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EXPLANATION FOR DIVIDEND PAYOUT POLICIES OF LISTED FIRMS IN NIGERIA- MACROECONOMIC FACTOR OR FIRM SPECIFIC CHARACTERISTICS?

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ABSTRACT

This study was carried out to investigate whether macroeconomic factor (proxied by inflation) affects dividend payout of firms while controlling for firm specific characteristics. Data was obtained from Datastream (worldscope database) on a final sample of sixty four companies. Results from random effect regression indicates that inflation has no significant effect on dividend payout of listed firms in Nigeria. Profitability and investment were found to be significant in explaining dividend payout. The study concludes that some of the firms are not paying dividends due to the need to explore viable investment opportunities. Thus, it was recommended that investors should be carried along on the justification for which the firm omits or cut dividend to avoid negative impact on firm's value.

INTRODUCTION

Dividend arises as a result of the primary goal of the firm which is the maximization of shareholder's wealth. Kapoor (2009) observed that the goal of wealth maximization is achieved by giving the shareholders a "fair" payment on their investment. Many finance scholars have carried out extensive research and have built different models to explain the "best dividend policy". Regardless of this fact, the basis of dividend policy remains a puzzle as Black (1976) noted that the "dividend puzzle" still remain unsolved. Therefore, there still exists questions that scholars in the field are currently struggling to provide definitive answers to.

Dividend policy is often regarded as an agent of economic growth and it is expected that the dividend behavior of listed firms can help to solve some of the problems currently facing the Nigerian stock market. Aivazian, Booth, and Cleary (2003) stated that dividend payments is extremely important to attract capital. This is achieved through attracting local and foreign investors. Conversely, it has been reported that many firms listed on the Nigerian stock exchange have not been meeting expectations of shareholders with regards to dividend payments. Ekwere (2012) stated that only 75 out of 190 firms (39%) quoted on the Nigerian stock exchange paid dividends in the year 2011. In the same vein, Eboh (2012) reported that a total of 41 companies quoted on the Nigerian stock exchange have failed to pay dividends to their shareholders for more than five years. However, past studies (Ap Gwilyn, Seaton, & Thomas, 2004; Baker & Wurgler, 2004; Fama & French, 2001; Hoberg & Prabhala, 2009; Kirkulat & Kurt, 2010; Ronapat & Evans, 2005) provide evidence of declining dividends in different parts of the world and offer explanations on the cause. The explanations offered include lower propensity to pay dividend due to changes in firm's characteristics (Fama & French, 2001); the dividend premium (Baker & Wurgler, 2004b); and the risk factor (Hoberg & Prabhala, 2009). The case in Nigeria needs to be investigated as public opinion has attributed inability of firms to meet up with dividend payments to economic factors. The economic situation in Nigeria is considered to be harsh with a two digit inflation rate and high rate of interest of 11.3% and 12.07% respectively as at September 2012 (CBN News, 2012). It is believed that this increases the operating costs of companies and impedes their liquidity, thus, making dividend payments almost impossible. Kirkulak and Kurt (2010) emphasize the importance of macroeconomic environment in dividend payments by demonstrating how its effect may lead to dividend omissions by firms.

The low level of dividend payments by Nigerian firms creates the need to add to existing literature by investigating whether the economic situation could actually explain this decline. Also, studies on factors influencing dividends have majorly focused on firm-specific characteristics and other internal factors. Little attention have been paid to external factors.

The paper is structured as follows: following this introductory part, section two provides the theoretical considerations and a synthesis of prior related studies: section three discusses the data and sample covered by the study while section four provides the empirical results from random effects regression. Section five concludes the paper.

LITERATURE REVIEW

Theoretical Consideration

Basically, there are two opposing views or theories on dividend policy viz: dividend irrelevance and dividend relevance. Miller and Modigliani (1961) assert that under certain assumptions, perfect capital market, rational behavior, perfect certainty-dividends are irrelevant and therefore have no influence on the share price. This theory suggests that whatever dividend policy a firm adopts has no influence on its market value; therefore, shareholders are indifferent as to whether they receive dividends or capital gains. On the other hand, other schools of thought have argued that assumptions of the MM theory may not hold in the real world where imperfections exist. Therefore dividend payments have been justified based on different theories which include bird in hand theory (Gordon, 1959; Walter, 1963); signaling theory (Bhattacharya, 1979; John & Williams, 1985; Miller & Rock, 1985); agency theory (Easterbrook, 1984; Jensen, 1986; Jensen & Meckling, 1976; Rozeff, 1982); clientele theory (Brennan, 1970; Elton & Gruber, 1970); and more recently, catering theory (Baker & Wurgler, 2004a); and lifecycle theory (De Angelo, De Angelo, & Stulz, 2006; Fama & French, 2001; Grullon, Michaely, & Swaminathan, 2002).

Prior Studies on Factors Affecting Dividend Payout Policies

Lintner (1956) submits that earnings and previous dividends are the most important determinants of dividend payout decisions. Empirical studies have provided further evidence on the importance of these variables. Earnings are positively and significantly related to dividends (Ameer, 2007). Al-Ajmi and Hussain (2011) and Imran (2011) found lagged dividends to be positively related and statistically significant in explaining dividend policy.

More recently, Fama and French (2001) spelt out the characteristics of a dividend payer to include higher profitability, larger size and lower investment opportunities. In line with this, more evidence has been provided that firms with higher profitability are more able to distribute cash dividends. Profitability has therefore been found to be positively related to dividends (Amidu & Abor, 2006; Huda & Farah, 2011; Al-Ajmi & Hussain, 2011; Imran, 2011). Size is also reported to have a positive and significant relationship with dividends (Mehta, 2012; Al-Ajmi & Hussain, 2011; Imran, 2011). Investment opportunity is also statistically significant in explaining dividend policy (Brav et al., 2005).

Amidu and Abor (2006) reported that cash flow is positively related to dividends. On the contrary Imran (2011) documents a negative relationship between dividends and cash flow as it was found that companies plough back into the business rather than pay dividends as cash flow increases. Risk is another important determinant of dividend policy (Hoberg & Prabhala, 2009; Mehta, 2012). Tax is also positively related to dividends (Amidu & Abor, 2006). Contrarily, Brav et al. (2005) found in a survey conducted on executives that tax is not significant as majority of the executives stated that dividend taxation would not affect their dividend decisions.

Brav et al. (2005) distinguished between what determines the dividend policy of a payer and a non-payer. They explained that dividend payers consider maintaining dividend level only after investment and liquidity needs are met while a sustainable increase in earnings and demand by institutional investors are the core determinants of initiating dividend by non payers. Contrary to their findings, Mehta (2012) found liquidity and leverage to be insignificant in influencing dividend payout.

Apart from the firm specific characteristics, empirical evidence of some other external factors that may influence dividend policy has been established. Studies have also provided evidence that ownership structure have significant influence on dividend policy (Bradford, Chen & Zhu, 2005; Al Shubiri, Al Taleb, & Al Zoued, 2012; Al Nawaiseh, 2013; Al-Gharaibeh, Zurigat, & Al-Harashseh, 2013; Michaely & Roberts, 2012; Kamat, 2008). Similarly, dividend payments across industries exhibit significant variations; therefore, the industry in which a firm operates have significant effect on its dividend behavior (Kamat, 2008). However, Rozeff (1982) contends that such effect can be reduced to the barest minimum by employing a set of firm-specific variables to explain dividend payouts across firms. This is because these variables differ significantly across industries. Ameer (2007) also found that product market competition and regulation play important roles in shaping a firm's dividend policy.

There is an apparent dearth of empirical studies on whether inflation affect dividend policies. Basse and Reddemann (2011) contends that lack of attention of the literature on how inflation affects dividend policy may be one of the possible reasons for the inconclusive findings on dividend studies. Contrary to the position of Kirkulak and Kurt (2010) that effects of the macroeconomic environment may lead to dividend omissions, Basse and Reddemann (2011) maintain that companies increase their dividend payments in an inflationary environment. Using co-integration technique, their study which analyzed the relationship between inflation and dividend policy in US from a macroeconomic perspective reported that inflation has positive effect on dividends. This finding was attributed to the reluctance of managers to cut dividends in order to signal good prospects even in a recessionary period. Consistent with the above findings, Basse (2009) argued that higher inflation is a major driver of dividend increases. His study found a stable and long run relationship between dividend and price level in Australia. Thus, it was concluded that dividend changes are related to the phenomenon of inflation. In the same vein, Wei (2010) reported a positive correlation between inflation and dividend yield.

The findings of Mlangi (2012) contradicts the previous results as it was revealed that inflation has no significant impact on dividend payout on the Nairobi stock exchange.

Data and Sample

The study covers listed firms in Nigeria that have firm level data on one word (Thomson Reuter's Worldscope Database). The sample is however limited to those companies that have been continuously listed on the Nigerian stock exchange between 2005 to 2011 and excludes those firms in

the financial sector. The exclusion of the financial firms is due to their different regulatory structure and this is in line with the approach of previous studies. The final sample consists of sixty four firms. Data was sourced majorly from the DataStream (Worldscope database).

Empirical Model

The study models how inflation affects dividend policy of listed firms on the Nigerian stock exchange while controlling for firm-specific characteristics that are established to influence dividend policies. The study relies on prior literature to select variables to be used as proxy for the theories being tested.

$$DPR_{it} = \alpha_0 + \beta_1 Inf_t + \beta_3 SIZE_{it} + \beta_4 INV_{it} + \beta_5 PR_{it} + e_{it} \quad (1)$$

The dependent variable is the dividend policy which is represented by dividend payout ratio (DPR). The main independent variable of interest is inflation (Inf) while the others are proxies for firm specific characteristics. In line with Fama and French (2001), a non-dividend payer is a firm with low profitability (ROE), smaller size, and more investment opportunities. Therefore, these variables are incorporated into the model as control variables. Size is defined as log of total assets. Profitability is defined as return on equity while investment opportunity is defined as the market to book ratio (INV). In order to capture the effect of the stock market crisis, a dummy variable (CrDummy) equal to 1 will also be introduced in the years in which the crisis was witnessed.

Empirical Analysis

In order to control for firm specific characteristics, the study deviates from the macroeconomic approach used by some prior related studies. Panel models have been used to analyze the relationships. Hausman test have been conducted to choose between the fixed effect and random effect models. The result of this test provides that the result from the random effect model is statistically better, thus the random effects result is presented in table 1 below:

Table 1: Random Effects Regression

DPR	B	Std. Error	z-value	p > z
Inf	-0.2945001	0.783363	-0.38	0.707
Size	1.54e-08	3.43e-08	-0.45	0.654
PR	0.2685556	0.0791229	3.39	0.001*
Inv	-0.013058	0.0075545	1.73	0.034*
n = 167				
R ² = 0.0030				
*significant at 5% level				

From the table above, it can be seen that inflation is negatively related to dividend payout. However, the relationship is very insignificant. The negative relationship reported is contrary to the findings of Basse and Reddemann (2011) and Wei (2011) where positive relationship was found. The insignificant relationship is however consistent with the findings of Mlangi (2012). This implies that dividend payment by the listed firms is not

affected by the rate of inflation. Among the control variables, the size and profitability are positively related to dividend payout and investment opportunities are negatively related to dividend as expected. However, only profitability and investment are significant in explaining dividend payout as indicated by the results. Thus, the more profitable a company is, the more the dividend payout and the more the investment opportunities, the less the dividend payout.

CONCLUSION AND RECOMMENDATION

The study examined whether macroeconomic factor proxied by inflation have more predictive power over firm specific characteristics in explaining dividend behaviour of firms listed on the Nigerian stock exchange. The study found no evidence to show that dividend payments by firms listed on the Nigerian stock exchange is affected by the rate of inflation. However, firm specific characteristics which include profitability and investment opportunities significantly impact on dividend policies of firms. Based on this, it can be concluded that some firms do pay dividends as a result of low profits while some are re-investing funds for the growth of the firm. The findings on the relationship between investment and dividend payout suggests that nonpayment of dividends is an indication that the firm has attractive investment opportunities which might be lost if dividends are paid. Thus, the study recommends that investors should be carried along in the dividend decisions of the firm. They should be educated on the justification for which firms omit or cut dividend payments.

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