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Corporate dividend policy in practice: the views of Nigerian financial managers

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Purpose – The purpose of this study is to provide an additional insight into the dividend puzzle by investigating the field practice of dividend policy in an emerging market such as Nigeria. It also aims to contribute to the literature on industry-related dividend effect by examining whether managerial views on dividend policy differ between financial and non-financial firms.

Design/methodology/approach – The study employs semi-structured interviews with the financial managers of 21 Nigerian listed firms. The interviewees were divided into two broad groups of financial versus non-financial firms based on the industry classification of the firms.

Findings – The findings suggest that, despite differences in institutional environment, the dividend setting process in Nigerian companies is similar in many extents to those in the US and other developed markets. Nigerian companies exhibit dividend conservatism and typically focus on current earnings, stability of earnings and availability of cash when determining their current dividend levels. However, unlike in prior studies, the interviewees suggest that their companies do not have a target payout ratio; instead, they target the dividend per share when determining the disbursement level. Nevertheless, views regarding these issues vary significantly between financial and non-financial firms.

Originality/value – This paper adds to the extant literature that has examined the behavioural aspects of dividend policy using interviews, especially in the context of less-developed markets such as Nigeria. The study also updates and extends prior evidence on an industry-related effect on managerial views on dividend policy.

Keywords Dividend policy, Signalling, Nigeria, Interviews

1. Introduction

Ever since Black (1976), the dividend puzzle has motivated many researchers to examine why firms pay dividends. The results from these endeavours suggest that despite the tax disadvantage of dividends in relation to capital gains, many firms continue to pay dividends and are reluctant to cut dividends even when internal funds are insufficient for good investment opportunities (Baker *et al.*, 1985; Brav *et al.*, 2005; Dhanani, 2005; McCluskey *et al.*, 2007; Baker *et al.*, 2008; Chazi *et al.*, 2011, Khan *et al.*, 2011). However, the dividend behaviour of financial and non-financial firms is often studied separately (Baker *et al.*, 2001 and Baker *et al.*, 2008; are notable exceptions). This shortfall represents a significant gap in the literature, since results from previous studies suggest that industry classification may affect dividend policy (Lintner 1956; Baker *et al.*, 1985; Barclays *et al.*, 1995; Baker and Powell, 1999).

The literature has also paid very little academic attention to dividend policy research that addresses issues related to the development of the emerging stock markets of sub-Saharan Africa, such as Nigeria. The few studies that have examined the dividend decision of Nigerian companies have relied exclusively on aggregated regression analysis of published financial reports (e.g. Soyode, 1975; Oyejide, 1976; Ariyo, 1983; Adelegan, 2003). There is no prior study on the behavioural aspects of dividend policy applied to the Nigerian context.

Thus, the extant research on dividend policy in Nigeria uses market data that can only explain surface reality but cannot measure motivation, which is the underlying force behind generating such data. Frankfurter *et al*. (2004) caution that the scale and sophistication of complex econometric models imported into the field of finance from neo-classical economics to test the dividend phenomenon might no longer be appropriate. To help solve the dividend puzzle, the authors advocate the use of behavioural approach in order to understand the motivation and perceptions underlying dividend decisions.

To provide additional insights into the dividend puzzle, unlike prior studies, this paper adopts a behavioural approach, and builds on the pioneering study on the dividend behaviour of firms conducted by Lintner (1956). Specifically, this study considers the perceptions of managers of Nigerian financial versus non-financial firms on various dividend policy issues using interviews. The motivation to examine this issue in Nigeria is to explore the role of dividends, especially the signalling theory of dividends, in an equity market with a tax regime significantly different from the developed markets where dividend policy has been extensively studied. In Nigeria, personal income from dividends is taxable while its equivalent from capital gains is exempted from taxation. Theoretically, the Nigerian corporate tax system is therefore skewed in favour of retention of profits for further investments. However, empirical research shows that majority of Nigerian listed companies distribute earnings in the form of cash dividends to shareholders (Adelegan, 2009). Thus, Nigeria with its distinctive tax system presents an excellent opportunity for research to examine the actual motivation for paying dividends, despite the tax consequences associated with such a disbursement. The current paper therefore makes unique contribution to an area that has not been previously explored before. The paper also updates and extends the results of prior studies on industry-related dividend effect. The organization of the remainder of this paper is as follows. Section 2 discusses the literature on the main theories of dividend policy and briefly summarises prior studies on the dividend behaviour of management. Background information about the Nigerian tax environment especially as it might impact on dividend payments is presented in Section 3. Section 4 describes the research methodology employed and the sample of companies studied while the main findings of this study are presented in Section 5. Finally, Section 6 summarizes and concludes the work.

2. Review of Related Literature

The subject of corporate dividend policy has puzzled financial analysts and academicians for several decades. Researchers' attempt to address the issue of why companies pay dividends and whether the adoption of a particular dividend policy can influence the value of a firm have been at the heart of numerous modern finance studies (Lintner, 1956; Baker *et al.,* 1985; Campbell, 2003; Bernstein, 2005; Brav *et al.,* 2005; Dhanani, 2005; McCluskey *et al.,* 2007, Baker *et al.,* 2008; Chazi *et al.,* 2011; Khan *et al.,* 2011). However, these studies have failed to resolve the dividend puzzle, as no single convincing explanation about the observed dividend behaviour of firms has emerged. A clear depiction of this situation was presented by Brealey *et al.* (2008) who listed dividends as one of the ten unresolved problems in finance; this reinforces Black's (1976: 5) statement "the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just do not fit together". Due to the voluminous amount of published work on dividend policy, this paper limits the discussion in this section to the main theories of dividend policy and some prior studies on the dividend behaviour of management.

Academics have taken two major paths in attempting to explain why firms pay dividends. Some researchers took the normative approach, and developed and tested theories to explain the dividend puzzle. From the angle of the dividend theories, two divergent views exist. The first strand of literature is the dividend irrelevance hypothesis advanced by Miller and Modigliani (1961). In a seminal paper, the authors argued that in a perfect world without information asymmetry, taxes, or agency problems, among other hypotheses, dividends do not affect the value of a firm because investors can create a 'home-made dividend' to earn the dividend the firm would be paying. In other words, investors would be indifferent as to whether they receive the firm's earnings in the form of dividends or capital gains. This dividend irrelevance argument has been supported by a number of researchers including Black and Scholes (1974) and Miller and Scholes (1982).

An alternative strand of literature is the dividend relevance theory, which suggests that a properly managed dividend policy is critical to the value of a firm. This view relies on the relaxations of the assumptions of perfect capital markets to offer theories about how dividends can influence the value of a firm in a world characterised by market imperfections. Prominent among these theories is the "dividend signalling" theory, which suggests that in the presence of information asymmetry between managers and shareholders, dividends provide a reliable signal to investors about future earnings prospects of a firm (Bhattacharya, 1979; John and Williams, 1985; Miller and Rock, 1985). The second class of dividend relevance theories focuses on agency conflicts between managers and shareholders and argues that dividend payments help reduce the agency costs associated with separation of management and ownership (Donaldson, 1963; Jensen and Meckling, 1976; Easterbrook, 1984; Jensen, 1986). The third broad group of theories focuses on tax or clientele effects and predicts that managers use dividends to influence the class of shareholders attracted to their firms (Brennan, 1970; Elton and Gruber, 1970; Miller, 1977). Finally, a fourth class of theories is the "bird-in-the-hand" argument, which asserts that dividends represent a more reliable form of returning profit to shareholders than capital gains because share prices are highly variable (Gordon, 1959; Lintner, 1962).

Other researchers took the behavioural approach, and surveyed managers about the motivation and perceptions underlying their dividend decisions. The pioneering study on the dividend behaviour of management was undertaken by Lintner (1956) who interviewed 28 corporate managers of US firms about their views on dividend policy. The author reported that dividend decisions are made conservatively, as reflected in the reluctance in the part of management to cut dividends. Lintner also stated that corporations had a flexible dividend policy, and that the primary concern among managers appeared to be the attainment of smooth growth in payout ratios. In other words, firms have long-term target dividend payout ratios that lead to smoothing of dividend payments over time. According to Lintner's behavioural model of dividend policy, the best predictors of current year's dividends are the earnings in the current year and the dividend paid in the previous year.

Numerous dividend surveys were undertaken in the wake of Lintner's (1956) study in the US (e.g., Baker *et al.*, 1985; Baker and Powell, 1999; Baker *et al.*, 2001; Brav *et al.*, 2005). All these studies documented results that broadly support Lintner's conclusion, especially regarding the concern about the continuity of dividends. For example, Baker *et al.* (1985) surveyed the Chief Financial Officers (CFOs) of 562 US firms to identify the major determinants of dividend policy. The authors found that the most important factors influencing dividend policy are the anticipated level of future earnings, the pattern of past dividends, the availability of cash, and the desire to maintain or increase the stock price. The authors concluded that respondents followed the Lintner's model, in that they try to avoid changing dividend rates that might soon need to be reversed in the future. Evidence from a non-US study by McCluskey *et al.* (2007) suggests that Lintner's model remains the best description of the dividend setting process in that Irish firms follow a policy in which dividend reductions are anathema and an increased dividend is declared only if management are convinced that the new dividend level can be maintained. Recently, Baker *et al*. (2008) investigated the dividend decision of Canadian financial and non-financial firms.

The authors reported that the factors that drive dividend decisions appears strikingly similar to those identified in Lintner's behavioural model of dividend policy in that companies are reluctant to reduce dividends and typically determine their current payout based on the level of current and expected future earnings. The authors also documented that management perceptions of the factors that influence dividend policy differ between financial and non-financial firms. More recently, survey evidence from the United Arab Emirates (Chazi *et al*., 2011) and Pakistan (Khan *et al.*, 2011) suggests that managers from developing countries hold similar views.

Despite the volume of research conducted on the behavioural aspects of dividend policy, there is no prior study that has examined the perceptions of Nigerian corporate managers about dividend policy. Previous studies on the dividend decision of Nigerian companies have either employed aggregated regression analysis to examine the determinants of dividend policy or were conducted more than 30 years ago (Soyode, 1975; Oyejide, 1976; Ariyo, 1983; Adelegan, 2003). The Nigerian investment environment has witnessed significant changes since the return to democratic rule in 1999. For example, the civilian administration has removed all the antiquated regulations and military dictatorship decrees that had limited foreign investments, thereby allowing free market institutions to flourish. This has led to influx in foreign direct investments into the country in recent years (Lewane, 2012). Moreover, the Nigerian stock market has witnessed several reforms recently, especially the introductions of an Automated Trading System (ATS) for transaction in phase with international standard, and a Central Security Clearing System (CSCS) to reduce the time it takes to transact and deliver shares to investors. The introduction of both the ATS and CSCS is expected to enhance the efficiency of trading, transparency in the market, realistic pricing of securities, and generate new trading opportunities for dealing members. Given these developments, the perception of Nigerian corporate managers on the factors that drive their dividend decision is worth studying.

3. Corporate taxation in Nigeria

In Nigeria, the country's main tax is the companies income tax introduced in 1961. The original law that created the companies income tax has been amended severally and is currently codified as the Companies Income Tax of 2004 (CITA CAP C21 2004 LFN) amended in 2007. Prior to 1996, the corporate income tax rate was 35 per cent and it is applied on the chargeable profit of the company. The corporate tax rate was changed from 35 per cent to 30 per cent with effect from 1 January 1996. However, the revenue derived from companies income tax has been grossly understated as a result of several factors such as high rate of tax evasion and avoidance by companies, poor tax administration, poor taxpayers' education, inconsistent government policies, lack of adequate statistical data, and corruption among tax officials (Ehigiamusoe, 2013). In January 2010, the Nigerian Government in an attempt to achieve high compliance in the tax system reduced the companies' income tax from 30 per cent to 20 per cent. In addition to this tax rate, companies incorporated in Nigeria are liable to tertiary education tax under CITA at rate of 2 per cent of their assessable profit and oil marketing companies and oil services companies are liable to tax at the rate of 20 per cent (Ekeocha *et al.*, 2012).

The choice of the payout channel (dividends vs. capital gains) depends on the relative taxation of dividends and capital gains. In general, there will be a preference for capital gains whenever the effective personal tax on dividends is greater than the effective personal tax on capital gains and vice versa. Nigeria operates a distinctive tax system whereby cash dividends received by individual shareholders are subject to a withholding tax at source of 10 per cent. The withholding tax provision was introduced into the tax system in 1977 with limited coverage to rent, dividends and directors fees. However, dividends received by a Nigerian company from other domestic companies are excluded in the determination of taxable income to the extent that such distribution has suffered withholding tax in the hands of recipients. In contrast, the Nigerian tax law does not require individual shareholders to pay any tax on capital gains. As a general rule, any distribution by a company in the form of bonus/scrip issue (stock dividends) is not taxable in the hands of individual shareholders and is excluded from the profits of any other company that is a shareholder in such a company.

Based on the discussion above, the corporate tax system in Nigeria favours the distribution of earnings in the form of additional stocks rather than dividends.

Consequently, both basic and high rate income tax payers would prefer profits to be retained rather than to be paid out as dividends in Nigeria. However, the extant empirical evidence indicates that most Nigerian companies distribute earnings in the form of dividends rather than capital gains (Adelegan, 2009). In the light of the above, the current study seeks to ascertain why

Nigerian companies continue to pay dividends, despite the tax consequences associated with such a disbursement.

4. Research Methodology

The sample firms for this study were drawn from the firms that took part in an earlier questionnaire survey administered to the financial officers of all the 191 firms listed on the Nigerian Stock Exchange as at mid-June 2012 (Ozo, 2014). From a sample of 68 firms that completed and returned their questionnaires, we identified and contacted the financial officers of 25 firms with established patterns of paying dividends, and whose responses to the survey require further discussion and understanding. From this list of firms, we excluded 4 firms for which their financial officers were unable to participate in the interviews, leaving a sample of 21 firms.

The choice of the companies interviewed was not based on random selection, rather it was purposive. Thus, a convenience sampling was adopted in the selection of the participants for the interviews (Creswell, 2009). We adopted purposive sampling because of the need to obtain cross-sectional differences in firm characteristics and dividend policy practices. The interviews targeted both financial and non-financial firms in order to reveal any substantive differences in attitudes to dividend policy between the two. The managers interviewed included the CFOs, finance director, group financial controller, and finance manager.

Table 1: Background Information about the Interviewees' companies

Firm	Sector	Industry Classification	Listings	CashDividend
C1	Banking	Financial	NSE/LSE	Yes
C2	Banking	Financial	NSE/LSE	Yes
C3	Agriculture	Non-financial	NSE	Yes
C4	Agriculture	Non-financial	NSE	Yes
C5	Industrial goods	Non-financial	NSE	Yes
C6	Insurance	Financial	NSE	Yes
C7	Insurance	Financial	NSE	Yes
C8	Consumer goods	Non-financial	NSE	Yes
C9	Consumer goods	Non-financial	NSE	No
C10	Construction/real estate	Non-financial	NSE	Yes
C11	Food & Beverages	Non-financial	NSE	Yes
C12	Food & Beverages	Non-financial	NSE	Yes
C13	Food & Beverages	Non-financial	NSE	No
C14	Insurance	Financial	NSE	Yes
C15	Banking	Financial	NSE	Yes
C16	Healthcare	Non-financial	NSE	No
C17	Healthcare	Non-financial	NSE	Yes
C18	Oil & Gas	Non-financial	NSE/LSE	Yes
C19	Banking	Financial	NSE	Yes
C20	Banking	Financial	NSE/LSE	Yes
C21	ICT	Non-financial	NSE	Yes

Note: This table provides details about the 21 interviewees. The 'listing' characteristic was based on responses to the question: "Is your company listed on stock exchanges other than the Nigerian Stock Exchange?" The cash dividend characteristic was based on responses to the question: "Has your company paid cash dividend to shareholders at least once in the past 5 years?" The acronym NSE stands for Nigerian Stock Exchange, while LSE stands for the London Stock Exchange

Table 1 provides a description of the companies selected for interview, indicating their industry grouping, whether they are financial or non-financial firms, whether they paid a cash dividend or a share dividend, and the stock exchanges where they are listed. A visual inspection of the table shows that all the sample firms are dividend payers and twelve of these reported paying cash dividends. Three of the firms paid share dividends instead of a cash dividend, while six of the firms paid both cash and share dividends during the period. The table also reveals that four of the firms had listings on both the Nigerian Stock Exchange (NSE) and the London Stock Exchange (LSE) as at the time of the study. Eight of the firms are financial firms, while thirteen are non-financial firms. To maintain the anonymity of the respondents and to protect the identity of their organizations, a unique code (C1-C21) was assigned to each of the interviewees.

The interview process started with preliminary contacts to obtain agreements to participate in the research. When seeking access into the companies, we sent personal letters to the selected interviewees requesting participation in the interviews. The letter assured all interviewees of their confidentiality as no company details will be divulged. Telephone calls were also made to all the respondents, during which we re-assured them of their anonymity. After confirmation of acceptance to take part in the interview, we contacted all potential respondents via the telephone to schedule a convenient date, time and venue for each interview. Through this process, we reached upon an agreed interview date and time with all the interviewees.

The interviews took place between December 2012 and March 2013 at the headquarters of the selected companies in Nigeria. The interviews lasted for about 1 hour to 1 hour 15 minutes. The interviews were recorded in seven cases where the interviewees granted permission and each interview was transcribed later for analysis. For some of the interviewees who did not wish to be tape-recorded, only manuscripts notes were taken during each interview. A semi-structured interview document was used to guide the interviews. The semi-structured interview document was piloted on both academics and practitioners, which provided further insight into the appropriateness of the research questions as well as the feasibility of the planned research timeline. The interview guide was designed based on the constructs from previous empirical literature review, including studies by Brav *et al.*, (2005), McCluskey *et al.*, (2007), Baker *et al.*, (2008), Chazi *et al*., (2011) and Khan *et al.*, (2011). A semi-structured interview is preferred to both the structured and unstructured interviews in this study due to its flexible nature, openness to changes, relatively high face validity and some measure of comparability (Bryman and Bell, 2007; Cameron and Price, 2009; Sekaran and Bougie, 2009). In addition, it also permits the interviewer to clarify any ambiguity in the answers that arise during the interview (Ryan *et al*., 2002; Bryman, 2004). All the interviews were conducted face-to-face, which helped to facilitate a comfortable communicative relationship with the interviewees (Quinlan, 2011).

5. Results

5.1 Factors that drive dividend decision

All the interviewees perceived current earnings as the main factor that drives their firms' dividend decision. For example, interviewee C12, the group finance controller of a food and beverages company, stated that: "Each year's dividend level is determined based on current earnings". By implication, this perception is consistent with the notion that firms pay dividends from earnings and reinforces the conclusion of Benartzi *et al.* (1997) who documented a strong concurrent link between current earnings and dividend changes in their empirical analysis of changes in dividends in the US. The evidence that current earnings is the most important factor in crafting a firm's dividend policy is consistent with evidence of Lintner (1956), Baker and Smith (2006) and Khan *et al.* (2011) where current earnings was found to be the most important determinant of payout levels. The views of the respondents also supports (although less strongly) the explicit implications of the Lintner's (1956) theoretical model of dividend policy which states that the current dividend levels are based on both the current earnings and the pattern of past dividends. When asked about the influence of the pattern of past dividends on current payout decisions, 12 out of the 21 interviewees stated that they consider the previous year's dividends when making the current payout decisions. However, according to these respondents, last year's dividend plays a minor impact on the dividend decision-making process because they only use it for comparative purposes. In this context, interviewee C21, the finance director of an ICT firm, stated that:

> We consider the dividend paid the previous year when deliberating on the current payout level, but we do so only for the sake of comparison. Basically, we arrive at the dividend we pay to shareholders based on the level of our earnings at the end of each financial year.

After the current year's earnings, the next most important influence on the dividend policy of Nigerian firms is the stability of earnings. Of the interviewees, 15 stated that after current earnings, the stability of earnings is an important factor that drives their firms' dividend policy. However, significant differences emerged in the perceptions of managers of financial and non-financial firms in this regard. In particular, managers of financial firms displayed stronger penchant towards determining their dividends based on stability of earnings than managers of non-financial firms. For example, interviewee C14, the CFO of an insurance firm, stated that: "volatility in earnings affects their ability to pay cash dividends". The importance the interviewees attached to the stability of earnings as a factor in crafting a firm's dividend policy suggests that managers of Nigerian financial firms recognize the importance of keeping the cash dividend from decreasing in the future. This perspective on dividend policy among Nigerian financial firms is consistent with recent findings in Baker *et al.* (2008), who reported that managers of Canadian financial firms gave the highest support to stability of earnings as a factor influencing dividend policy than their counterparts from non-financial firms.

Furthermore, there was a strong view among the interviewees that firms should base current dividends on liquidity considerations such as the availability of cash; this was particularly the case for non-financial firms who regularly pay cash dividends. Baker *et al.* (2006) noted that the firm's current earnings and availability of cash provide the basis for paying dividends. All the cash dividend-paying non-financial firms stated that the availability of cash is an important factor that drives their dividend decision. For example, interviewee C8, the finance manager of a firm in the consumer goods sector stated that "the Board of directors take into consideration the cash available in our company when making the decision about dividend payments". This evidence suggests that managers of Nigerian nonfinancial firms recognize that firm's ability to pay dividends depends on the availability of cash, since dividends are paid from cash, not on earnings based on accrual accounting. The importance that the interviewees attached to liquidity as a factor that drives a firm's dividend policy is consistent with recent findings reported for Norwegian firms by Baker *et al.* (2006) and for Pakistani firms by Khan *et al.* (2011).

5.2 Dividend conservatism

Based on an extensive field study of the dividend policy of companies in the US, Lintner (1956) concluded that corporate dividend decisions are made conservatively. Dividend policy is said to be conservative because of the extreme reluctance on the part of management to cut dividends. This unwillingness to reduce dividends is rooted in the firm's concern about its ability to maintain higher dividends in the future and in the negative view of dividend decreases (Lease *et al.,* 2000). Part of the interviews focused on the conservative nature of dividend policy. Consistent with the predictions of Lintner's (1956) behavioural model of dividend policy, the responses of the interviewees indicated that dividend decisions are made conservatively in Nigeria. 18 out of the 21 respondents interviewed in the present study stated that they are reluctant to make a dividend decision that cannot be sustained in the future. For example, interviewee C11, from the food and beverages industry, stated that: "we are unwilling to raise dividends to an unsustainable level". In addition, more than two-thirds of the interviewees noted that they try to maintain consistency in dividend payments, and as such try to avoid reducing the dividends per share. In this context, interviewee C4, the finance director of a firm in the agricultural sector stated: "we try to avoid cutting the dividends per share". This apparent reluctance by managers to cut dividends is consistent with the findings reported for US firms by Brav *et al.* (2005) and for UAE firms by Chazi *et al*. (2011).

A unique observation of the present study is that all the interviewees from financial firms stated that they are extremely aware of the negative signalling effect associated with a dividend cut, whereby investors are less attracted to shares of companies that reduce dividends. The interviews suggested that managers of financial firms believed that the market is not willing to accept a reduction in dividends; this makes firms to be more conservative in their dividend policy. The interviewees also noted that they are reluctant to reduce dividends because investors consider the dividend to be very important when appraising their shares. For example, interviewee C20, the finance director in a commercial bank, argued that "since dividend reductions are seen as a very bad news, we strive to maintain stable dividends in order to attract investors to our shares". In addition, interviewees from financial firms exhibited stronger preference to borrow externally to fund an extremely large positive NPV projects or bypass some projects instead of cutting dividends. Interviewee C7's view point is typical of respondents at all the financial firms when he stated that:

> We strive to maintain the level of the dividend and would be more willing to borrow to finance potentially profitable investments or pass up some projects than reducing dividends.

Overall, the interviews with the financial managers suggest that Nigerian firms exhibited a conservative dividend policy consistent with the predictions of Lintner (1956), in that Nigerian managers interviewed in the present study are unwilling to cut dividends quickly even when internal funds are insufficient for good investment opportunities. The interview results also highlighted two key differences about the conservative nature of dividend policy between the Lintner's (1956) study and the current study. First, managers interviewed in Lintner's study tend to favour reduction in dividends to reflect any substantial decline in earnings. In contrast, in view of the financial crisis, the respondents in the current study view drop in current earnings as temporary and hence believe they can ride out the storm either by borrowing or bypassing some positive NPV projects, instead of cutting dividends. Finally, while the respondents in Lintner's study were less concerned about the consequences of cutting dividends, the present-day managers believe that there is a large penalty for reducing dividends.

5.3 Target payout ratio

Lintner (1956) identified the payout ratio as the starting point for most dividend decisions. Part of the interviews focused on the potential targets used to determine dividend payout. Discussions with the interviewees revealed that most Nigerian firms do not have a target payout ratio or formal speed of adjustment processes. Yet, significant differences emerged in the perspectives of managers of financial and non-financial firms in this regard. For the non-financial firms, the views of the interviewees contrasts strikingly with the predictions of Lintner's (1956) theoretical model of dividends and the recent empirical findings reported in McCluskey *et al.* (2007). Specifically, all the managers of non-financial firms interviewed in the present study indicated that they are less concerned about setting a target dividend payout ratio; rather, they set their dividends based on current year's earnings. For example, interviewee C18, the finance director of a very profitable firm in the oil and gas industry, noted that "the dividend is set each year based on current earnings". In the same manner, interviewee C10, from the construction and real estate sector, opined that "the variable targeted when setting the amount of dividends to pay is the dividend per share dependent on the level of current earnings". This evidence of decline in the importance of target payout ratio in determining dividend payout is consistent with the recent findings reported by Brav *et al*. (2005) for US firms, Chazi *et al*. (2011) for UAE firms and Khan *et al*. (2011) for Pakistani firms.

However, some interviewees from financial firms did not appear to share these perceptions and believed that the target payout ratio was the starting point for their firm's dividend decisions. Of the financial firms, 3 stated that they have a target dividend payout ratio. The primary concern among managers of financial firms who spoke in favour of the notion that a firm should have a target payout ratio seemed to be the realization of smooth growth in their firm's dividends in relation to expected cash available over time. For example, interviewee C2, from the banking industry, stated that: "we have a dividend payout ratio which ranges from 16 to 22 per cent". This evidence of existence of target payout ratio among financial firms supports recent evidence reported for Canadian financial firms by Baker *et al.* (2008), but is not consistent with the Lintner's (1956) original analysis (where a speed of adjustment factor of 0.3 was reported). In response to a specific question about the existence of a formal speed of adjustment processes, the interviewees stated that they do not use gradual increases to move towards their target. Interviewee C6, the CFO of an insurance company, took to this view, when he stated that: "there is no specific formula for determining a dividend payout ratio in our company". Overall, the responses of the interviewees suggested that Nigerian firms interviewed in the present study do not have a definite formula for dividend payout.

Regarding the issue of dividend stability, the interviewees stated that they would maintain stable dividends rather than stable payout ratios; this is especially so in the case of non-financial firms. Of the interviewees from non-financial firms, 12 claimed that they are aware of the perceived negative consequences of reversing dividend changes in the future. The interviewees noted that stability in dividend payouts were a common phenomenon in Nigeria because investors are generally concerned with dividend predictability. The primary reason responsible for the consistency in dividend payout was that the interviewees believed that dividend reductions would be perceived as negative signals, as suggested in developed capital markets (Lintner, 1956; Brav *et al.*, 2005, Dhanani, 2005; McCluskey *et al*., 2007). Interviewee C12, the most outspoken among them noted that:

> Because of investors' clear preference for stable dividends; it would not be sensible to allow dividends to fluctuate. This is because variability in dividends will send a wrong signal to present and potential investors.

In summary, the interview evidence suggests that the target payout ratio is no longer the central focus of dividend policy at many firms. Most of the financial managers of Nigerian listed firms interviewed in the present study do not have target payout ratios or speed of adjustments in determining the dividend payout as predicted by Lintner (1956). Rather, the variable targeted by Nigerian companies when setting the amount of dividends to pay to their shareholders appeared to be the dividend per share.

5.4 Residual Dividend Policy

In establishing a dividend policy for their firms, management can follow any of the three types of dividend policy: residual, managed or a hybrid dividend policy. A firm is defined as following a "pure" residual dividend policy if the firm's dividend decision is a direct consequence of its investment policy. With a residual dividend policy, dividends are likely to fluctuate sharply with variations in earnings and changes in investment plans, thus resulting to highly variable and sometimes zero dividend payments. Alternatively, if a company attempts to achieve a specific pattern of dividend payments, such a company is following a managed dividend policy. Finally, in a hybrid dividend policy, the dividend decision is neither totally residual nor totally managed (Baker and Smith, 2006). Part of the interviews deals with the issue of residual dividend policy in the modern Nigerian environment.

Discussions with the interviewees suggested that Nigerian companies do not follow a residual dividend policy. Out of the 21 interviewees, 20 stated that their dividend policies are related to the cash flow implications of their firm's investment and financing policies. For example, interviewee C15 stated noted that "given earnings, we set desired dividends and anticipated future investments simultaneously". This finding is at odd with the notion in finance theory that investment, financing and dividend policy decisions are independent (Miller and Modigliani, 1961; Soter *et al.*, 1996). Thus, the Nigerian companies interviewed in the present study follow a managed dividend policy, and consider the dividend policy as an integral part of business strategy, which includes both investment and financing decisions. With a managed dividend policy, firms set the size of dividend payment and desired investments and if internal funds are insufficient to meet these needs, the shortfall will be financed with debt. This evidence of interrelationship between dividend, investment and financing decisions is consistent with the recent evidence reported for Pakistani firms by Khan *et al.* (2011). In this context, interviewee C7, the CFO of a commercial bank summed up the position of all the interviewees when he noted that:

> At every financial year-end, we determine the amount that will be paid to shareholders as dividends from our earnings viz-a-viz the amount that will be retained in the company for future investment needs. If the fund left after determining the dividends is not enough to take care of our investment needs, we source external financing to fund the shortfall in order to undertake all desirable projects.

One of the obvious reasons for the adoption of a managed dividend policy by Nigerian firms was the investors' clear preference for dividend predictability (Baker and Smith, 2006). The financial managers of Nigerian firms interviewed in the present study believed that adopting a dividend policy that prioritized dividends and growth will attract more investors to their firms. In this case, dividend policy was regarded as very important to investors and that share price valuation can be positively influenced by the firm's dividend policy.

Interviewee C17, the finance manager of a healthcare firm acknowledged this explicitly: "we pay dividends because stable dividend payments affect share prices positively in the market". Consistent with this argument, interviewee C4, the finance director of a firm in the agricultural sector that had consistently paid cash dividends from its inception, stated that:

> We pay dividends regularly because our investors are interested in stable, dependable dividends. Most of our shareholders are institutional investors who are aware of the implications of fluctuating dividends; and as such, may not be willing to invest in firms with highly variable dividend payments.

In summary, the evidence from the interviews suggests that corporate managers attach more importance to managed dividend policy than performance linked dividend policy. In other words, adopting a pure residual dividend policy appears to be the less plausible alternative for firms. In practice, firms adopt either a managed or hybrid dividend policy. The financial managers of Nigerian firms interviewed in the present study attached very importance to their firm's dividend decision because they believed that shareholders are entitled to dividends and that stable dividends influence share prices positively. On the basis of this evidence, therefore, it seems reasonable to conclude that Nigerian firms follow a managed dividend policy, influenced by investors' desire for dividend stability.

5.5 Market Signalling

Given the presence of information asymmetry between managers and outside shareholders, the signalling theory argued that managers may use dividend payments to signal firm insiders private information about the current performance and future prospects of the firm (Bhattacharya, 1979; John and Williams, 1985; Miller and Rock, 1985). The basic thrust of the dividend-signalling model is that "managers have private information about future prospects and choose dividend levels to signal that private information" (Lease *et al.,* 2000: 97). The suggestion is that dividends serve as a signalling mechanism to mitigate information asymmetry between corporate insiders and outside shareholders. Thus, a change in the dividend conveys unique information as a reflection of management expectations about underlying company performance, financial strength and earnings growth. Consequently, dividend increases (decreases) convey positive (negative) information to the market about the company's future performance (McCluskey *et al.*, 2006; Al-Yahyaee *et al.*, 2011). Part of the interviews focus on the signalling hypothesis of dividend announcements in Nigeria.

The findings from the interviews suggested that financial managers of Nigerian firms believed that dividend policy conveys private information to investors. However, significant differences emerged in the attitudes of managers of financial and non-financial firms in this regard. The corporate managers of financial firms expressed much stronger support for the view that dividend policy conveys information than their counterparts from non-financial firms. Specifically, all interviewees from financial firms agreed with the notion that dividends convey management's confidence about the future and that the market interprets a dividend change as a signal of future earnings prospects. Among those eight interviewees from financial firms, the opinion of interviewee C6, the finance director of a leading bank in the country, was typical when he noted that: "payout policy is a link by which the company communicate missing information to investors". However, in response to a question regarding the impact of a rise (fall) in dividends on a firm's share price, an overwhelming majority of respondents from both financial and non-financial firms disagreed with the notion that an unexpected increase (decrease) in dividends will generally lead to a rise (fall) in share prices. For example, interviewee C8, the finance manager of a consumer goods firm, stated that:

> An increase in the dividends paid to shareholders will not necessarily be accompanied with an increase in share prices. Similarly, a reduction in dividends would lead to decline in share prices, only if the company did not inform the shareholders the reason for reducing the dividend.

Another unique observation of the present study is that all interviewees from financial firms claimed that they use dividend payment to make their firms look better than their competitors in the market. The interviewees from financial firms believed that investors perceive dividends as an indicator of the financial health of a company. In this case, management use dividend payments to reflect the success of a company since it indicates its ability to make this payment into the foreseeable future, without recourse to external funds (Dhanani, 2005). Interviewee C14, the CFO of an insurance firm, justified this claim thus:

> We use the dividend to credibly convey good news to investors about future earnings prospects of our company. Since potential investors make use of the dividend information when assessing the companies to invest in, we use the dividend to make our firm stand out among other firms in the same industry.

Interviewee C21, who worked for a firm in the banking industry that had consistently distributed generous dividends to shareholders over the past two decades, concurred on the use of dividend policy to outperform their competitors, arguing that:

> Investors generally believe that only profitable companies pay dividends regularly. As a company that is doing well, we distribute generous dividends in order to differentiate ourselves from our competitors in same industry. In fact, investors use dividend payments as a yardstick for assessing whether a company is successful or not.

The evidence that companies use dividend payments to compete with other firms in the same industry appears to contradict the evidence reported for US firms by Brav *et al.* (2005), who documented no evidence that dividend policy is used to separate a given firm from its competitors.

5.6 Taxation

The impact of taxes on dividend policy depends on the relative taxation of dividends and capital gains. Consequently, any differential tax treatment of capital gains relative to dividends might influence investors' after-tax returns and, in turn, affect their demand for dividends. In Nigeria, personal income from dividends is taxable while its equivalent from capital gains is totally exempted from taxation, when this interview was conducted. Theoretically, the imposition of withholding taxes on personal income from dividends and zero tax on its equivalent capital gains may make stock dividends the preferred form of distributing earnings to shareholders in Nigeria. Part of this interview sought the views of Nigerian financial managers on the role that taxation plays in the dividend decisions of their companies.

Out of the 21 interviewees, 16 stated that taxation was not an important factor in setting their firms' dividend policy. The respondents stated that they are unconcerned about the taxation of dividends since it was the shareholders responsibility to pay tax on dividends. Although this finding is unexpected considering the tax consequences associated with dividend payments in Nigeria, the transaction costs of selling shares may be responsible for this result given that the Nigerian equity market is dominated by individual investors. However, this evidence is consistent with recent findings reported for US firms by Brav *et al.* (2005) and for Pakistani firms by Khan *et al.* (2011). These authors reported that taxes were not a major concern in the dividend payout policy of firms. Interviewee C5, from the industrial goods sector captured the position of the interviewees, when he stated that:

> We are not bothered about taxation on cash dividends because it is the shareholders that pay tax on dividends. Our major responsibility is to ensure that shareholders get their dividend warrant as at when due.

In response to a specific question "did the introduction of 10 per cent dividend withholding tax made dividends less attractive to shareholders?", 18 interviewees replied "no", confirming that investor-level taxes was not an important factor in payout policy decisions in Nigeria. Interviewee C19, from the banking sector, was typical of these responses when noting that:

> Our investors, most especially the individual investors, tend to favour dividend income than capital appreciation because they need cash to take care of their immediate needs. Therefore, they are less concerned about deducting the dividend tax before paying them their dividends.

Overall, the Nigerian financial managers interviewed in the present study believed that taxation was not an important factor that influences the dividend decision of Nigerian companies.

6. Conclusions

We interview the managers of dividend-paying firms listed on the NSE about their views on dividend policy. We also examine the perceptions of managers of financial versus nonfinancial firms on various dividend policy issues in order to determine any substantive difference between the two. The evidence reinforces some earlier findings while not supporting others. In terms of the factors that drive dividend decisions, the evidence suggests that the most important determinants of the disbursement level are the level of current earnings, stability of earnings and the availability of cash; last year's dividends are considered, but only for comparison purposes. Nigerian managers stress the important of dividend continuity and Nigerian firms exhibit dividend conservatism as described by the behavioural model of Lintner (1956). Nigerian managers express strong support for the signalling explanation for paying dividends. However, there was no support to residual dividend policy, a common concept in the dividend literature. Also, managers of Nigerian listed firms do not follow any specific formula in determining the disbursement level.

Further analysis suggests that industry classification (financial versus non-financial firms) affects managerial views on dividend policy.

The implication of our results as a whole is that despite the differences in institutional environment between emerging and developed markets, some of the earlier findings about managerial views on dividend policy in the developed markets also prevail in emerging markets. Further research could usefully extend the analysis reported here by examining the extent to which the views of financial managers in other countries with relatively small stock markets in Africa and beyond are consistent with those found to exist in the Nigerian stock market. In terms of the limitations of the study, a major problem with an interview-based research is that the participants are necessarily a self-selecting group. Closely related to this point is that only a small fraction of the NSE-listed dividend-paying firms were took part in the study. Nonetheless, we deliberately chose the firms with established patterns of paying dividends in order to provide generalizability. Moreover, there may be subjectivity or bias in the analysis of the findings of this study since the interviews were only taped in seven cases where the interviewees granted permission. In terms of those who did wish to be audio recorded, manuscripts notes were taken during each interview. Despite these limitations, our study provides new evidence on managerial perspectives on dividend policy in the context of an emerging market.

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