ratios of listed companies in Ghana. The results of their study showed that payout ratios were positively related to profitability, cash flow and tax but are negatively related risk and growth. Crutchley and Hansen (1989) find that the greater the size of the firm, the greater the risk of the firm’s operation, and the lower the costs of capital, the greater the dividend payout ratio the firm has. Jensen, Solberg and Zorn (1992) showed higher profit contributed by lesser director ownership, provides lower growth rate and lower level of investment, resulting higher level of dividend payout ratio.

Other studies showing that the which identified the major factors influencing dividend policy as profitability, leverage, ownership structure, firm size, risk, age, firm growth and dividend changes include Eriostis and Vasiliou (2003), Amidu and Abor (2006), Al-Malkawi (2007, Kowaleski, Stetsyuk and Talavera (2007). Few studies have been done on dividend payout decisions of financial firms. Onali (2009) find a positive relationship between default risk and dividends. Lee (2009) in a Korean Banking industry finds that major factors influencing a bank dividend decision includes profitability, safety of banks and risk. Huda and Farah (2011) in a Bangladesh banking industry study finds the factors influencing bank dividend decision to include Revenue, earnings per share, cash and cash equivalent factors and retained earnings. Marfo-Yiadom and Agyei (2011) find the determinants of dividend policy of banks in Ghana to include profitability, leverage, and changes in dividend, collateral capacity, growth and age.

While most of the studies discussed so far are in developed Countries and some emerging markets. The studies also focused on non-financial firms. Studies have been done in Nigeria on dividend policy decisions of non-financial firms. However, most of Nigerian studies focus attention on replicating or modifying Lintner’s model. Some of Nigerian studies include Uzoaga and Aloizieuwu (1974), Inanga (1975, 1978) Soyode (1975), and Oyejide (1976), Izedonmi and Eriki (1996) etc. The recapitalization of the banking industry boosted the number of securities on Nigerian stock market increasing public awareness and confidence about the Stock market. The recapitalization also made the banking sector to be the most dominant sector in the Nigerian economy. For instance, 15 of the 20 highest capitalized companies are banks. The Banking sector stocks made up about 56% of total market capitalization by the end of 2008 (Securities and Exchange Commission, 2009). It will be of interest to examine the factors influencing dividend decision of Nigerian banks.

**Dividend Irrelevance Proposition: Modigliani &Miller Approach (1961)**

In 1961, two noble laureates, Merton Miller and Franco Modigliani (M&M) showed that under certain simplifying assumptions, a firm’s dividend policy does not affect its 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, dividends 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.

M&M 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 situations 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 and non contracting or agency cost exist.
3. Flotation and transportation costs are non-existent.

Indian Scenario

In Indian Context, a few studies have analyzed the dividend behavior of corporate firms. Krishnamurty and Sastry (1971) analyzed dividend behavior of Indian chemical industry for the period 1962-67 and undertook cross sectional data of 40 Public Limited companies. The results revealed that Lintner model provides good explanation of dividend behavior.

Dhameja (1978) in his study tested the dividend behavior of Indian companies by classifying them into size group, industry group, growth group and control group. The study found there was no statistically significant relationship between dividend payout, on the one hand and industry and size on the other. Growth was inversely related to dividend payout and was found to be significant. The main conclusion were that dividend decisions are better explained by Lintner’s model with current profit and lagged dividend as explanatory variable.

Mahapatra and Sahu (1993) found cash flows as a major determinant of dividend followed by net earnings. Bhat and Pandey (1994) undertook a survey of managers’ perceptions of dividend decisions and found that managers perceive current earnings as the most significant factor. Narsimhan and Asha(1997) observed that a the uniform tax rate of 10 % on dividend as proposed by Union Budget 1997-98, alters the demand of investors in favor of high payouts.

Mohanty (1999) found that firms, which issued bonus shares, have either maintained the payout at the pre bonus level or only decreased it marginally thereby increasing the payout to shareholders. Narsimhan and VijayLakshmi (2002) analysed the influence of ownership structure on dividend payout of 186 manufacturing firms. Regression analysis shows that promoters holding as of September 2001 has no influence on average dividend payout for the period 1997-2000.

Anand Manoj (2002) analyzed the results of 2001 survey of 81 CFOs of Business today- 500 companies in India to find out the determinants of the dividend policy decisions of the corporate India. He used factor analytic framework on the CFOs' responses to capture the determinants of the dividend policy of corporate India. The findings revealed that most of the firms have target dividend payout ratio and were in agreement with Lintner's study on dividend policy. CFO’s use dividend policy as a signaling mechanism to convey information on the present and future.
prospects of the firm and thus affects its market value. The managers design dividend policy after taking into consideration the investors' preference for dividends and clientele effect.

Reddy Y. Subba and Rath Subrendu (2005) examined dividend trends for large sample of stocks traded on Indian markets indicated that the percentage of companies paying dividend declined from over 57% in 1991 to 32% in 2001, and that only a few firms paid regular dividends. Dividend – paying companies were less likely to be larger and more profitable than non-paying companies, though growth opportunities do not seem to have significantly influenced the dividend policies of Indian firms.

The rise of the number of firms not paying dividends is not supported by the requirements of cash for investments Sharma Dhiraj (2007) empirically examined the dividend behavior of select Indian firms listed on BSE from 1990 to 2005. The study analyzed whether or not the dividends are still vogue in India and tried to judge the applicability of one of the two extremely opposite schools of thoughts- relevance and irrelevance of dividend decision. The study also analyzed the applicability of tax theory in the Indian context. The findings offered mixed and inconclusive results about tax theory indicating that the change in the tax structure does not have a substantial effect on dividend behavior of firms.

A number of conflicting theoretical models, all lacking strong empirical support, define recent attempts by researchers in finance to explain the dividend phenomenon. But to come with concrete conclusions an intensive study of all theoretical models together with empirical proof is needed. The extensive literature on dividend policy in the last five decades have been unable to reach a consensus on research on a general dividend theory that can either explain the process of dividend decision making or predict an optimal dividend policy. Therefore it becomes important to study dividend behavior of Indian companies using the framework of empirical models.

**Shareholders’ Value Creation and its Linkage with Dividend Policy Decisions**

It has been recognized by various research studies that a dividend policy could make significant impact on corporate future value when established and carefully followed. The goal of profit maximization is widely accepted goal of the business as it reconciles the varied, often conflicting, interest of the stakeholders.

The interest in shareholders’ value is gaining momentum as a result of several recent developments:

1. The threat of corporate takeovers by those seeking undervalued, under managed assets
2. Impressive endorsements by corporate leaders who have adopted the approach
3. The growing recognition that traditional accounting measures such as EPS and ROI are not reliably linked to the value of the company’s shares
4. Reporting of returns to shareholders along with other measures of performance in business press.
5. A growing recognition that executives’ long term compensation needs to be more closely tied to returns to shareholders.

The “shareholders value approach” estimates the economic value of an investment (e.g shares of a company, strategies, mergers and acquisitions, capital expenditure) by discounting forecasted cash flows by the cost of capital. These cash flows, in turn, serve as the foundation for shareholder returns from dividends and share price appreciation.
A going concern must strive to enhance its cash generating ability. The ability of a company to distribute cash to its various constituencies depends on its ability to generate cash from operating its business and on its ability to obtain any additional funds needed from external sources. Debt and equity financing are two basic external sources. Borrowing power and the market value of the shares both depend on a company's cash generating ability. The market value of the shares directly impacts the second source of financing, that is, equity financing. For a given level of funds required, the higher the share price, the less dilution will be borne by current shareholders. Therefore, management’s financial power to deal effectively with corporate claimants also comes from increasing the value of the shares. This increase in value of shares can be brought about by rewarding shareholder with returns from dividends and capital gains.

The most famous statement about the relationship between dividend policy and corporate value claimed that, in the presence of perfect markets, “given a firm's investment policy, the dividend payout policy it chooses to follow will affect neither the current price of its shares nor the total return to its shareholders” However, “market imperfections as differential tax rates, information asymmetries between insiders and outsiders, conflicts of interest between managers and shareholders, transaction costs, flotation costs, and irrational investor behavior might make the dividend decision relevant”

The relevance of dividend policy to corporate value is due to market imperfections. Shareholders can receive the return on their investment either in the form of dividends or in the form of capital gains. Dividends constitute an almost immediate cash payment without requiring any selling of shares. On the contrary, capital gains or losses are defined as the difference between the sell and buy price of shares. Friction costs are one of the market imperfections and are further distinguished in transaction costs, floatation costs and taxes. Another market imperfection is that of information asymmetries between the insiders (e.g. managers) and the outsiders (e.g. investors). Agency conflicts, stemming from the different objectives of company's stakeholders, form the third market imperfection. Finally, there are some other issues that are related to dividend policy and cannot be placed among the previously mentioned imperfections.

Methodology
A survey research design will be used. Survey research selects a sample from a subset of the population using techniques of sampling. The population is the total number of banks in Nigeria. The simple random sampling techniques, which divides the population into stratum selected from the sample size: the number of quoted banks in Nigeria. Primary data was used. The reason for the choice of primary data was to ensure direct gathering of information from the respondents. This was done through questionnaires. The method of data analysis adopted for this study was the chi-square. We formulated that:

H01: Dividend policy is not a strategic tool for growth in the banking industry
H02: Dividend payout does not impact on the wealth maximization in the banking industry
H03: There is no significant relationship between the dividend policy and profitability in the banking industry.

Data Analysis and Discussion
H01: Dividend policy is not a strategic tool for growth in the banking industry.

Test Statistics
From the table, the three questions related to the hypotheses have all their chi-square values (23.551-0.000; 80.286-0.000; and 31.408) significant at 0.000 which is lesser than the p-value of 0.05. The significance of this is that dividend policy is a determinant for bank growth. This is evidenced in modern finance and anecdotal evidences that companies who pay dividend is likely to have growth in share price (dividend growth rate model) and thus maximizing shareholders’ wealth and a factor for public to select and buy shares of the companies. This will inadvertently increase the share capitalization and asset base of the bank. The result also depicts that the bank has good and strong dividend policy which gives shareholders the assurance of predictable dividend payments. The acceptance of the alternative hypothesis that dividend policy is a strategic tool for the growth in the banking sector also connotes that there is a continuous increase in dividend payout which in turn increases the share prices of individual bank in the financial sector. This finding is also in line with Zaman (2013a) who studied the determinants of dividend policy of a private commercial bank in Bangladesh. His results show that bank growth, size and profitability are determinants of dividend policy. His finding further revealed that profitability is however a better determinant that bank growth and size. However, a change in dividend policies may not necessarily affect the change in banks’ growth over time. Zaman (2013b) suggested that a rapid growth rate may not necessarily be a strong determinant of Bangladesh private commercial banks. Furthermore, our finding submits and supports empirical evidence of Kapoor (2009) that there is a relationship between growth and dividend payout ratio however negative.

**H02:** Dividend payout does not impact on the wealth maximization in the banking industry.

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<td>Chi-Square</td>
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a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 16.3.
b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 9.8.
c. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 12.3.

The asymptotic significances of the chi-square values in the table above are put at 0.000 which are measured on 5% level of significance. This establishes the independence of test that dividend payout has an impact in the wealth maximization in the banking industry. This explains that
banks maintain steady and growing dividend payments as this increase the banks’ value as well as share value. In addition, the banks have also involve in the practice of adjusting dividend payments towards a target payout ratio and its regularity in the declaration of dividend have greatly impacted on the wealth maximization in the banking industry. We accept the alternative hypothesis that dividend payout has an impact in the wealth maximization in the banking industry. Our findings collaborate with that of Haque, Siddikee, Hossain, Chowdhury and Rahman (2013) who revealed that dividend payout has an inverse relationship with shareholders’ wealth creation. They however advised that the pharmaceutical company should retain large portion of their earnings rather than high payout ratio. Our findings also submit to the empirical finding of Gul, Sajid, Razzaq, Iqbal and Khan (2012) that there is significant influence of dividend policy on wealth of shareholders for companies paying dividend. Gul et al. (2012) further submitted that there is difference in the market value of paying dividend firms and non-paying dividend firms. However, Tahir and Raja (2014) presented a divergent finding that there is insignificant relationship between dividend payout ratio and shareholders wealth.

**H03:** There is no significant relationship between the dividend policy and profitability in the banking industry.

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<th>Test Statistics</th>
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<td>Chi-Square</td>
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<td>Asymp. Sig.</td>
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a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 16.3.
b. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 9.8.
c. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 12.3.

The chi-square values in the table are all significant. This is evidenced in their respective asymptotic significances as they are all well below the p-value (decision criterion) of 0.05. We therefore accept that there is significant relationship between dividend policy and profitability in the banking industry. The culture of the banking firms to pay dividend will result in the removal of excess cash flows that could be invested in unprofitable projects. This result also signifies that dividend payments are better signals of confidential information than other media forms; thus raising share value and it is a demonstration that the bank is strong enough and can pass up profitable investments. Our findings support the works of Ajanthan (2013) and Adediran and Alade (2013). Ajanthan (2013) established that there is a strong positive relationship between dividend policy and firm profitability which will therefore enhance shareholder value. Adediran and Alade (2013) posit a significant positive relationship between dividend policies of organizations and profitability, investments and Earnings per Share (EPS). Thus, our paper contributes and converges with empirical studies that establish a significant relationship between dividend policy and banks’ profitability most importantly in the Nigeria banking industry.
Conclusion and Recommendations
The primary objective of this research is to examine the effect of dividend policy on the profitability and growth in the banking industry. That dividend policy has effect on profitability and growth in the banking industry is not a doubt.

The purpose of this research is to investigate how dividend policy can be used as a tool for developing banking industry. The study attempts to find out whether dividend policy contributes to the shareholders wealth maximization (profitability) of banking industry in Nigeria and to find out whether dividend policy have impact on bank’s profitability and growth in Nigeria. Findings revealed that dividend policy is a strategic tool for growth in the banking industry and dividend payout has an impact in the wealth maximization in the banking industry. It also revealed that there is significant relationship between the dividend policy and profitability in the banking industry. Based on these findings, the following are the recommended line of action which the country should take so as to be in line with other countries:

- The board of directors should review the dividend payout policy of the banking industry to ensure maximum operation.
- The banking sector should ensure that they comply with relevant and required policy of paying dividend in order to reduce the effect of dividend on the profitability of the banking industry.
- The level of dividend payments should be determined by shareholders preference and implemented by their management representative.
- The banking industry should ensure application of “shareholders value approach” to estimates the economic value of an investment by discounting forecasted cash flows by the cost of capital.

References


