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MANAGERIAL COMPENSATION AND PROPENSITY TO PAY DIVIDENDS AMONG QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

Recent decline in dividend payout by banks in Nigeria and huge packages of compensation paid to executives stimulates the interest to conduct this study. The study examined how managerial compensation affects the initial decision "to pay" or "not to pay" as opposed to amount paid which most past studies focused on. Secondary data was extracted from the annual reports and accounts of 15 deposit money banks listed on the Nigeria Stock Exchange between 2006 and 2016. Logit model was employed due to the categorical nature of the dependent variable and pooled logit was used specifically as result shows preference for it above random/fixed effects logit. The study found that managerial compensation has negative impact on the decision to pay out dividends which suggests that the high compensation packages of the executives are paid to the detriment of the shareholders. Other variables found to be significant include past payout decision, profitability and leverage. However, estimates of marginal effect shows that profitability records the highest impact while leverage have the lowest impact on payout decision of the banks. In line with these findings, the study recommends that stock-based compensation should be included or increased in the compensation packages as this will make them align their interests with that of shareholders and focus more on value creation.

Introduction

Literature shows that dividend policy remain one of the most controversial issues in finance. Brealy, Myers, and Allen (2006) confirmed further that one of the ten unsolved problems in finance is dividend policy. The importance of payout policy cannot be overemphasised as different theories have negated the argument of dividend irrelevance by Miller and Modigliani (1961). These alternative explanations to dividend payout have proved the importance of payout policies in diverse ways.

One of the prominent arguments on dividend policies relates to the differing interests of shareholders and managers of

the firms. The fact that shareholders want management to run the firm in a way that increase shareholders' wealth while the management seeks to maximise their personal wealth which may not be in the best interest of shareholders creates differing interests among shareholders and managers. Corporate governance mechanisms are employed to align these differing interests. One of such mechanisms that presses managers to pursue actions beneficial to shareholders is executive compensation (Geiller & Renneboog, 2016). However, this is doubtful as firm's payout decision may be influenced by such compensation to the detriment of shareholders. Executives usually operate in the interest of

shareholders but might sometimes use additional profits for their personal gains (Baumol, 1967)

How executive compensation affects financial policies is a growing concern in recent empirical works. Veito, Cerqueira, Brandao and Khan (2009) documented that, with the growth of the world economy in the 1990's, shareholders felt the need to contract executives and give them incentives to enhance speedy growth of stock markets. Prior to this period, executives were mainly rewarded with salaries and bonuses. In today's world, such compensation varies from short term compensation (salary or bonuses) to longer term compensation (stock options; restricted stocks; long term incentive plans). Recently, there has been wide deviation from the sole use of cash based compensations. Equity-based compensation is widely employed as a means of reducing agency costs. Since the managers will become co-owners through such compensation packages, they are expected to focus more on value creation.

This study is motivated by certain reasons. Firstly, on a global level, Fama and French (2001) asserted that there has been a dramatic change in shareholders' payout over the past two decades as payout ratios have fallen substantially. Prior evidence (Abdulkadir, Abdullah & Wong, 2016) shows that 67% of firms listed on the Nigerian Stock Exchange did not pay dividends in year 2012. However, this study excluded the financial sector. Anecdotal evidence suggests that the banking sector is not spared from this issue of declining dividends as Business News (2015) reported that deposit money banks decreased dividend payout from an average of 60% to 35%. There are considerable studies on dividend payout policies in Nigeria. However, very little attention has been paid to the financial sector which is usually excluded in most studies due to the nature of their regulation. Thus, little explanation has

been offered on payout policies of financial firms. More so, most of the dividend studies in Nigeria have focused attention on how firm attributes (like earnings, size, leverage, investment opportunities) affect payout while ignoring other important factors that may influence such financial policies. One of such factors is the compensation received by executives.

Another motivating factor is excessive compensation which is seen as one of the ways by which managers divert corporate assets to themselves. It is widely held that executives manipulate incentives structures to increase their compensation. Specifically, the banking sector is highly regulated, but news report shows that the sector is characterised with high packages of managerial compensation. However, anecdotal evidence indicates that this compensation is not linked to high quality managers which suggests that such compensation packages may not be in the best interest of shareholders. Vanguard News (2015) noted that ten banks paid 143 directors ₦7.66 Billion in year 2015. Further reports from the same source noted significant rise in the compensation packages of the executives between year 2014 and 2015. The high compensation packages is a serious cause for concern as it is widely held that insiders in charge of corporate assets can employ such assets for purposes that are detrimental to the interests of outside investors.

This study differs from existing related ones that have also examined how executive compensation affects dividend payout. Most of the existing studies (Agha, 2015; Anderson, Bhattacharya, Morrill & Roberts, 2018; Bhattacharya & Elston, 2011; Geiler & Renneboog, 2010) focused on developed markets. This study centres on a different geographical setting. Results obtained for the developed countries cannot be applied to Nigeria due to differences in institutional setting and corporate

governance structure. La porta et al. (2000) noted that the severity of agency issues which minority shareholders are exposed to varies significantly across countries. More so, this study concentrates on the banking sector which has received very little attention in dividend studies. In addition to the different geographical region and the banking sector observed, this study did not consider amount of dividends paid like most of the existing studies but considered the propensity to pay or not to pay as a measure of dividend payout policy. Fama and French (2001) emphasised the importance of knowing what determines the decision to pay or not to pay.

In line with the foregoing, this study seeks to examine how managerial compensation affects dividend payout of deposit money banks in Nigeria.

Literature Review

Theoretical Consideration

Agency theory (Jensen & Meckling, 1976) derives from the separation of ownership of the firm and control. The theory is concerned with resolving conflicts that emerge from agency relationships. The theory explains that agency costs arises as a result of the conflicting interests of shareholders and managers. In relation to dividend payment, shareholders will prefer stable or higher payouts where agency costs are high as this serves as means of returning excess funds to shareholders rather than being wasted. The free cash flow hypothesis (Jensen, 1986) explains that the excess fund or free cash is reduced when firms pay dividends. This creates little avenue for managers to waste funds or invest in negative NPV projects. Thus, steady or high payout is regarded as a means of curbing managerial discretion on one side. Similarly, Bhattacharya's (2007) model is based on "principal-agent" paradigm where the shareholders are considered as principals and the managers are the agents. In line with

Bhattacharya's model, dividend are means of resolving agency conflicts. Thus, the model predicts negative relationship between dividend payout and managerial compensation. More so, when executives have controlling shares, they have strong abilities to push for corporate decisions to their benefits. Thus, they may extract unjustifiably high salaries and benefits that might result in lower profitability and dividend payments. In line with the foregoing, it is expected that managerial discretion is employed to extract higher compensation which will lead to lower dividend payment. Thus, a negative relationship is expected.

Empirical Review

Considerable empirical studies (Anderson, Bhattacharya, Morril & Roberts, 2018; Azhari, 2015; Bhattacharya & Elston, 2011; DeAngelo, DeAngelo & Skinner, 2008; Huang, 2012; Kubo & Saito, 2006; Lambert et al., 1989) showed that dividend policy is affected by financial incentives of managers. Existing literature shows that the effect of executive compensation depends on the type of compensation. Regardless, there exists mixed findings with respect to the nature of relationship. Few studies (Azhari, 2015; Brown, Liang & Weisbenner, 2006; Das & Mohanty, 2018; DeAngelo, DeAngelo & Skinner, 2008; Olufawoye, Iyoha & Izedonmi, 2017; Omokhudu & Toluwa, 2018) found managerial compensation to be positively related to dividend payout. These studies particularly found this positive relationship to hold when the company adopts equity-based compensation. Azhari (2015) contended that incentive plans which involves CEO share equity ownership is used to align managerial interest with shareholder's interest in terms of cash payment to shareholders, resulting in the positive relationship. Similarly, Brown et al (2006) argued that with higher compensation in form of stock ownership,

there is an incentive on the part of managers to increase dividends for personal liquidity reasons. From the different forms of compensation examined, Geiller and Reneeboog (2016) found only salary and bonus to be positively related with dividend payment.

Olufawoye et al. (2017) and Omokhudu and Toluwa (2018) offered a different explanation on the positive relationship reported. The authors documented that as firm's management seek to achieve their own interest in form of higher compensation, they also try to make shareholders happy by distributing more dividends. This is based on the argument that managers seeks to prevent scrutiny of their own compensation by satisfying shareholders in terms of dividend payment.

Other studies (Anderson et al., 2018; Bhattacharya & Elston, 2011; Bhattacharya, Manawi & Morril, 2008) found that executive compensation is negatively related to dividend payout. Bhattacharya et al. (2008) argued that high quality managers have access to more positive NPV projects. Thus, they are induced to plough back and invest firm's earnings in productive ventures. Consequently, the high quality managers are rewarded with higher compensation making less amount available for dividend distribution. On the other hand, lower quality managers earn lower compensation as they invest less, thus leaving more money available for dividend distribution. Quite similar to this is an earlier finding reported by Gaver and Gaver (1993). The authors documented that where the company has high growth rate, dividend rate is relatively low and salary level is relatively high in comparison to companies that have attained maturity. The authors argued that younger firms will prefer to invest rather than pay dividends. As such, they would seek qualified executives and the need arises to

give them high compensation for the success of their investment policy.

From a different point of view, some studies (Agha, 2015; Ferri & Li, 2016; Geiler & Renneboog, 2016; Lambert, Lanen & Larcker, 1989) reported that higher compensation in form of option incentives are associated with lower dividend payout and preference for repurchases over dividends. This is due to the fact that compensation in form of stock options widen the differences between the interests of the CEOs and shareholders with detrimental effects on the latter party (Geiler & Renneboog, 2016). Similarly, Agha (2015) reported that managers overinvest and underpay dividends when offered option incentives. Consequently, options have become a popular means of compensating executives as it is considered the most effective way of extracting wealth from the firm without provoking shareholder's outrage (Bebchuk, Fried & Walker, 2002).

In support of the negative relationship, Hauser, Yosef, Solomon, Schohat, and Tanhuma (2006) reported that in closely-held firms where controlling shareholders hold more than 50% and less than 75%, there is greater incentive to prefer higher compensation and avoid paying dividends. The controlling interests of such executives give them unlimited power to draw salaries and benefit in a way that is not based on the economic interest of external shareholders. Similarly, Jacob and Alstadsaeter (2013) reported that in closely-held firms, wages appear to be the dominant payout channel to owner managers. The authors contend that debt covenants may limit dividend payment to availability of profits while smooth wages can be paid even in years with losses.

Unlike studies reviewed above, Odia and Ogiedu (2013) found insignificant association between directors' compensation and dividend payout.

Dividend literature shows that different firm attributes affect dividend payment of firms across the globe. Lintner's (1956) model indicates that earnings and previous dividends are the most important factors that can explain current dividend payout. Similarly, Fama and French (2001) identified certain factors as attributes of a dividend payer. The factors include higher profitability, larger size and fewer investment opportunities. Many studies (Al-Malkawi, 2007; Arshad, Akram & Amjad, 2013; Bebczuk, 2004; Benito & Young, 2003; Bradford, Mark & Qun, 2013) appeared to support the significance of these factors in explaining dividends though with mixed findings. Besides the factors identified by Lintner (1956) and Fama and French's (2001) characteristics of a dividend payer, other prominent firm attributes that have been documented in the literature to affect dividend payout include leverage and cash flow (Ahmed, 2014; Amidu & Abor, 2006; Bradford et al., 2013; John & Muthasamy, 2010; Vo & Nguyen, 2014).

As noted earlier, existing empirical studies on how managerial compensation affects payout policies basically concentrates on other countries, particularly developed market setting. Little or no explanation exist in this regard with respect to Nigeria. Most of the studies reviewed have also focused on non-financial firms. In addition, the study goes beyond looking at how managerial compensation affects how much is distributed by also considering how it affects the initial decision to pay or not to pay dividends.

Methodology

This study is based on a balanced panel data set of 139 firm-year observations. This was obtained from 15 listed deposit money banks in Nigeria over the period of 2006 to 2016. Data was extracted from the annual reports and accounts of the banks obtained from the Nigeria Stock Exchange.

Both descriptive and inferential statistics were employed. Descriptive statistics (mean, standard deviation, minimum and maximum values) was employed to describe the data set, while logistic regression analysis was employed to observe the relationship between the explanatory variables and outcome variable. Logistic regression is a non-linear method that is used when the outcome variable is categorical in nature. Thus, this study employed logistic regression because the dependent variable given in the first model specified below is categorical in nature and involves the discrete choice "to pay" or "not to pay" dividends. To examine the relationship between the explanatory variables and payout decision, the logit regression model specified below was estimated.

$$\ln \frac{DIV}{(1-DIV)} = \alpha_0 + \beta_1 CMP_{it} + \beta_2 PDIV_{it} + \beta_3 PROF_{it} + \beta_4 SIZE_{it} + \beta_5 INV_{it} + \beta_6 CSHF_{it} + \beta_7 LEVR_{it}$$

Measurement of variables in the model is guided by the literature. The dependent variable is the discrete choice "to pay" or "not to pay" dividends. There are seven independent variables in the model and they include: managerial compensation; previous year payout decision; profitability; size; investment opportunities; cashflow and leverage.

Dividend Payout Decision (DIV): This is the discrete choice "to pay" or "not to pay" dividend. This is measured by a dummy variable which takes the value of 0 when the bank does not pay dividend and value of 1 when dividend is paid (Abdulkadir et al., 2016; Fama & French, 2001).

Managerial Compensation (CMP): This is the main explanatory variable in the model. The study defines this variable in terms of cash compensation to the directors/managers (Anderson et al., 2018;

Bhattacharya & Elston, 2011). Analysis is restricted to cash compensation since it forms a higher proportion of compensation paid to managers in Nigeria (KPMG, 2017) and due to data availability considerations.

Previous Year Dividend Payout Decision (PDIV): Previous year decision "to pay" or "not to pay" (PDIV) is included in the model as prior dividend is one of the two important variables established by the prominent Lintner's (1956) model to explain payout. PDIV is also a dummy variable which takes the value of 0 when the firm does not pay dividend in the previous year and takes the value of 1 if the firm pays dividend in the previous year (Abdulkadir et al., 2016).

Profitability, Size and Investment Opportunities: The other variable in Lintner's model which is earnings is not included because this study includes a variant of it, profitability. Profitability (PROF), size (SIZE) and investment opportunities (INV) are included in the model as they have been established as features that can be used to differentiate between a dividend payer and a non-

dividend payer by Fama and French (2001) and many other recent studies. PROF is measured as return on assets; SIZE is measured as the natural logarithm of total assets; and INV is measured as value of market to book ratio (Ahmed, 2014; Al-Malkawi, 2007; Fama & French, 2001).

Cashflow and Leverage: Other variables included in the model are cash flow (CSHF) and leverage (LEVR) as considerable studies have shown that these variables are other firm attributes that could explain dividend decision. The study therefore includes the variable to avoid model mis-specification. Cashflow is defined as net operating cash flow while leverage is defined as total debts to equity ratio (Ahmed, 2014; Al-Malkawi, 2007).

Results and Discussion

The summary statistics of variables in the model are presented in Table 1. The table excludes the dependent variable (decision to pay or not to pay dividends) and the prior year's dividend payout decision as these two variables have dummy values.

Table 1: Descriptive Statistics of Variables and Variance Inflation Factor

Variable	Obs	Mean	Std. Dev	Min	Max
Managerial Compensation	139	48.62	22.77	18.93	205.26
Profitability	139	2.134	4.127	-0.721	4.586
Size	139	8.885	0.392	8.030	9.630
Investment Opportunities	139	41.576	71.346	-37.94	472.14
Cashflow	139	0.225	0.202	0.017	1.109
Leverage	139	55.039	9.567	41.946	80.865

Note: profitability and leverage values in the table are already expressed in percentages. Owing to their large values, some variables such as managerial compensation and cashflow were rescaled to avoid measurement unit error. These variables were scaled down through division by certain number of zeros (6 zeros in this case)

as suggested by Wooldridge (2013). The descriptive statistics shows that, on the average, executives of the sampled banks earn approximately ₦50m per annum. The table shows that some banks recorded losses during the period of study as revealed by the minimum value of profitability. Average return on assets of the banks is 2.13% over the study period. The mean value of

leverage which is 55% shows that most of the banks are highly levered.

Assumptions related to the distribution of independent variables such as linearity, normality and homoscedasticity are not required to be satisfied to execute a non-linear model (Schwab, 2010). However, multicollinearity, model fit and model specification tests were conducted. The

study employed variance inflation factor (VIF) to test for multicollinearity. VIF values above 10 indicates multicollinearity problem (Hair et al., 2010). VIF values presented in Table 2 reveals absence of multicollinearity as the values fall below 10 for all independent variables.

Table 2: Variance Inflation Factor

Variable	VIF	Tolerance Value
Size	2.96	0.337437
Cashflow	1.76	0.569139
Profitability	1.71	0.584839
Past dividend decision	1.31	0.760682
Managerial Compensation	1.30	0.770700
Investment Opportunities	1.28	0.783477
Leverage	1.06	0.942003

Table 3 presents results of model fit tests and model specification tests. The study employed Hosmer-Lemeshow to test for the fit of the model in addition to the likelihood ratio χ^2 depicted in the results of the logit model. The likelihood ratio χ^2 statistic of 73.33 is statistically significant at 1% and

this shows overall goodness of fit. To further reveal the fitness of the model, Hosmer-Lemeshow χ^2 is insignificant (p-value=0.7782). An insignificant chi-square indicates adequate fit of the data, and inadequate fit of the data if otherwise (Hosmer & Lemeshow, 2000).

Table 3: Model Fit and Model Specification Test

Tests	Results
Likelihood Ratio χ^2	p-value=0.0000
Hosmer-Lemeshow	p-value=0.7782
Link Test	
_hat	p-value = 0.000
_hatsq	p-value = 0.967

The link test which is the main model specification test for non-linear model stipulates that for a properly specified model, addition of any other independent variable should not be significant, except by chance. _hat which represents the predicted value from the model is expected to be

significant while _hatsq stands for the predictor to rebuild the model which is expected to be insignificant (Pregibon, 1980). Thus, results shows that the model is correctly specified as _hatsq is not significant.

Estimates of the logit regression analysis are presented in Table 4. Since the

data is in panel form, the need to compare the appropriateness of pooled logit over random/fixed effects logit model becomes necessary. However, the Breusch and Pagan Lagrangian Multiplier test cannot be applied for panel logit. Consequently, the ρ parameter after random effect logit is employed to decide on this. Significance of

ρ is an evidence of random effects while insignificant ρ implies that pooled logit is preferable. Results obtained from estimate of random effect logit shows that ρ is insignificant ($\rho=0$; $p\text{-value} = 0.499$). Thus, the study reports estimates from the pooled logit model only.

Table 4: Pooled Logit Regression Estimates

Variable Outcome variable=DIV (0,1)	Marginal effects	Robust standard errors	z-stat	p-value
Managerial Compensation	-0.0171	0.0062	-2.78	0.005
Prior Year's Dividend Payout Decision	0.4383	0.1079	4.06	0.000
Profitability	1.3155	0.4599	2.86	0.004
Size	0.0960	0.1894	0.51	0.612
Investment Opportunities	-0.0005	0.0005	-0.87	0.386
Cashflow	0.0115	0.0761	0.15	0.880
Leverage	-0.0129	0.0066	-1.95	0.052
Log Likelihood	-51.576			
No of Observations	139			

Marginal effects were reported as opposed to the coefficient as the former estimates are considered more intuitive in interpretation of non-linear regression. Results shows that managerial compensation is negatively related to decision to pay dividends. This implies that as such compensation rises, managers are less inclined to pay dividends. In line with one of the arguments of agency theory, this finding suggests that managers employ their discretion to extract high compensation for themselves which leads to lower ability to reward shareholders. This inference is justified based on the prominence of weak corporate governance among Nigerian Banks. Negative relationship reported for managerial compensation is consistent with earlier findings (Agha, 2015; Anderson et al., 2018; Bhattacharya et al., 2008; Geiler & Renneboog, 2016; Hauser et al., 2006).

Finding of the study indicates strong support for Lintner's (1956) model as payout decision in the previous year and current year profitability affects dividend payout decision in the current year.

However, as noted earlier, Lintner (1956) employed a variant of profitability (earnings). Therefore, firms that pay dividends in the previous year have higher propensity to pay in the current year. This implies that the sampled banks try to maintain a stable dividend policy. Similarly, findings show that the higher the profitability of a firm, the higher the likelihood that such firm will pay dividend. Findings on profitability is consistent with Fama and French (2001). However, only profitability was found to be significant among the three attributes of a dividend payer spelt out by Fama and French (2001). The positive results obtained for profitability

indicates that the banks comply considerably to Sec 379 (5) of CAMA which states that contingent on provisions of the act, companies can only pay dividends to shareholders out of their distributable profits. Leverage is also significant with negative co-efficient. This implies that the higher the debt in the capital structure of the firm, the lower the likelihood that the bank will pay dividend. Thus, high debt servicing may constrain the banks from distributing dividends. Other variables (size, investment opportunities, cashflow) in the model were found to be insignificant. Estimated marginal effects show that among the significant variables, profitability has the highest impact on the bank's decision to pay or not to pay dividends. This is followed by prior year's dividend decision while leverage records the least impact on dividend payout decisions. Results of the log-likelihood function shows that the model has a good fit.

Conclusion and Recommendation

The study examines whether managerial compensation explains firm's dividend to pay or not to pay dividends. This was done in consideration of other factors that have been established in the literature to explain payout policies of firm. Pooled logit model was employed on data extracted from 15 deposit money banks listed on the Nigerian Stock Exchange over 2006 to 2016. Based on the findings, it could be concluded that managerial discretion is employed for the benefit of the executives but to the detriment of shareholders. Thus, the study indicates that recent decline in payout by banks is partly due to rise in managerial packages, possible decline in the profitability and rising debt levels of the banks. Based on the findings, the study recommends that policy makers should try to include/increase stock-based compensation in the packages of the executives. Most likely, this will make them

align their interests with that of shareholders and focus more on value creation. Moreover, executive compensation should be matched with distribution to shareholders to avoid negative reactions from the shareholders. Such negative reactions may severely push down the value of a firm.

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