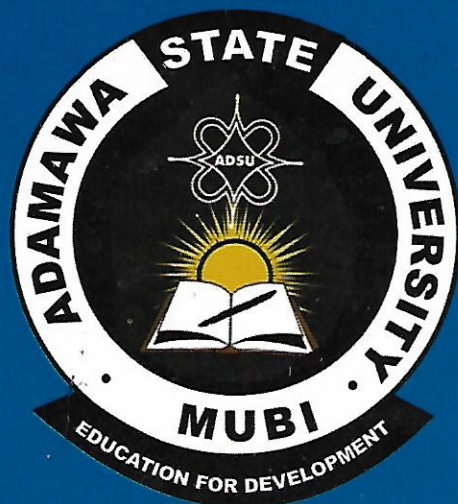


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DIVIDEND RELEVANCE DURING FINANCIAL CRISIS: A STUDY OF QUOTED NIGERIAN BANKS

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Abstract

Dividend relevance suggests that dividend policies have effect on market value of the firm as reflected in their share prices. The study examined whether this relevance is maintained during financial crisis. The study covered banks listed on the Nigerian Stock Exchange during the period 2008 to 2009 as it is believed that they account for huge portion of the dividend payments. Data was sourced majorly from the DataStream (Thomson Reuter's Worldscope database). A model was formulated to test whether the dividend payout policies of banks influence their share prices during crisis period using market price per share as the dependent variable and dividend payout ratio as the main independent variable. It was revealed that dividend payout ratio is positively and significantly related to share prices during the crisis period. Thus, dividend relevance holds even during financial turmoil. Based on this, it was recommended that firms should not use crisis period as an opportunity to cut or omit dividends as it may impact negatively on their market value although such cuts or omission may be necessary for strategic reasons in some situations.

Introduction

Dividend decision is one of the decisions made in corporate finance. Dividend decision is considered important in determining stock prices and in assisting existing and potential investors in valuing a company.

Basically, there are two opposing views: Dividend irrelevance and Dividend relevance theory. Miller and Modigliani (1961) assert that under certain assumptions; perfect capital market, rational behaviour, perfect certainty, dividends are irrelevant and therefore have no influence on the share price. This theory suggests that whatever dividend policy a firm adopts have no influence on its market value. A more radical approach to the Miller and Modigliani (MM) dividend irrelevance theory suggests that in view of the differential taxation of dividends and capital gains, dividends will reduce the firm's value as they are taxed at

a higher rate. On the other hand, other schools believe that the value of the firm is affected by decision of a firm to pay or not to pay dividends. The supporters of dividend relevance theory state that payment of dividends reduces uncertainty to the shareholders and therefore increases the market value. These other schools of thoughts consider factors such as asymmetric information, agency costs, taxes, and transaction costs which can cause imperfection to explain the relevance of dividend. This debate over the relevance or irrelevance of dividend has led many researchers to conduct empirical tests in order to offer explanations on the relationship between dividend policy and market value of firms.

The present study is motivated by the serious crisis experienced on the Nigerian Stock Exchange in recent years. One of the major weaknesses that crippled the Nigerian stock market is share price

manipulation (Oladipupo, 2010; Okereke, 2012; Sanusi, 2012). The problem was compounded with the effect of the global financial meltdown. Okereke (2012) noted that the ill wind of the global meltdown crept into Nigeria in year 2008. Olisaemeka (2009) observed that market capitalization declined from N13.5 trillion (USD 85.8 billion) in March, 2008 to less than N4.6 trillion (USD 29.2 billion) in January 2009. All-share index was also reported to have reduced from 66,000 points to less than 22,000 points in the same period. Olisaemeka (2009) noted further that over 60% of the securities have constant supply over demand thus leading to drastic fall in prices of shares. More so, stocks that were actually over valued needed price adjustment to fall in line with their fundamentals (Oladipupo, 2010). The listed firms recorded very low market performance as there was persistent fall in equity prices. This problem continues to impact negatively on the market performance of the listed firms. This also worsened the performance of the market resulting in loss of confidence and divestment by local and foreign investors. Although extant literature documents that dividend policy affects share prices, however the persistent fall in market prices, despite constant dividend payments by some banks, created the need to add to existing literature in investigating the effect of dividends on the market value of the firms using their share prices as proxies. This was done with particular reference to the crisis period. The study specifically chose the crisis period as prior findings on how dividends affect share prices on the Nigerian stock market relate to non-crisis period. Thus, it is imperative to examine whether results obtained during crisis period differ from those obtained in non-crisis period.

Generally speaking, two directions can be followed in explaining the relationship between dividends and value of the firm. The effect of dividend announcements on

share prices on one hand, and the effect of dividend policy (proxied by dividend payout or dividend yield) on stock prices or stock returns as the case may be. Attention of recent literature has exclusively focused on the announcement effects of payout policy (Divecha & Morse, 1983; Nippel & Nekat, 2009). Nippel & Nekat (2009) argued further that payout policy may not only affect prices at the announcement date but also at the payment date. Thus, this study adopted the second approach by observing the relationship between dividend payout ratio and market value during financial crisis. Apart from the need to observe the relevance of dividend during financial crisis, the study is also justified based on the inconsistent results shown by previous studies.

Adefila (2000) conducted a similar study in Nigeria by taking the correlation coefficient of dividends and share prices between 1990 and 1999. The Nigeria stock market has witnessed tremendous changes after the period covered by this study which is almost 13 years back. Dividend policies also change over time, and so there was need to study the relationship between dividend policy and market value of firms particularly during the period in which the stock market crisis has been witnessed. This will enable us ascertain whether the relevance of dividends is maintained during financial crisis.

In view of the issues highlighted above, the study sought to proffer answer to the question of whether dividend is relevant during financial crisis or not by observing its effect on the market value of banks listed on the Nigerian stock exchange. It was reported in Investor's Newsbeat (2012) that the financial services sector has the highest number of dividend paying companies from year 2009 up till the end of first quarter of 2012. Findings of this study are expected to educate the managers on the effect of their dividend policies on the firm's market value. The

findings of the study are also beneficial to potential and existing investors as it will assist them to make their future investment decisions.

Literature Review and Hypothesis Development

The MM theory assumes symmetric information and this suggests that all market participants have the same information about the firm. In contrast, information content of dividend which is revealed by the signaling hypothesis (Bhattacharya, 1979; John & Williams, 1985; Miller & Rock, 1985) reveals that the privileged information which managers (as insiders) have about the firm is unknown to the investors. Although information is made available publicly, managers may possess more information than outside investors (Khang & King, 2002; Pandey, 2008). Investors therefore get clue on such information when dividend announcements are made. Such in turn influences their investment decisions. This knowledge of the manager's behavior can serve as a basis for bidding the price of a firm's stock up in case of positive dividend announcements and beating it down when the announcement fails to meet investor's expectation. Therefore, as opposed to the assumption of MM theory, the problem of information asymmetry may arise in practical situation as those within the organization have more information than outsiders. The existence of asymmetric information therefore may signal the true value of the firm to investors. The sensitivity of dividend to future prospects of the firm will be high if the level of information asymmetry is high. Thus, signaling theory explains that dividends have effect on the market value of firms.

Previous studies have shown that certain accounting parameters affect stock prices. However, dividends appear to be the most prominent accounting information shown in the literature to affect share price. Some

of the earlier studies that examined the relationship between dividend and stock prices include Walter (1956), Litzenberger and Ramaswamy (1982), Baskin (1989), Gordon (1963), Blume (1980), and Allen and Rachim (1996). Findings from the earlier studies up till the recent empirical results have generated mixed results. Gordon (1963) reported that dividend policy have positive effect on stock prices and argued further that firms that pay higher dividends face less risk in terms of volatility in stock prices. Contrarily, Baskin (1989) reported a negative relationship between two measures of dividend policy and stock prices. Allen and Rachim (1996) found no relationship between dividend yield and stock prices.

Walter (1956) developed a model which depicts the relationship between dividend policies and share prices based on the assumption that stock prices over longer periods reflect the present values of anticipated future dividends. Walter (1956) contends that earnings retained today will have effect on the future dividends which will consequently affect stock prices. The model which distinguished between growth and intermediate stocks depicts that in the case of growth stocks, low dividend payout can be expected to enhance stock values. This model provides a basis for many empirical researches that has been conducted in this area.

Baskin (1989) and Allen and Rachim (1996) recommended that firm specific characteristics should be controlled for as they have strong explanatory power in predicting the relationship between dividend and stock prices. In investigating this relationship, recent empirical studies (Habib, Kiani, & Khan, 2012; Hashemijoo, Ardekani, & Younesi, 2012; Hussainey, Mgbame, & Chijoke, 2011; Jecheche, 2012; Nazir, Nawaz, Anwar & Ahmed, 2010; Nazir, Abdullah and Nawaz, 2011) have followed Baskin (1989)'s

recommendation by controlling for the same factors which include size, earnings volatility, long term debt and growth.

In line with the above recommendation, Habib, Kiani and Khan (2012), Hashemijoo, Ardekani and Younesi (2012), Hussainey, Mgbame and Chiyoke-Mgbame (2011), Jechebe (2012), Nazir et al. (2011), and Nazir, Nawaz, Anwar and Ahmed (2010) all examined the relationship between dividend payments (using dividend payout ratio and dividend yield) and share price volatility on the Karachi stock exchange, Bursa Malaysia, UK, Zimbabwe and also Karachi stock markets respectively. Hashemijoo et al. (2012), Husseiney et al. (2011), Jechebe (2012), and Nazir et al. (2011) reported a negative relationship between the two measures of dividend payments and share price volatility by arguing that fluctuation in share price reduces as both dividend yield and dividend payout rises. These studies demonstrated that the relationship is not reduced much even after controlling for the aforementioned firm specific factors. Hashemijoo et al. (2012) contends that dividend yield and size have the most significant impact on share prices among the predictor variables. Similarly, Jechebe (2012) argued that the co-efficient of dividend yield is much more significant than payout in explaining stock price volatility. Habib, Kiani and Khan (2012) and Nazir et al. (2010) also revealed that a negative relationship exists between share price volatility and payout ratio but contrary to the earlier findings, Habib, Kiani and Khan (2012) found a positive but insignificant relationship between share price volatility and dividend yield and Nazir et al. (2011) found a significant positive relationship between share price volatility and dividend yield. Based on the findings of the five different studies which show a negative relationship exists

between dividend payout and price volatility is consistent with the study by Baskin (1989) and Allen and Rachim (1996). Contrarily, evidence of negative or positive relationship between dividend yield and stock prices revealed by the studies discussed above contradicts Allen and Rachim (1996) that found no relationship between the two.

Unlike the studies above that used two measures of dividend in observing relationship between dividend payment and stock prices, Mc Manus, Ap Gwilym, and Thomas (2004) observed the role of payout in influencing the relationship between dividend yield and stock prices in the UK stock market and concludes that payout is an add-on to dividend yield in explaining the stock prices. Khan, Aamir, Qayyum, Nasir, and Khan (2011) also used only dividend yield as measure of dividend payment. In examining the effect of dividend on stock prices on the Karachi stock exchange, the study controlled for other set of variables which include earnings per share (EPS), profit after tax (PAT), return on equity (ROE) and found dividend yield to be positively related to stock prices. The findings is similar to that of Habib, Kiani and Khan (2012) and Nazir et al. (2010) who also found a positive relationship between share price volatility and dividend yield. Bougatef (2011) examined the effect of cash dividend on stock prices and reported a significant positive relationship between the two. It was found that stock prices of Tunisian firms increase as the cash dividends increase. Azhagaiah and Sabari (2008) also documents that dividend policy have significant impact on shareholder's wealth as a positive relationship was found between market price per share and dividend per share among organic chemical firms in India. Other empirical studies (Andrés, Betzer, Van den Bongard, Haesher & Theissen, 2011; Ali & Chowdhury, 2010,

Gunasekarage & Power, 2006, Olweny, 2012; Vieira, 2011) have shown that dividend announcements affect share prices. As mentioned earlier, this study was focused on the actual dividend paid and not the announcement event.

Studies have shown that certain factors may alter the relationship between dividend and share prices. Farooq, Saoud, and Agnaou (2012) suggested that growth period is relevant in explaining the relationship between dividend and stock price volatility. Dividend payout was shown to have significant negative relationship with stock price volatility in stable growth period. However, this relationship becomes insignificant in high growth period. This is consistent with Salimen and Martikainen (2008) where it was also documented that the high growth period is characterized by a lesser signaling role of dividend. Similarly, Borges (2009) showed that price movements after dividend event depend on the type of investors in a model developed to show possible equilibrium conditions for stock price adjustment after a dividend distribution. Borges (2009) therefore contends that since tax rate on dividend and capital gains is not equal for all investors, then different possible equilibrium exists for the level of stock price adjustment following a dividend distribution event but no unique equilibrium exists.

Gombola and Liu (1993) also argued that the relationship between dividend and stock returns vary across the bull and bear markets. Findings from a sample of 1,107 companies indicate that dividend yield and average monthly stock returns were positively related during bear markets and negatively related during bull markets. Baker and Wurgler (2004) also found that when the market premium is high, stock price reaction to news of dividend increases is more favorable. Therefore, the present study extended the literature in this

area by examining whether the relationship between dividend and stock prices documented by prior studies is altered during financial crisis.

There is dearth of research on how dividend payments affect share prices in Nigeria. Adefila, Oladipo, and Adeoti (2004) examined the effect of dividend policy on market price of common stocks among 15 quoted companies in Nigeria between 1990-1999. The study found no correlation between dividend payment and share prices of Nigerian firms. Similarly, Adaramola (2012) who studied three top firms listed on the Nigerian Stock Exchange between 1997 and 2009 argued that there is no sufficient evidence to suggest that stock price changes are caused by dividend payments. In the same vein, Amadasu (2011) contends that dividend relevance can only be confirmed with the existence of other factors. Contrarily, Uwuigbe, Olusegun, and Goodswill (2012) who studied 30 firms listed on the Nigerian Stock Exchange concludes that dividend payout is a strong determinant of share prices in Nigeria, thus supporting dividend relevance. Adelegan (2009) also documents that share prices react to dividend announcements. The findings of Adelegan (2009) shows that cumulative excess returns are significant and positive for dividend paying firms for 30 days from the announcement but negative and significant for dividend omitting firms. It was also indicated that reactions to omissions are more pronounced than to payments of dividends. However, as opposed to the approach of studies in other parts of the world, there is no evidence to show that firm specific characteristics have been considered in investigating the relationship between dividends and stock prices in Nigeria.

Based on the above review, it is established in most of the available literature that dividends do affect share prices. What remains uncertain is whether

this holds during financial crisis. Thus the study proposed as follow:

H_0 : There is no significant relationship between dividend payout and market price per share of Nigerian Quoted Banks during financial crisis.

Methodology

The study is conducted on commercial banks listed on the Nigerian Stock Exchange during the study period (2008-2009). Data was sourced majorly from the DataStream (Thomson Reuter's Worldscope database).

The model below was formulated to test whether the dividend payout policies of banks influence their share prices during the crisis period observed. The study relied on prior literature to select variables to be used as proxy for the hypothesis being tested. Regression analysis was used to test the hypothesis.

$$MPS_{it} = \alpha_0 + \beta_1 DPR_{it} + \beta_2 SIZE_{it} + \beta_3 EARN_{it} + \beta_4 DEBT_{it} + e_{it}$$

The dependent variable is the share price which is represented by market price per share (MPS). The main independent variable of interest is the dividend payout ratio (DPR) as Chai (2010) noted that Dividend payout ratio is the most commonly used measure of dividend policy. In line with the approach of prior studies, other firm characteristics (size, earnings, and debt) have been incorporated into the model as control variables. Size is defined as log of total assets, earnings is defined as earnings before interest and tax (EBIT) and debt is defined as ratio of long term debt to total assets.

Discussion of Findings

The results of the regression analysis have been presented in tables 1 and 2 below.

Table 1: Analysis of Variance Results ANOVA^b

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	6203.669	4	1550.917	2.765	.046 ^a
Residual	16267.254	29	560.940		
Total	22470.924	33			

Table 2: Regression Results Coefficients^a

Model	Unstandardized coefficients		Standardized coefficients		t	Sig.
	B	Std. Error	Beta			
Constant	4.859	8.334	.583		.564	
Div. Payout Ratio	.411	.233	.330		1.767	.088*
Size	9.490E-7	.000	.5172		.722	.011**
EBIT	-3.653E-6	.000	-.235		-1.463	.154
Debt	-.427	.867	-.081		-.493	.626

a. Dependent Variable: Market Price Per Share

*significant at 10%

**significant at 5%

The hypothesis stated above is rejected as it can be seen from table 2 that dividend payout is significant in explaining share

prices of the banks listed on the Nigerian stock exchange. Therefore, dividend relevance holds even during financial crisis. This can be attributed to financial

constraints which the crisis may impose on shareholders, thus resulting in more negative reactions towards dividend cuts or decreases. However, the predictive power of dividend over share prices holds at 10% significance level. The co-efficient of dividend payout ratio is also positive. This is inconsistent with the signaling theory of dividends. Thus, as the banks increase their payout, shareholders react positively towards this increase and this is reflected in the share prices.

Among the control variables, size has been shown to be significant and positively related to share prices. Thus, it can be inferred that larger firms may not suffer so much decline in share prices during financial crisis. EBIT and Debt have no effect on share prices during the period observed.

Conclusion and Recommendations

The study examined whether the impact of dividends on share prices documented in previous studies extend to financial crisis period. The study was conducted on banks listed on the Nigerian Stock Exchange as it is observed a large portion of dividend payments in the market emanates from the banks.

It was concluded that dividends still have predictive power in explaining share prices even during financial crisis. Based on this, it was recommended that although dividend cuts or omission may be a strategic means of preserving financial flexibility during crisis, however, firms should not take crisis period as an opportunity to omit or suspend dividend payments as this will ultimately affect their market value.

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