

RESEARCH ARTICLE

Dividend Payout Ratio and Performance of Deposit Money Banks in Nigeria

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Abstract

This study examined the impact of performance on dividend payout ratio of some selected deposit money banks in Nigeria spanning the periods between 2004 and 2013. Guided by explanatory research design, four deposit money banks were selected and data relating to relevant variables of leverage and profitability and dividend payout ratio were gathered. Correlation analysis and multiple regressions were carried out to analyses the data. The findings revealed that dividend payout ratio is negatively related to banks' leverage and profitability. The study concludes that dividend payout ratio is inversely related to performance of deposit money banks in Nigeria. The study recommends that deposit money banks should consider the dividend policy of the banks if they must achieve shareholders' wealth and improve the consistent performance of the banks' share prices.

Keywords: *Dividend payout ratio, leverage, profitability.*

Introduction

Dividend decisions involve the periodic determination of proportion of a firm total distributable earnings that is payable to its ordinary shareholders. Sometimes, firms use repurchasing process that either helps or hurts stockholders. The larger the dividend paid, the fewer funds are retained for reinvestment and the more the company relies on its sources of long term funds such as additional issues of equity and or debt capital to finance projects. Company earned profit is distributed yearly to shareholders. This process is known as dividend policy, and its delivery procedure differs from different countries because of different tax policies, rules, regulations and different institutions and capital markets [1, 2].

Companies listed on the stock market are expected to pay dividend which is paid out of the company's earnings and reduces the amount of retained earnings that could be used for internal financing by the firm. Companies are expected to evaluate dividend in the light of maximizing the shareholders wealth which may include

market price of the share and the current dividend. Firms may fashion out a way to retain or distribute all earnings depending on the optimism of having viable investment opportunities in the future. But in a situation where the investment yields negative returns, dividends are increased and the share price falls. The dividend policy is used in targeting a particular payout ratio. Dividend as a residual in line with some other school of thoughts believing that dividend payout is a function of financing decision. The investments opportunities should be financed by retained earnings where internal accrual forms line of financing growth and investment.

A firm dividend policy is usually influenced by both internal and external factors. The internal factors which focus on firm specific attributes noted among the money deposit banks in Nigeria are management controllable factors which include bank size, profitability, liquidity, leverages. The external factors considered mostly in the

firm include inflation rate, interest rate (this covers the exchange rate local and international), and the gross domestic products are known to be factors beyond management control and regulatory measures.

Most studies carried out in the Banking industry in Nigeria were centered on different variables like capital adequacy, credit risk ratio, loan loss provision, and impact of capital market on banks performance [1, 2, 3]. This paper tends to analyse the trend of dividend payout ratio in the money deposit banks in Nigeria. Dividend policy in different dimensions in the Nigeria context of examining the firms, while other examined dividend policy in an emerging capital market of Africa. Despite the numerous studies on the factors affecting dividend payout ratio of firms conducted in developing countries, there is no criterion that has commanded general consensus in the finance literature for the trend of dividend payout ratio in money deposit banks in Nigeria. Due to lack of universal agreement of the factors affecting dividend behaviour of the firm, the study therefore seeks to examine the extent to which this specific attributes of firms can be compared and the influence of dividend payout ratio on performance of some listed banks in Nigeria. It is therefore, necessary to empirically assess the impact of dividend payout ratio on the performance on deposit money deposit banks in Nigeria. The paper is structured into five sections; introduction, review of related literature, methodology of the study, discussion on the findings, and recommendations.

Literature Review

Dividends are distributions of a company's profit distributable to its shareholders. This amount of dividend depends on the number of shares owned by the shareholders in stock which the company pays. Cash payment is paid per share while stock dividends involve given out shares in form of bonus to existing shareholders. Increasing dividend payment, a company may largely attract a good number of lightly taxed investors and will in-turn increase the share price of the company. It changes the institution to please

certain influential clientele as a result the relationship between dividend changes and future cash flows as predicted by signaling theory as the preferential treatment given to investors in relation to tax payment really matters. The debt equity trade-off indicates the relative proportion or fraction of debt to equity used to finance the bank assets. This trade-off also referred to as risk, gearing leverage indicates that risk affects dividend policy according to which firms with both high growth rates and high dividend payout ratio after utilizing debt financing. Other author suggested negative relationship between firm's risk and the dividend payout ratios. This shows that the authors concentrated on signaling theory, agency theory and debt equity ratio to determine the pattern of dividend stream across industries. The net effects of leverage and retention ratios on dividend payout ratio on firms in Nigeria.

Leverage and Dividend Payout Ratio

Another attribute that will be used to analyse the trend of money deposit bank in Nigeria is leverage which influences firms' dividend behaviour. It is measured as the ratio of debt equity of the firm. Firms that finance with high debt are likely to pay lesser return as dividends to their shareholders. This is because highly levered firms are more risky and volatile. Al-Twairry [4] observed in his study an inverse relationship between leverage and dividend payout connoting a higher leverage and a lower dividend payout ratio. This is in line with the argument put forward by Al-Malkawi [5] that firms that finance with more debts commit their companies to financial charges inform of interest payments and failure to fulfill these periodic payments may lead to business liquidation.

Empirical studies had also discovered a negative significant impact between leverage and dividend payout ratio [5-7]. These authors argued that highly levered firms retained their cash flow instead of distributing cash to their shareholders and protect their creditors. Thus, leverage has consistently has negative effects on dividend payout of the firms.

Dividend policy in Pakistan banking sector considered leverage as high means that firm have interest expense which will lead to a low net income and thus less earning will be available for shareholders. They observed that dividend payments to shareholders may suffer the financing and investment plans especially in case of high leveraged firm concluding that firms using more debt commits itself to fixed financial charges in forms of interest payment and failure to pay these periodic interest payments leads to business liquidation. This means that a risk is associated with highly leverage firms that results in low dividend payments. Negative and insignificant relationship between leverage and dividend payout ratio of listed companies on Karachi stock exchange with the conclusion that leverage has no significant effect on firms. Contrary to the above argument, findings indicate that there is a direct relationship between financial leverage and dividend payout, this means that the higher the leverage of the firm, the more the dividend distributed to shareholders. Studies conducted by Eriotis and Vasiliou [8], and Ebeneze [9] argued that firms with high leverage ratio have high transaction costs and are in a weak position to pay higher dividend in order to avoid cost of external financing. However, Hashima et al. [10] found a negative and insignificant relationship between leverage and dividend payout ratio. This outcome implies that whether there is an increase or decrease in the value of leverage, the dividend payout will not be affected in anyway.

Profitability and Dividend Payout Ratio

The decision on whether the firm distributes dividend to its shareholder depends on its ability to make profit. Thus, profitability is seen as one of the important elements that could influence dividend behaviour of the firm. Profitability of the firm plays a significant role in influencing and predicting dividend payout ratio of the selected money deposit banks. For the purpose of this study, profitability is measured as ratio of net profit before tax to total equity of the selected money deposit bank (First Bank, UBA, GTB and Access). When a firm makes

profit overtime and declares dividends to its investors, it serves as an indication that the firm is performing well and also has good external investors. Thus, relation between profitability and dividend behaviour of the firm is supported with *Catering and Signaling theory* which in practice states that change in firms dividend policy can be observed to have an effect on its share price because an increase in dividends produces an increase in share price while a decrease in dividends produces a decrease in share price which is mostly contrary to M&M model.

Al-Malkawi [5] opined that firms that earn high profit prefer to pay more dividends if they have no investment opportunities and in the context of Nigeria banks, equity invested by the banks can earn more profits. Empirical results in respect of profitability and dividend payout ratio revealed a mixed result [5]. Abdul and Haruto [11] arrived at a positive and significant relationship between profitability and dividend payout of the firm. This implies that the higher the financial performance of a firm, the more likely, firms will be willing to payout dividends to shareholders. In essence, the more profitable a firm is, the more such firm will be willing to improve on its dividend policies to its shareholders. On the other hand, studies conducted in pharmaceutical sector and Amitabh & Chara [12] confirmed that firm profitability is negatively related to dividend payout of the firm concerned. The main reason behind this outcome was put forward in the work of Baker et al [13] who argued that there may be a situation where firms would need to plough back a major proportion of its profit to support their investment opportunities. In this case, such firm may declare a low dividend payout ratio. However, studies conducted by Adediran and Alade [14], Boamah et al [15] revealed that profitability is not a significant variable in explaining and predicting dividend behaviour of the firm.

Dividend Signaling Theory

In practice, change in a firm's dividend policy can be observed to have an effect on its share price. 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. Rise in dividend payment is viewed as positive signal conveying positive information about a firm's future earnings prospects resulting in an increase in share price while reduced individual payment is viewed as negative signal about future earnings prospects resulting in a decrease in share price. One of the theories is discussed briefly.

Free cash flow theory/ agency theory: the concept of this theory starts from agency problem and agency cost. Agency problem refers to the problem arising between principal and agent, principal are shareholders and agent are managers. Main duty of managers is to run the business efficiently and increase the shareholders wealth. The agency problem arises when managers have excess cash flow, they invest in low or negative NPV projects and use that cash for their leisure and comfort and this is agency problem. This made shareholders to monitor the managers. The cost of monitoring is referred to as agency cost. To reduce the agency cost, dividends are given to the shareholders, when dividends are issued then managers had less cash in hand and they can't misuse it. Easter book (1984) argued that when managers have less cash for financing new projects they will move towards the capital market, since capital market impose some restrictions to the managers for misusing the money and capital market

A Catering Theory of Dividend

The theory has three basic ingredients. First, it posits a source of uninformed investor demand for firms that pay cash dividends, second, limits on arbitrary allow this demand to affect current share prices. Third, managers rationally weight the short run benefits of catering to the current mispricing against the long run costs and then make the dividend payment decision. The theory has predicted a model that focused on an empirical work that the propensity to pay dividend depend on a

dividend premium or sometimes discount in stock prices. Time variation in four proxies for dividend premium were used to test hypothesis the broadest was called dividend premium which was different between the average market to book ratio of dividend payers and non-payers while other measures are the difference in prices of citizens utilities (CU), cash dividend and stock dividend share classes according to this theory dividend premium, the CU dividend premium, and initiation effects are positively related to prevailing excess demand for payers while in contrast, the difference in future returns of payers and non-payers would be negatively related to this demand if demand for payers is currently so high that they are relatively over period their future returns will be relatively low.

Dividend premium variables are driven by sentiment indicating that investors seeks firms that exhibit salient characteristic of safety including dividend payment but when it is low, investors prefer firms with the characteristics of maximum capital appreciation potential which means no dividends indicating that sentiment is the positive correlation between the dividend premium and the closed end fund discount. In summary, the test catering view of dividends relaxes the market efficiency assumption of Miller and Modigliani dividend irrelevance proof. It also adds to the literature of behavioural corporate finance developed by Shefrin and Stamm (1984) known to be theory of investors preference for dividend based on self-control problems. Catering model looks into managerial decision to cater for investors by paying dividends when investors put a stock premium on payers and not when investors prefer non-payers. In the course of this research catering theory would be adopted because it seems applicable to the Nigeria money deposit banks selected. It looks into the managers rationally weights, the shareholders/investors salient interest and demand for firms that pay higher dividend and relaxes the market efficiency.

Methodology

For the purpose of the study, descriptive

analysis and correlation design were adopted. The descriptive analysis, correlation analysis and multiple regressions were carried out.

Definition of Variables

Dividend payout ratio (DPR): This is defined as ratio of EPS to DPS

Leverage (Lev): This is defined as total debt to total equity

Profitability (ROE): This is defined as profit after tax divided by total equity share

Model Specification

Dividend payout ratio (DPR) is the independent variable which is explained by variables of leverage (LEV) and profitability (represented as ROE).

$DPR = f(LEV, ROE) \dots$ mathematical equation (i)

$DPR_{it} = \beta_0 + \beta_1 LEV_{it} + \beta_2 ROE_{it} + \epsilon \dots$ regression/linear equation (ii)

Where:

DIPV= Dividend Payout ratio

LEV= Leverage calculated as total debts to total equity

ROE= Return on Equity

ϵ = Error term

β_0 , β_1 , and β_2 are the parameters to be used to estimate priori expectation

Results and Discussions

Data gotten were analyzed and the results of the descriptive statistics, correlation result, and multiple regression analysis were presented. Descriptive statistics were used to describe the data; correlation analyses were done to determine the nature and degree of relationship between the variables; while multiple regressions were carried out to measure the coefficients of the linear equation model.

Descriptive Statistics

This section presents the descriptive statistics of the study where the minimum, maximum, mean, and standard deviation of

the coefficients were described. The summary of the descriptive statistics are shown below:

Table 1: Summary of Descriptive Statistics (2003-2013)

Var	Min	Max	Mean	StdDev	Obs
DPR	0	9654.67	268.06	1524.6	40
LEV	.273	9.143	3.383	2.36	40
ROE	3.13	387.10	112.91	87.18	40

Source: STATA 11.2

The data set as indicated from the table above contained a total of 40 observations for 4 selected deposit money banks (FBN, UBA, GTB and Access bank respectively) over a period of ten years for two independent variables and one dependent variable. The analysis above revealed that the data were normally distributed. This signifies that the study is considered valid if obtained from data of quality and further affirmed the validity of regression results. The mean values of all the variables as indicated above ranges from minimum of 0.000 for dividend payout ratio.

The average value of the dividend payout which is measured by the ratio of yearly dividend to net income after tax is 268.1 with a standard deviation of 1524.7. This implies that dividend payout of selected deposit money bank in Nigeria deviate from its mean value up to 0.15%. Leverage of the firm as measured by the ratio of total liabilities to total assets of some selected deposit money banks in Nigeria has an average value of 98.1 with standard deviation of 57.47. This signifies that there is no moderate significant variation among values of leverage of selected banks. The analysis revealed that both the profitability as measured by the ratio of net income after tax to total assets gave values of 3.39 and 98.1 respectively with their standard deviation of 57.47 and 2.36 respectively. In comparison, this result shows a significant variation among values of profitability and leverage across the selected banks.

Correlation Analysis

The section presents the correlation result of the explanatory variables and the explained variable. The correlation matrix is used to examine the linear association between the

independent and dependent variables and also between the independent variables. The study therefore adopted person correlation co-efficient to assess the level of association between the variables concerned.

The table below shows the correlation between the independent variable which is dividend payout and independent variables identified to be leverage (LEV) and profitability (ROE).

Table 2: Correlation Matrix

Var	Dpr	Lev	Roe
DPR	1.0000		
LEV	-6.54858	1.0000	
ROE	-3.61099	0.3357	1.0000

Source: STATA 11.2

The indication from the result above shows the significant level of the variables. The result shows that all the variables are weakly correlated with dividend payout ratio of selected deposit money banks in financial sectors of the firms operating in Nigeria with indication that it spread across other twenty banks not sampled. This shows that the explanatory variables move in opposite direction with the dividend payout ratio of selected deposit money banks in Nigeria. The test was carried out at 1%, and 5% level of significance.

Regression Results

This section presents the regression result of the dependent variable, which is measured by the ratio of yearly dividend to net income after tax (DPR), on components of the explanatory variables which are leverage (LEV) and profitability (ROE). The result is shown below:

Table 3: Summary of regression based on random effect model

Variables	Coefficient	T-value	P-value
LEV	-6.54858	-1.20	0.239
ROE	-3.61099	1.23	0.071
R-square:			
Within		0.1113	
Adj R- square		0.0373	
F (3, 36)		1.50	
Prob		0.2302	

Leverage and Dividend Payout

Financial leverage of selected deposit money bank as measured by the ratio of debt to equity has a t-value of -1.20 and a co-efficient value of -6.54858 with an insignificant value of 0.239. This means that leverage of the selected deposit money bank is negatively and insignificantly influencing and predicting the dividend payout of some selected deposit money banks in Nigeria, as the probability is insignificant at 1% level of significance. Thus, financial leverage and dividend payout of the selected deposit banks has inverse relationship. That is the higher the value of leverage, the lower the dividend payout of the firm. The negative effect of leverage is consistent with the priori expectation implying that every 1% increase in leverage of the firm causes the dividend payout to reduce by N6.55k which supported the argument. Firms with high leverage have high transaction costs and are in a weak position to pay higher dividend to avoid the cost of external financing. Highly levered banks look forward to maintain their internal cash flow to fulfill obligations instead of distributing available cash to shareholders and protect their creditors.

The negative effect of leverage on dividend payout may be as a result of high interest expenses, and some administrative cost which will lead to low net income and less earning will be available for shareholders. According to Al-Twairjy [4] argument that states that high levered firms retain more instead of distributing profit to shareholder and that firms with more debt commits itself to fixed financial charges in form of interest payments and failure to pay these periodic interest payments may lead to business liquidation. The result also conform with those empirically revealed by Al-Kuwari [6], Faccio et al [7] etc.

Profitability and Dividend Payout

The priori expectation is that profitability of some selected deposit money banks in Nigeria should have positive and significant impact on the dividend payout of listed bank firms operating in Nigeria. This is because the decision about paying dividend starts with firm's profits and firms earning high

profit prefer to pay more dividends if they have no investment opportunity and other internal issues such as payment of retired staff gratuity and pension.

On the other hand, the result of the research shows that the selected deposit money banks whose profitability were measured by the ratio of net income after tax i.e. profit after tax (PAT) to total asset of selected banks in Nigeria has a value of 1.23 and a beta value of -3.61099 with a significant value of 0.071. This implies that the profitability of the firm is negatively and significantly influencing dividend payout of some selected deposit money banks in Nigeria, with an indication that profitability and dividend payout of the banks move in an inverse direction. That is, the higher the profit earned by the bank, the lesser the dividend declared by the selected banks to the shareholders. The negative impact of profitability on dividend payout of the firm implies that every 1% increase in profitability, the dividend payout will be reduced by 0.36k. The negative impact of profitability may arise when the banks need to plough back a major proportion of its profits to support rapid growth, low dividend may result. Thus, the opportunity cost of holding dividend will increase and tendency to pay dividend decrease. It therefore confirmed with earlier empirical research by Boamah et al [15] and Amitabh & Chera [12] and contradicts with Abdul & Haruto [11].

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Conclusion

In view of the findings above, the statistical and empirical evidence provided above arguably constitute the trend of dividend payout of some selected deposit money banks in Nigeria, with leverage and profitability employed to explain the dividend payout ratio for ten years. As noted above, the findings revealed that leverage has negative and insignificant impact on dividend payout ratio. This is because highly levered banks are not disposed to distributing profits to shareholders. Similarly, the profitability of the banks has negative but significant impact on dividend payout of these selected deposit money banks in Nigeria, suggesting that banks with high profit plough back a major proportion to supports rapid growth/expansion leading to low dividend payout ratio [16-31].

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